

# Federal Employee Roth TSPs – The Good, The Bad & The Ugly

December 1, 2016 by The Federal Employee Blog Team

The TSP added a Roth option in 2012, but for many, there are still more questions than answers.

The Roth TSP is primarily a tax consideration. It is not a new investment option. Money goes into a Roth on an after tax basis – meaning you pay taxes on the money and then it goes into the Roth TSP. By comparison, money goes into the traditional Roth before it is taxed. The net result is that, if you change your TSP contributions from traditional to Roth, your net paycheck will be smaller because you pay taxes on the money that goes into the Roth TSP, but you do not pay taxes on the money that goes into the traditional TSP.

The benefit of contributing to the Roth TSP vs. the traditional TSP is that you do not pay taxes when you withdraw money from the Roth TSP while you do pay taxes when you withdraw money from the traditional TSP. Simply put, with the traditional TSP, you enjoy tax savings now, but you pay taxes later; with the Roth TSP, you pay taxes now, but you enjoy tax-free distributions in the future.

One way to think about the tax considerations of the Roth TSP / traditional TSP is paying taxes “on the seed” compared to paying taxes “on the harvest” – paying taxes today on the initial contributions vs. paying taxes in the future on the contributions plus all the growth in the account. With the Roth TSP, as long as you comply with the account rules (which are not particularly intrusive), all the growth in the account is tax free.

If you decide on the “pay me now” tax consideration of the Roth TSP, there are several logistical aspects of the Roth to be aware of:

- Contribution limits are the same for traditional and Roth, and you can divide your contributions between traditional and Roth any way you want.
- Regardless of how you allocate your contributions between traditional and Roth, the agency automatic and matching contributions are always into the traditional side.
- You cannot convert or transfer money from the traditional TSP to the Roth TSP.
- Your investment options are the same for both traditional and Roth balances, and whatever allocation you choose for your account is the same for both traditional and Roth.

- The traditional and Roth portions of your TSP are held in the same account but tracked separately for tax purposes.
- You can take loans, in-service withdrawals and partial withdrawals from both traditional and Roth TSP. All loans and withdrawals come proportionately from both sides.

As the Roth TSP is currently structured, there are two issues that make it fine for accumulation while you are working but not efficient for taking distributions in retirement – making a Roth IRA preferable:

1. All distributions are taken proportionately from both the traditional and Roth sides of your TSP account. This means that the Roth TSP cannot be used as a tax planning vehicle – as a Roth IRA can be used.
2. When you reach age 70 ½ and Required Minimum Distributions (RMD's) come into play, the TSP will take RMD's from Roth balances the same as traditional balances.

Combining these issues with the restrictions that TSP places on distribution options (for traditional and Roth), it is almost always preferable to rollover TSP balances that include a Roth component. A rollover allows you to determine whether distributions come from a traditional or Roth account, enables you to avoid RMD's on Roth balances (one of the primary benefits of Roth accounts which is, unfortunately, not available through Roth TSP) and provides unlimited flexibility in how you take distributions.

At the end of the day, the Roth TSP is a great, tax-free accumulation vehicle, but it comes up short when it is time to take distributions. If you decide to use the Roth side of your TSP, you should plan on rolling your TSP into an IRA when you retire in order to give yourself maximum flexibility and efficiency.

### **Federal employee question of the day**

From a SSA Federal Employee: I am a CSRS employee that works for SSA in CA, 57 years of age, and will have 40 years in November 2016. I am thinking about retiring in December 2016. Would it be better to retire in Jan, April or wait until I have 41 years of service? I would like to have 80% in retirement. Or does it make a difference? I'm currently paying back a TSP loan and have a little contributed in TSP.

### **Have you ever had any questions like this?**

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