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Understanding the TSP Modernization Act - Part Four - What didn't change?

Unfortunately, some of the most important rules were not modified. Though they don't apply to everyone and every scenario, I do think the majority of you could benefit from knowing what could be in store for your estate. I have addressed this matter before but it definitely merits revisiting. Addressing the potential impact of these rules could help prevent the depletion of a sizeable portion of your nest egg, a consequence from the taxes caused by the accelerated payout imposed on the beneficiaries. A **TSP Beneficiary Participant Account** is established upon the death of a married TSP participant, whose surviving spouse has no TSP of their own and elects to leave the funds in the TSP.

I'd like to illustrate what could be a common scenario with implications that could blindside your heirs:

Ben is a retired Federal employee aged 74 when he passes away leaving his widow Rose, aged 67. Ben's TSP account balance was \$1,000,000, from which he was taking Required Minimum Distributions (RMDs). Rose decides the easiest thing to do is to leave the money in the existing TSP account which now becomes a TSP Beneficiary Participant account. Since Ben was over age 70 ½ she will be required to continue taking RMDs just as Ben had been doing. In the second year Rose noticed that the RMD was substantially higher than the first year even though the account balance remained virtually the same. Concerned this was a mistake, she called the TSP to gain some insight. It was explained to her that the TSP uses more than one table to calculate RMDs for Beneficiary Participant accounts. The first year the RMD calculation is done using the uniform lifetime table which would make her RMD \$36,496. Every year after that the RMD is calculated using the single life table which purges at a higher rate causing her second year RMD to increase to \$61,349.

Had Rose chosen to move Ben's TSP account to an IRA of her own or had the option to move it into her own TSP, she would have been able to defer taking her RMDs until she reached age 70 ½. Her RMDs would then never be subject to the single life table. This could possibly be beneficial to anyone who doesn't need a larger income supplement, wants to pay less tax, or whose estate planning goals are to leave as much to their loved ones as possible.

Years pass with Rose never taking action to transfer her TSP Beneficiary Participant account to an IRA of her own. Upon her passing, her surviving children Tom and Kate inherit the remaining balance of their mother's TSP Beneficiary Participant account equally. They're hopeful that they can have some flexibility and control of the distributions in an effort to minimize their taxes. Unfortunately, they discover that upon the death of a TSP Beneficiary Participant account owner, the only option for beneficiaries is to receive the full amount in one lump sum. Assuming the balance of the account is still at \$1,000,000 Tom and Kate would each receive a \$500,000 death benefit. As beneficiaries of a TSP Beneficiary Participant account they cannot maintain,

transfer the account, or roll it over to an IRA of their own. They will both have to claim their \$500,000 inheritance as ordinary income in the year they receive it. This translates into losing a major portion all at once to taxes which could be as high as 37% federal tax plus the additional state taxes. Had Rose moved the money from the TSP Beneficiary Participant account into an IRA of her own, the beneficiaries would have been able to take lifetime income or receive the entire account balance over a few years. Both options can help mitigate the tax implications more effectively than a terminal lump sum payout. I encourage you to explore investments outside the TSP that can add value in your lifetime, be a better fit for your estate, and nullify the implications of the unfavorable TSP rules that were not improved by the TSP Modernization Act.

If you are one of the many PMA members who need advice on options to avoid this situation, need estate planning guidance, or a consultation to discuss retirement options, please contact me with any questions or concerns. To read the TSP information related to this article please follow the link below.

<https://www.tsp.gov/PDF/formspubs/tsp-776.pdf>