Important Tax Information About Thrift Savings Plan Death Benefit Payments

We are required by law to provide you with this tax notice, which summarizes tax rules applicable to Thrift Savings Plan (TSP) **death benefit** payments. Because the tax rules are complex, you may wish to consult a tax advisor before you make any decision.

1. Tax Liability

Under the Internal Revenue Code, death benefits paid from the accounts of deceased TSP participants are taxable income for Federal income tax purposes in the year the payment is made. The person receiving the payment is responsible for paying the tax. However, you may be eligible to reduce the tax you must pay by using the **5- or 10-year tax option**. *(See Section 4 of this notice.)*

Also, if you are the surviving spouse, you may want to consider whether you should either **transfer** or **roll over** all or a part of your payment to an Individual Retirement Arrangement (IRA). *(See Section 3 of this notice.)*

Note: The early withdrawal penalty imposed under the Internal Revenue Code does not apply to TSP death benefit payments.

2. Tax Withholding

Tax withholding and rollover rules for TSP death benefit payments depend upon whether the payment is made to the surviving spouse or to someone other than the surviving spouse.

Tax Withholding on Death Benefit Payments Made to Surviving Spouses

If you are the surviving spouse, a death benefit payment made by the TSP to you is subject to mandatory 20% Federal income tax withholding. However, there is no withholding on the part of your payment that is transferred directly by the TSP to an IRA.

By law, a death benefit payment to a surviving spouse is considered an **eligible rollover distribution**. The following tax withholding rules apply:

> We will withhold 20% for Federal income tax purposes from any amounts you choose to receive directly from the TSP. **This 20% withholding cannot be waived.** Note: The 20% is tax withholding, not actual tax paid. You may be entitled to a refund of a portion of this amount, or you may be required to pay an additional amount, when you file your annual Federal income tax return.
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> Before you receive an eligible rollover distribution, you can avoid withholding on all or any portion of your payment by asking the TSP to transfer that amount to an IRA. However, you **cannot** avoid the mandatory 20% withholding on any amount that you elect to receive directly, even if you then roll it over to an IRA. *(See Section 3 of this notice.)*
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> You may elect to have an amount withheld in addition to the 20% withholding by completing Line 3 on IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments, and submitting it to the TSP Service Office at the address provided at the end of this notice. Line 1 and Line 2 are not valid elections for this type of payment.
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> There will be no mandatory withholding if the total death benefit payment to the surviving spouse is less than $200. However, you can still elect withholding for a payment of less than $200 by completing Line 3 on Form W-4P. Payments that are less than $200 are also eligible to be transferred by the TSP or rolled over to an IRA.

Tax Withholding on Death Benefit Payments Made to Persons Other Than Surviving Spouses

If you are receiving a death benefit payment from the TSP and you are not the surviving spouse of the deceased, your payment is treated as a **nonperiodic payment** for Federal income tax withholding purposes.

The TSP will withhold 10% for Federal income tax from your payment, unless the TSP Service Office receives from you Form W-4P, Withholding Certificate for Pension or Annuity Payments.

If you submit Form W-4P, you may elect:

– to have no Federal income tax withheld, by completing Line 1 on Form W-4P; OR

– to have an amount withheld in addition to the 10% by completing Line 3 on Form W-4P.

Note: You may not complete both Line 1 and Line 3 on Form W-4P. Line 2 on Form W-4P is not a valid election for this type of payment.

Other Tax Withholding Information

The following information applies to your TSP death benefit payment whether or not you are the surviving spouse of the deceased:

If you do not have enough Federal income tax withheld from your payment, you may be responsible for paying estimated tax. You may also incur penalties under the IRS estimated tax rules if your withholding and estimated tax payments are not sufficient.

The TSP does not withhold for state, city, county, or other local income tax. Therefore, you should consult your tax advisor or relevant state or local taxing authorities regarding any potential tax obligations to them.

Note: The $5,000 death benefit exclusion (which is available only to beneficiaries of participants who died before August 21, 1996) is not taken into account in calculating tax withholding. *(See Section 5 of this notice.)*

Special Note for Nonresident Aliens and Beneficiaries of Nonresident Aliens

Special tax withholding rules apply to TSP payments made to nonresident aliens and beneficiaries of nonresident aliens. For a detailed explanation of how these rules apply to you, please read the TSP tax notice "Tax Treatment of Thrift Savings Plan Payments to Nonresident Aliens and Their Beneficiaries."

A nonresident alien is an individual who is neither a citizen nor a resident of the United States. For purposes of residency, the United States includes the 50 states and the District of Columbia; it does not include U.S. possessions such as Guam, Puerto Rico, or the Virgin Islands.

You can obtain a copy of the notice by calling or writing the TSP Service Office.

3. Transferring or Rolling Over a TSP Payment Made to a Surviving Spouse

A **transfer** occurs when you instruct the TSP to send all or part of your distribution directly to an IRA, instead of issuing it to you.

A **rollover** occurs when the TSP makes a distribution to you (which includes the amount of the check you receive plus the amount withheld) and you deposit any part of that distribution into an IRA within 60 days of the date you receive it.

If you are a surviving spouse receiving a TSP death benefit payment, that payment is an **eligible rollover distribution**. This means that all or any part of your payment can either be transferred or rolled over to an IRA. An IRA is an Individual Retirement Arrangement, which can be either an Individual Retirement Account or an Individual Retirement Annuity (other than an endowment contract). However, you cannot transfer or roll over your payment to a "Roth" IRA (which became available January 1, 1998).

By transferring or rolling an amount over to an IRA, you can postpone paying tax on that amount until you receive the money from the IRA. The mandatory 20% Federal income tax withholding does not apply to an amount that the TSP transfers directly to an IRA; **however, it does apply to any payment made directly to you, even if you then roll it over.**

In deciding whether to choose a transfer or a rollover, you should consider the following. You must pay Federal income tax on any part of the payment that you do not transfer or roll over. Moreover, because all eligible rollover distributions of $200 or more made directly to you are subject to mandatory 20% withholding, you will have to pay tax on the amount withheld — even if you roll over the amount you receive — unless you deposit personal funds into your IRA equal to the amount withheld. (If you do this, you may receive a refund of taxes withheld, but you cannot wait until you receive a refund to complete a rollover.) Therefore, if you do not want to use personal funds to make up the amount withheld, you should choose to have the TSP transfer the death benefit payment to your IRA directly, instead of rolling it over to your IRA yourself.

If you are not the surviving spouse of the deceased participant, you cannot transfer or roll over your TSP death benefit payment.

4. Five- or 10-year Tax Option

If the death benefit payment you receive from the TSP qualifies as an **eligible lump sum distribution**, you may be able to lower the income tax you pay by using the 5- or 10-year tax option. This tax option can be used by all beneficiaries. You do not need to be the surviving spouse.

An **eligible lump sum distribution** is one in which the deceased participant's total TSP account balance is distributed to all beneficiaries in the same year. Although TSP death benefits are usually paid to all beneficiaries at the same time, there are situations in which all the beneficiaries may not be paid in the same year. For example, this can occur when one beneficiary cannot be located. If this happens, other beneficiaries will not be able to elect the 5- or 10-year tax option for their payments.

Also, a surviving spouse who transfers or rolls over all or any part of a death benefit distribution cannot use the 5- or 10-year tax option. However, this does not affect the ability of other beneficiaries to use the 5- or 10-year tax option.

You may be able to use either the 5- or 10-year tax option, depending upon the age of the TSP participant at the time of death. (If you use the tax option for this death benefit payment, you may still use the tax option again for payments you receive from your own plan or for death benefit payments you receive from a plan as the result of the death of another individual.)

At present, if you use the **5-year tax option**, your payment is taxed as if it were paid to you over five tax years, using the tax rates for single taxpayers in effect in the year payment is made. The 5-year tax option is available if the TSP participant was at least age 59½ at the time of death or was age 50 before January 1, 1986. (In 1996, Congress eliminated the 5-year tax option for tax years beginning after December 31, 1999.)

With the **10-year tax option**, your payment is taxed as if it were paid to you over 10 tax years, but you must use the tax rates in effect in 1986. The 10-year tax option is available only if the TSP participant was age 50 before January 1, 1986.

Election of either the 5- or 10-year tax option is made by filing IRS Form 4972, Tax on Lump Sum Distributions, with your annual income tax return.

5. The $5,000 Death Benefit Exclusion

A $5,000 death benefit exclusion is available to beneficiaries of participants who died before August 21, 1996. This $5,000 exclusion from Federal income tax applies to all amounts paid to beneficiaries of a deceased individual by that individual's employer and any employer-sponsored retirement plans. Therefore, if the participant died before August 21, 1996, and if the TSP death benefit payment to you qualifies as an eligible lump sum distribution *(see Section 4 of this notice)*, you may also be able to exclude from Federal income tax up to $5,000 of the amount paid to you. You should consult with the executor or administrator of the deceased participant's estate or your tax advisor to determine if all or any part of this exclusion can be applied to the payment you receive from the TSP.

6. Tax Reporting

The TSP will report to the IRS all death benefit payments, including all amounts transferred to IRAs by the TSP at the request of surviving spouses. We will also report such payments and transfers to the state in which our records show you resided at the time the payments were made, if that state imposes an income tax.

In January of the year that follows a TSP payment, the TSP will send you Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. **You should keep the TSP Service Office informed of any changes in your address until this tax information is sent to you.**

Note: The TSP must provide the correct Taxpayer Identification Number (TIN) to the IRS on Form 1099-R. In the case of payments to beneficiaries, the beneficiaries' Social Security numbers will be used. For payments to a trust or estate, an executor, administrator, or trustee must furnish to the TSP a TIN for the trust or estate before payment will be made to that entity. An individual who applies to the TSP for a payment under a state's small estate procedure must also furnish a TIN for the estate. Thus, a TIN must be furnished for a trust or estate, although there may be no need to file IRS Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

You should include the amount reported on Form 1099-R as income on your individual income tax returns for the year in which payments were made. However, you should then exclude from adjusted gross income on your return any amounts that are transferred or rolled over. If an amount was withheld for Federal income tax, you should also attach a copy of Form 1099-R to your Federal tax return.

7. Other Information

All correspondence with the TSP Service Office that concerns a TSP death benefit payment should be directed to the TSP Service Office at the following address:

TSP Service Office
National Finance Center
P.O. Box 61500
New Orleans, LA 70161-1500

Include both your name and Social Security number and the name and Social Security number of the deceased TSP participant. The Social Security numbers are important in identifying the TSP account to which the payment relates.