

## How Legislative Changes will Affect TSP Participants

**M**ost federal government employees rely on the government's Thrift Savings Plan (TSP) as their primary retirement savings tool. The TSP is designed to serve as a 401(k)-type retirement plan for these workers.

However, there are some serious drawbacks to TSPs when compared to 401(k)s, especially when it comes to their distribution rules. The good news is that new legislation will soon broaden the TSP distribution options for plan participants. These new withdrawal options will become available starting in September 2019.

### The Current State

Currently, TSP participants have only one opportunity to take a lump-sum distribution from the plan. After this, participants must either agree on a monthly dollar amount or annuitize their plan over their lifetime, which will prevent the account's balance from growing larger.

Once participants choose a monthly payment amount, they cannot take intermittent lump-sum withdrawals from their account to pay for things like a new car, vacation or even unexpected healthcare expenses. Their only option is to change the amount of their monthly payment, and they can only do this during the open season between October 1 and December 15.

Another TSP distribution drawback is the requirement that participants make a full withdrawal election after they turn 70½ years-old if they no longer hold their government job. This can result in unwelcome tax consequences for retirees whose retirement income needs and TSP withdrawal requirements don't match.

### Legislation Provides More Distribution Options

The TSP Modernization Act will provide TSP participants with more options for how and when they can withdraw money from their accounts. These changes will make it more beneficial for some participants to leave funds in their TSPs after they retire, instead of rolling them over to another retirement account like an IRA.

One of the main changes will allow participants to choose quarterly or annual, instead of just monthly, payouts from their account. They can also change the amount or schedule of payouts whenever they like. And the requirement that participants take a lump-sum distribution of the remaining balance after stopping payouts will end beginning in September.

When the legislation becomes effective, participants who are at least 59½ years-old will be allowed to make up to four age-based "on-demand" withdrawals each year. This may present opportunities for retirees to rollover portions of their TSP to an IRA to facilitate wealth transfer strategies, such as Roth conversions or naming different IRA beneficiaries in order to skip a generation.



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## Other Beneficial Changes

The legislation makes a number of other changes to TSPs that are beneficial from a distribution standpoint, including the following:

- There will be no limit to the number of partial withdrawals participants can make after they leave their government jobs. The only exception here will be that no more than one withdrawal can be made every 30 days.
- Participants will be allowed to make partial withdrawals while they receive post-separation installment payments.
- If participants make age-based, in-service withdrawals, they will not be prevented from making post-separation partial withdrawals.
- Participants will no longer be required to make a full withdrawal election after reaching age 70½. IRS-mandated required minimum distributions (RMDs) will still apply, however.
- Participants who have Roth and traditional account balances will be able to make withdrawals from these balances in whatever percentages they want. Currently, withdrawals must be made from these balances on a pro rata basis.

## Some TSP Drawbacks Remain

While the legislation makes beneficial changes to TSP distribution options, it doesn't address some of the other problems with TSPs. One of the biggest is the fact that the investment choices available to participants are limited to just five broad index funds along with their Lifestyle funds which are age-based, asset allocation portfolios. Such a limited choice of investment options can make it harder for participants to increase return on their assets while assuming less risk.

In addition, there is still no "stretch" option for account beneficiaries to rollover shares to an inherited IRA. Subsequent beneficiaries (after the initial beneficiary) must receive the entire TSP account balance all at once, and this money is taxable during the year it's distributed. This can push beneficiaries into the highest tax bracket and result in a major tax hit for the year. With an inherited IRA, beneficiaries can stretch out the taxes over many years and thus remain in a lower tax bracket.

Also, when withdrawing funds from their investments, participants still won't be able to decide from which

investment options to make withdrawals. This can be important when planning RMD strategies. For example, in 2018 the C Fund posted a negative return, so it would have been more beneficial to take RMDs from another fund.

Finally, TSP participants still can't take advantage of many beneficial wealth management strategies that can lower taxes. These include Roth IRA conversions, qualified charitable distributions (QCDs) and penalty-free 72(t) distributions before age 55.

## TSPs Have Pros and Cons

The TSP Modernization Act makes some long-overdue changes to TSP distribution options that will benefit many participants. But there are still some significant drawbacks to TSPs that limit the control and flexibility participants have over their assets during retirement.

If you participate in the TSP, you should speak with a fee-only fiduciary advisor about the best retirement saving strategies for you and your family in light of the changes brought about by this legislation. [MM](#)

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