BY CLARK KENDALL

How legislative changes affect TSP participants

Most 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 with 401(k)s, especially when it comes to their distribution rules. The good news is that recent legislation broadened the TSP distribution options for plan participants. These new withdrawal options became available starting on Sept. 15, 2019.

The old program

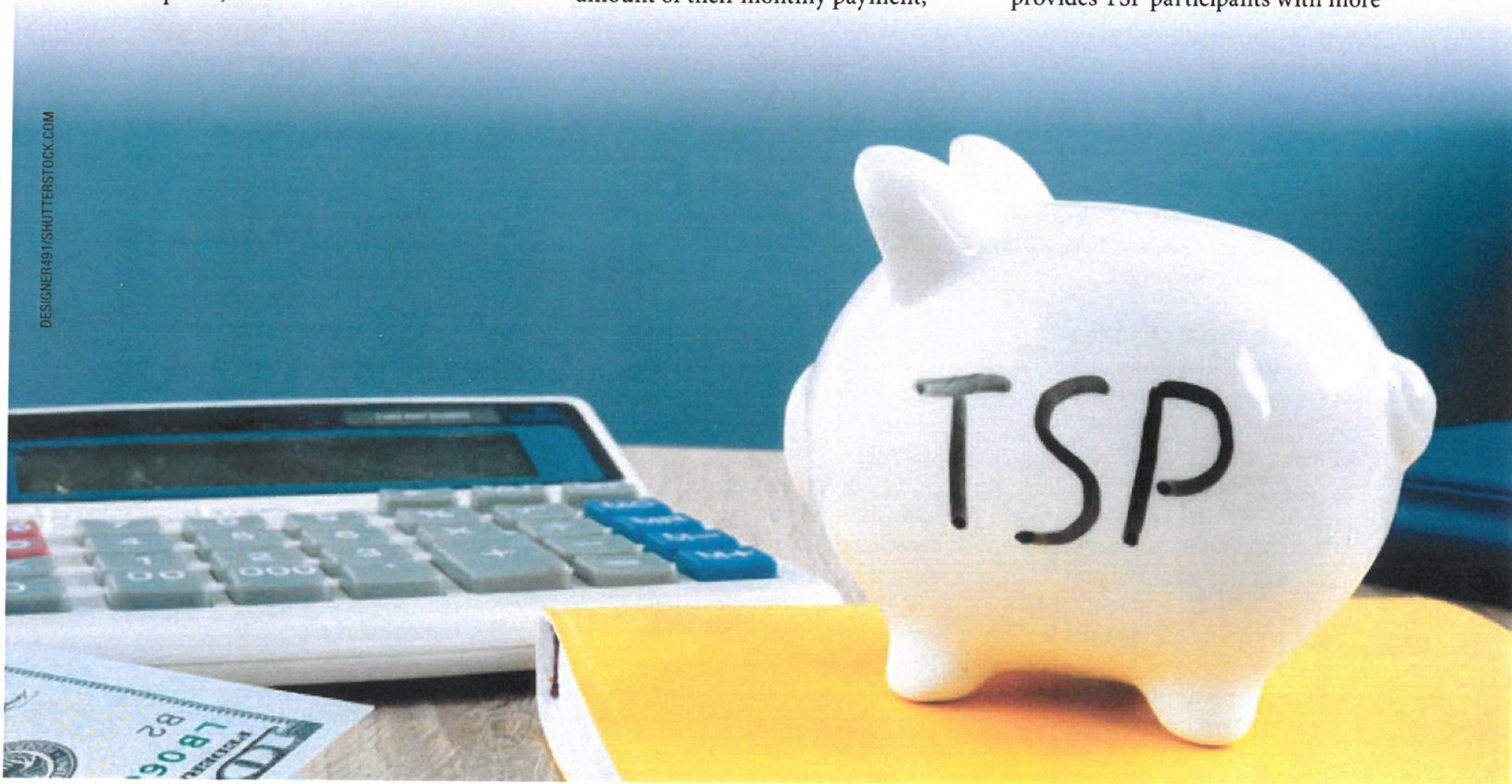
Until recently, TSP participants had only one opportunity to take a lump-sum distribution from the plan. Participants had to either agree on a monthly dollar amount or annuitize their plan over their lifetime, which prevented the account's balance from growing larger.

Once participants chose a monthly payment amount, they could not 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 was to change the amount of their monthly payment, and they could only do this during the open season between Oct. 1 and Dec. 15.

Another TSP distribution drawback was the requirement that participants make a full withdrawal election after turning 70½ years old if they no longer held their government job. This could result in unwelcome tax consequences for retirees whose retirement income needs and TSP requirements withdrawal requirements didn't match.

New distribution options

The TSP Modernization Act provides TSP participants with more



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options for how and when they can withdraw money from their accounts. These changes 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 allows 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 ended in September 2019.

Now, participants who are at least 59½ years old are allowed to make up to four age-based "on-demand" withdrawals each year. This may present opportunities for retirees to roll over 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.

Other beneficial changes

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

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

Some drawbacks remain

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

In addition, there is still no "stretch" option for account beneficiaries to roll over 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, resulting 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 can't 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, and penalty-free 72(t) distributions before age 55.

TSP strategy

For a financial advisor in the Washington, D.C. metro area, having clients who are federal government workers is common. I need to know the nuances of TSPs. For advisors with few federal clients, the differences between a TSP and traditional retirement plans may be a surprise. But it's worth investing in the knowledge, and it's good to know that TSPs are now more flexible.

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