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Continuing with the topic of the importance of taking advantage of the withdrawal option from your Thrift Savings Account (TSP), the final point I want to touch on could be incredibly important to your estate plan. It won't impact you, but it could be devastating to the estate you leave to your heirs. Let's look at some TSP rules for inheriting a TSP account:

Once the TSP has been notified of the **death of a TSP account holder**, they will verify beneficiaries and (usually within 30 days) send out a decision letter to all eligible beneficiaries. If the deceased TSP account holder was married with **spouse designated as beneficiary**, the account automatically becomes a beneficiary participant account. Only the surviving spouse has the option to leave the funds with the TSP or transfer the account to their own IRA. They basically will have the funds treated as their own for tax and withdrawal purposes. In this scenario, everything is so far, so good.

The problem with this situation is that, once the **surviving spouse dies** and the beneficiaries are in position to receive the remaining balance, only one choice for distribution is available. In my opinion, that one choice is not a good one. Since funds from a beneficiary participant account cannot be transferred to an inherited IRA, the beneficiaries will have to take a direct payment from the TSP. This eliminates the chance to establish an inherited IRA for the beneficiaries and offer them the chance to take lifetime income from the account, thus spacing out the payment of taxes due. Rather, taxes owed will be due as a result of the distribution. This means that if the account is large, a significant portion of the inheritance will be lost to taxes.

Here's a real-world **illustration of the above scenario**: If a beneficiary participant account had a value of \$500,000 upon death of the owner, a sole beneficiary would receive this as a fully taxable distribution. This means that the money is taxed as ordinary income to the beneficiary, graduating them into the highest tax bracket for one year, even if they had no ordinary income of their own outside of the inheritance. Currently the highest federal bracket is 39.6%. The state taxes must be paid on top of that. It isn't difficult to see that the beneficiary could easily lose a large portion of the original balance. If the account had been transferred to an IRA the remaining balance could have maintained its tax deferred status. That should get your attention.

Allow me to offer you another possibility. Let's say that the original **TSP account holder dies leaving the account to someone other than a spouse**. The TSP would allow for each beneficiary of the account to transfer their portion to an inherited IRA. The inherited IRA would allow the owner to take income from the account balance over their individual lifetime. This has the potential to greatly reduce the tax burden by spreading it out over many years, while the account is still potentially growing at fair return. It should be noted that in this situation, the beneficiaries must have the funds they're entitled to directly transferred to the new custodian of the inherited IRA. If the funds are not directly transferred, the beneficiaries won't be permitted to roll the money over to the inherited IRA even if they attempt to do so during the customary 60 day window.

If the **surviving spouse has their own TSP account**, then the deceased spouse's account could be rolled into theirs without losing the ability for the next beneficiary to have an Inherited IRA. Additionally, if the surviving spouse is under the age of 59 1/2, it might make sense to leave some or all of the account with the TSP until they reach 59 1/2. The IRS will treat the account as a death benefit and won't subject it to any distributions prior to age 59 1/2 (there is normally a 10% penalty associated with early distributions from IRA's). It does, however, put the funds at risk if the surviving spouse should die before transferring funds to an inherited IRA.

If this topic is of particularly importance to you, please contact me by email or phone. I would be happy to help you review all viable options in order to make the best choices for you and your family's financial future.

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