



Benefit Planning Inc
CFP® CLU®

1900 NW South Outer Road, Ste 200
Blue Springs, MO 64015
816-229-5948
wguemmer@moneyconcepts.com

Understanding the TSP Modernization Act – Part Three

Old Rules	New Rules
All withdrawals had to be taken as a proportional distribution and include both traditional funds and Roth funds as a pro rata distribution, if the participant had both accounts.	A TSP participant can choose to withdraw his or her traditional TSP account only, Roth TSP account only, or a proportional amount of both.

Before the new rules were implemented in September 2019, TSP participants had no control over whether withdrawals came from the Traditional side of their TSP or the Roth. For TSP participants who have balances in both, it was mandatory that distributions were taken on a pro rata basis. If you had 80% of your account in Traditional TSP and 20% in Roth TSP any withdrawal taken would have been 80% from the Traditional and 20% from the Roth. Under the new rules participants still have the pro rata option if they so choose but they also have the option to specify if they would like their entire withdrawal to come from their Traditional balance or Roth balance.

Here are a few reasons why this control can be helpful:

1. Even if you have invested in the Roth since it was first available in 2012, you'll still have the majority of your TSP balance in your Traditional account. That being the case, many of you will want to wait to take distributions from your Roth TSP until you've had it for at least five years and are 59 ½ or older to avoid taxes on your gains. You may also want to let your Roth balances grow so that you can either look forward to the tax-free distributions from it in your future or perhaps desire to leave it as a tax free benefit to your heirs.
2. Tax rates have decreased since the Tax Relief Act of 2017 and most likely they will revert to previous rates which is a reason to hold on to your Roth balance and let it grow as long as possible as a potential tax hedge for taking future retirement distributions.
3. It's quite possible that you could find yourself retired and needing supplemental income from your TSP. If you still had to take money out of your Traditional and Roth balances pro rata you might violate the Pre 59 ½ and/or five-year rule and as a result the growth portion of your Roth distribution would be taxable. There may be some exceptions.

While the distribution options are no longer only pro rata under the new TSP rules you still only get one allocation choice for your entire account which is unfortunate. Whatever traditional allocation election you made, you'll have the same allocation in your Roth portion. For example: if your current allocation is 50% in the G Fund and 50% in the C fund, your Roth will have the identical allocation. Because of the tax-free growth Roth accounts enjoy you may want to invest

those accounts more aggressively or have a more long-term view on that money. Taking a withdrawal from your Roth TSP and rolling it over to a Roth IRA would allow you to invest your Roth assets independently of your Traditional TSP. My advice to my clients is to make your Roth a more long-term investment and utilize your Traditional account for income needs earlier in retirement which often necessitates different investment allocations.

The new, enhanced online tools will make the withdrawal process more efficient. This will greatly reduce the chance of errors that could cause delays, rejections, or unintended withdrawals that can't be reversed. In many cases you'll still need to provide notarized signatures but now you'll only be given the necessary pages to fill out and submit. Beneficiary participants and spouses of deceased TSP participants with established accounts can make the same withdrawal elections as separated TSP participants.

All in all these withdrawal changes are definitely for the better and allow participants more flexibility and control over the tax treatment of their distributions in retirement. There are further changes that could be made to improve your ability to manage your assets in the TSP but this is certainly a step in the right direction.