

TSP vs TSP Roth “the Basics”

In brief for Kansas City area Federal Employees
Created for the FY 2021 Calendar Tax Year

Web presenter:

--Jeff O’Connell

- ▶ Link to FEB website for the slides and support spreadsheet:
- ▶ www.KansasCity.FEB.gov

TSP “the Basics”

2

Brief background on the TSP:

The TSP is a retirement savings plan for Federal Employees. It offers the same types of savings and tax benefits that many corporations offer their employees under 401(k) plans. The hallmark of this plan initially was to allow employees to make pre-tax contributions to retirement funds and help better control their own retirement and match private sector options available.

Congress passed legislation in 2009 directing the TSP Board to look into allowing Federal Employees to have a Roth TSP option. In May, 2012, USDA employees could begin contributing to the TSP Roth in addition to the regular TSP. TSP Roth contributions are post-tax.

TSP “the Basics”

3

Every Federal Employee can have 1 TSP account.

TSP Accounts have 2 components:

1) Traditional Balance, made up of:

- a) Contributions**
- b) Agency matching funds (TSP & TSP Roth, excludes CSRS employees; FERS employees only)**
- c) Earnings & losses**
- d) Rolled over funds (if applicable)**

2) TSP Roth Balance, made up of:

- a) Contributions**
- b) Earnings & losses**
- c) Rolled over funds (possible future functionality)**

TSP “More Basics”

4

Contributions and Limits:

For both the Traditional TSP and the TSP Roth combined, the total amount that can be contributed either or both types for FY 2021 is either \$ 19,500 or \$ 26,000 depending on the employee’s age. For anyone “in the year of their 50th birthday”, they can make a “catch-up” contribution of up to \$ 6,500 additional funds to a TSP or TSP Roth fund (or a combination).

TSP Basics

5

How much can I contribute to either the regular TSP, the TSP-Roth or both? (well, it depends on your age):

➔ **\$19,500 maximum total if you are under age 50 (not yet in the ‘year of your 50th birthday’)**

OR

➔ **\$26,000 maximum for 2021 if you are at or above “the year of your 50th birthday”;**

Note: this does *not* include agency matching contributions, which are *always* pre-tax.

TSP Basics

6

		FERS employees only				
A	B	C	D	E		
Employee Puts In:	Agency Automatic	Agency Match:	Total Agency Portion	Total Invested	Incremental Match Amount	
0%	1%	0%	1%	1%	1%	1%
1%	1%	1%	2%	3%	1%	1%
2%	1%	2%	3%	5%	1%	1%
3%	1%	3%	4%	7%	1%	1%
4%	1%	3% plus 0.5%	4.5%	8.5%	0.50%	0.5%
5%	1%	3% plus 0.5% plus 0.5%	5.0%	10%	0.50%	0.5%
6%	1%	3% plus 0.5% plus 0.5%	5.0%	11%	0.00%	
7%	1%	3% plus 0.5% plus 0.5%	5.0%	12%	0.00%	
8%	1%	3% plus 0.5% plus 0.5%	5.0%	13%	0.00%	
9%	1%	3% plus 0.5% plus 0.5%	5.0%	14%	0.00%	
10%	1%	3% plus 0.5% plus 0.5%	5.0%	15%	0.00%	
Can be Mixed Roth & Traditional	Traditional TSP only	Traditional TSP only	FERS Employees	Can be Mixed Roth & Traditional	Traditional TSP only	
A	B	C	(B + C) = D	(A + B + C) or (A + D)		
Your goal should be to put in the most you can so and do so for the length of your career!						
ALWAYS take the 'free money'!!!						

TSP Basics

7

How can I contribute to or make changes to my TSP account?

- 1. fill out a TSP-1 form, or**
- 2. go on-line to the National Finance Center (or your federal processor) website and do it through your account there**

What are the tax impacts?

(see Contribution Chart, next slide)

TSP Basics

8

Contribution Chart	Traditional TSP	Roth TSP	Regular Roth IRA	Regular IRA
Earnings & Contribution Limits for Calendar Year 2020	\$19,500 plus \$ 6,500 catch-up if in calendar year of 50th birthday	\$19,500 plus \$ 6,500 catch-up if in calendar year of 50th birthday	\$6,000 plus \$1,000 if 50 years old or older (\$7,000); AGI limits apply	\$6,000 plus \$1,000 if 50 years old or older (\$7,000); AGI limits apply
Matching Contributions	Up to 5% if the plan allows	up to 5% if the plan allows	none (this is done outside the TSP)	none (this is done outside the TSP)
Do Income & Earnings Limits Apply to Allowing Contributions?	No, not applicable	No, not applicable	Yes (generally)	Yes (generally)
Tax of Contributions	taxable in the tax year withdrawn	n/a for principle, conversions and earnings, if qualified	n/a, contributions are after tax	taxable in the tax year withdrawn
Rollovers (out of the TSP)	To most other retirement plans or converted to Roth IRA	To Roth IRAs or Roth employer plans	Allowed to other IRAs, not the TSP Roth	Allowed to other IRAs, not the TSP Roth
Required Distributions? (note this changed in 2019, per the Secure Act)	At age 72 (unless still working), fully taxable	not required	none for Roth owners	At age 72 (unless still working), fully taxable
Non-qualified Distributions	not applicable	Use pro-rata rule	Use Roth ordering rules	not applicable; all funds withdrawn are fully taxed
Qualified Distributions	not applicable; all funds withdrawn are fully taxed	5 years after date Roth TSP was established and 59 1/2 or death or disability	5 years after date Roth IRA was first established and 59 1/2 or death, disability or first time home buyer	not applicable; all funds withdrawn are fully taxed

TSP vs. TSP Roth Differences

9

What are the differences between contributions to a TSP and the TSP-Roth:

It all boils down to **3 main items:**

- 1) “income tax treatment”; and**
- 2) your “time horizon”;**
- 3) what you think the markets will do in the future.**

TSP & TSP Roth: Strategies to Consider

10

Some Possible Strategies to consider:

- **Go 50-50 between the Traditional TSP and the Roth TSP at first and then evaluate next March (tax time next year). Try to move to contributing 100% in TSP Roth as soon as possible for better long-term tax results and estate planning purposes.**
- **Make a one time transfer at age 59 ½ or later and then start systematically converting the funds to Roth, in phases, outside the TSP, and paying the tax on conversion, in phases, as you convert the money. Eventually, the TSP may allow for Roth conversions within the TSP. Ideally, complete this before you actually start drawing Social Security.**
- **A younger person or a person with larger Roth balances will generally see a more positive impact on their retirement effects due to compounding effects over longer periods of time.**

TSP & TSP Roth Considerations

11

What should I consider before I make TSP/TSP Roth contributions?

Three questions you need to ask yourself:

- 1. How long will you live (and your spouse/significant other)?**
- 2. What will be your income tax situation in retirement & what will markets likely do before you get there?**
- 3. What will be your projected income and expenses in retirement?(you need a budget)**

TSP Considerations

12

Drill down...first question:

- 1. How long will you live (and your spouse/significant other)?**

TSP Considerations

13

Drill down...first question:

- 1. How long will you live? (and your spouse/significant other):**
 - Sometimes that is a bit hard to predict 😊

TSP Considerations

14

Drill down...first question:

- 1. How long will you live (and your spouse/significant other):**
 - Look at your health situation vs. that of your parents, grandparents and siblings and try to reasonably estimate a possible life span.**

TSP Considerations

15

Drill down...second question:

2. What will be your income tax situation in retirement:

- **Question #2: what will be the income tax rates in the future, what do you think they will do? What will the markets do?**
- **This includes (from your personal budget):**
 - **Federal income tax;**
 - **State income tax (if any);**
 - **Local taxes & any other taxes you might pay, such as sales tax on purchases;**
 - **Real Estate taxes on your residence.**
 - **Look at other transaction taxes such as fuel taxes, airline fees, etc.?**
 - **What will the markets likely do? Historically, what have they done?**

TSP Considerations

16

Drill down...third question:

3. What will be your projected income and expenses in retirement?

--For this, you need to prepare a budget and a projected future budget. Take this and include your projected retirement income. This will include Social Security benefits (which are often partially or mostly taxable), any other sources of income you might have, and any annuity income you might have (for example, if you use your TSP money to buy an annuity).

TSP Considerations

17

Review: 3 questions you need to ask yourself:

- 1. How long will you live, your ‘best guess’ (and your spouse/significant other)**
- 2. What will be your income tax situation in retirement & what will markets likely do before you get there?**
- 3. What will be your projected income and expenses in retirement? (you need a budget to plan properly)**

Once you have successfully “answered” the above 3 items correctly, you can begin to make a wise and informed decision, that can be adjusted over time, as your situation/circumstances change.

TSP vs TSP Roth Review Questions

18

Review Questions:

- a) What is the one component that is present in a Traditional TSP balance but is never present in a Roth TSP balance?**

(note: this applies to FERS employees only)

TSP vs TSP Roth Review Questions

19

Review Questions:

- b) What is the most a person can contribute for CY 2021 if they are 30 years old to both balances (Regular Roth and TSP Roth (in total))?**

TSP vs TSP Roth Review Questions

20

Review Questions:

c) What is the most a person can contribute for CY 2021 if they are ‘in the year of their 50th birthday’ to both balances (in total) and what are the two components of this?

TSP vs TSP Roth Review Questions

21

Review Questions:

d) Can a person roll IRA funds into the TSP?

TSP vs TSP Roth Review Questions

22

Review Questions:

- e) Which balance is better to have for estate planning purposes: Roth TSP or traditional TSP *and why?*

TSP vs TSP Roth Review Questions

23

Review Questions:

- f) **What are agency matching contributions and what component do they go into?**

TSP vs TSP Roth Review Questions

24

Additional Review Questions:

- g) What is one advantage of a TSP Roth over a traditional Roth IRA?**

TSP vs TSP Roth “the Basics”

25

Additional Review Questions:

h) What is a “one-time transfer” and how can it be used effectively for retirement or estate planning purposes?

TSP vs TSP Roth “the Basics”

26

Additional Review Questions:

- i) **Can a person transfer money from an individual Roth IRA into their Roth TSP balance?**

TSP vs TSP Roth “the Basics”

27

Additional Review Questions:

- j) Can a person make simultaneous contributions into both a Traditional TSP balance and a Roth TSP balance?**

TSP vs TSP Roth “the Basics”

28

Summary:

So, which plan is right for me? (TSP or TSP Roth)

Well, *it depends* on your tax situation, how and when you want to pay taxes (no one answer fits all situations).

I prefer to pay the taxes now rather than later because I want to avoid the “tax trap” that is looming on the horizon. Less retirement “surprises”.

Having large balances in Roth is a very powerful estate planning tool. To me, this is the single greatest benefit of doing the TSP Roth and also for contributing to a Roth IRA (if you can).

TSP vs TSP Roth “the Basics”

29

➤ A few Takeaways:

- Contribute at least 5% to the TSP (and/or TSP Roth) to get the match/‘free money’;
- Contribute as to the TSP/TSP Roth as *early* as you can in your career and do it for your whole career (*the presenter recommends TSP Roth almost exclusively*);
- Contribute as much as you possibly can afford to your TSP account for a better retirement (assuming growth of the markets);
- If you max out your contributions before the end of the year, however, you could lose out on agency matching contributions;
- Leave those funds in the TSP *untouched* for your career (except possibly for the one-time transfer) to attain a better retirement;
- If you take money out of the TSP or an IRA prior to age 59 ½ there is generally a 10% penalty in addition to the tax on the funds withdrawn. This is generally not the case with the TSP Roth or a regular Roth IRA;
- Some funds cannot be rolled into the TSP Roth (e.g., Roth IRA funds, currently).
- Funds withdrawn from the TSP are prorated from both fund components based on the balance you have in each (TSP and TSP Roth). This changed in September, 2019. Now you can withdraw from the fund subaccount level, (Regular TSP or TSP Roth portion) as you choose;
- The TSP Roth is better for the longer term and estate planning purposes;
 - You could consider converting all TSP balances to Roth prior to age 70 ½ (now age 72, per the Secure Act) to avoid Required Minimum Distributions (RMD’s);
 - There are no RMD’s on TSP Roth distributions for the Roth owner in retirement, so there are no tax concerns (except for the agency match component, which went into your TSP account ‘pre-tax);
 - Agency matching contributions have never been taxed for income tax purposes so they are considered ‘pre-tax’ and will likely be taxed in retirement (this includes TSP Roth contributors for the agency match portion only, e.g., CERS)

TSP vs TSP Roth the Basics

30

(Other charts and materials to supplement this will be posted to the FEB website please check these out)

Any Questions?? (please message or email those into the webinar)