FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
77K Street, NE Washington, DC 20002

April 11, 2013

To: Employee Thrift Advisory Council

From: Gregory T. Long
Executive Director

Subject: Furloughs/Thrift Savings Plan

We have received inquiries from Thrift Savings Plan (TSP) participants about the effect a furlough would have on a participant's TSP contributions. In response to those inquiries, we created a new fact sheet entitled *Sequestration and Your TSP Account*. We have also updated our fact sheet *Effect of Nonpay Status on Your TSP Account* to reflect the likelihood that furloughs will not be continuous but rather one or two days per pay period. Both of these fact sheets are attached for your information.

We have received inquiries from ETAC members and our participants about what, if any, alterations can be made to the TSP to assist TSP participants impacted by sequestration and furloughs. Some suggested changes have been to allow participants to take two general purpose loans (rather than one) or to defer repayment of loans if a participant has been furloughed.

Our ability to alter rules regarding TSP loans or withdrawals is limited by statute. Section 8433(g) of title 5, United States Code, allows participants to take loans, however, the loans must comply with Section 72(p) of the Internal Revenue Code. As a result, we cannot relax the rules to allow a deferral of a loan repayment.

Since July 1, 2004, a TSP participant has been restricted to one general purpose loan and one residential loan at any given time. In addition, since that time, when a participant pays off a TSP loan, that participant is not eligible to apply for another loan of the same type for 60 days. We have reviewed this policy to determine what changes could be made. Issues that would have to be addressed to allow 2 general purpose loans include:

- Revising regulations
- Reprogramming computer system edits and processes to allow for 2 general purpose loans;
- Revising multiple pages of the website, on both the public and secure sides

- Throwing away (or storing) current hard copy printed materials
- Identifying, revising, printing, and distributing the new hard copy materials
- Pulling and replacing documents from mail plan material held by mail fulfillment contractor
- Issuing notification Bulletin(s) to agencies about the new process and instructing them to refrain from using older material and to order new material
- Providing instruction and guidance to the call center representatives; and

The level of effort involved in reprogramming the computer system and revising the website would be in excess of 2,000 hours and would take roughly 23 weeks. This means that the changes would not be implemented prior to October 1, 2013, by which time the furloughs will have been concluded. For this reason, we do not believe it is wise to make a change to the number of general purpose loans that a participant can take.

Allowing a participant to take a second loan in a furlough situation may not be as helpful as it appears. Since a participant who is furloughed would have less take home pay, keeping the payments on two TSP loans current would be more difficult. Failure to keep the payments current would require us to declare the outstanding portion of the loan as a taxable distribution, which would have further financial consequences for the participant. We would be happy to discuss this topic further at the ETAC meeting on April 22.

Attachments

Effect of Nonpay Status on Your TSP Account

This fact sheet explains the effects a period of nonpay has on TSP loans, contributions, and withdrawals. It is for civilian employees who are placed in nonpay status (e.g., furlough or leave without pay) and for members of the uniformed services who are in the Ready Reserves and have been given approval by their command to skip scheduled drills, or whose yearly drill schedule is performed over a one- or two-month period.[1] It does not apply to employees who are in nonpay status performing an assignment with a state or local government agency under the provisions of the Intergovernmental Personnel Act (IPA) or to employees who are in nonpay status serving as full-time officers or employees of a union.[2]

1. Loans

After you have read this section, see the chart at the end of this fact sheet for a summary of the rules that apply to employees in nonpay status who have TSP loans.

Can I take a TSP loan while I am in nonpay status?

No. When the TSP issues you a loan, loan payments are deducted from your pay. Therefore, if you are not receiving pay, you will not be eligible for a TSP loan.

Can I take a TSP loan while I am furloughed?

If the furlough is expected to last 30 days or less — yes. If the furlough will last more than 30 days — no. If you expect to be furloughed on a periodic basis (for example, one day per pay period), you can take a TSP loan but will be responsible for keeping your loan payments up-to-date if you don't earn enough per pay period for your agency to make each required loan payment. The section of this fact sheet, "What if I already have a TSP loan when I am placed in nonpay status," discusses how to keep your account current under these circumstances.

When you sign your TSP Loan Agreement, you promise to repay your loan and authorize the TSP to deduct your loan payments from your pay. The first payment is due on or before the 60th day following the loan issue date. 5 Code of Federal Regulations (CFR) § 1655.14(c). If you reasonably believe your furlough will last 30 days or less, you can truthfully sign the Loan Agreement because you reasonably believe that your loan payments will start within the required period and that you will be able to repay your loan. However, as discussed below, should the furlough exceed 30 days, you run the risk of being required to pay taxes on all or a portion of the loan amount, as well as an additional 10% tax penalty.

What happens if my furlough exceeds 30 days?

The Internal Revenue Code (IRC) requires that TSP loans be repaid in level payments. IRC § 72(p)(2)(C). Payment through regular payroll deductions satisfies this requirement. If your loan is not repaid in level payments, the IRC requires the TSP to declare a taxable distribution. This means that the TSP will report the unpaid loan balance (including any accrued interest) as income to you. You must pay tax on this amount and, if you are under age 59½, you may also be subject to an additional 10% tax penalty. Treas. Reg. § 1.72(p)(1), Q. & A. 11. Although tax-exempt and Roth contributions that may be included in the distribution are not subject to tax, any Roth earnings included in the distribution will be subject to Federal income tax, even if you have already met the conditions necessary for your Roth earnings to be qualified.[3] Therefore, you must be very sure that your furlough

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[1] Most uniformed services members will never be in nonpay status.

[2] Under these arrangements, your TSP contributions will continue. If you have a TSP loan, your loan payments must also continue. See your personnel or benefits office for information about your TSP account.

[3] Roth earnings become qualified (i.e., paid tax-free) when the following two conditions have been met: (1) 5 years have passed since January 1 of the calendar year in which you made your first Roth contribution **and** (2) you have reached age 59½ or have a permanent disability. **Note:** The TSP cannot certify to the IRS that you meet the Internal Revenue Code's definition of a disability when your taxes are reported. Therefore, you must provide the justification to the IRS when you file your taxes.

will last 30 days or less when you sign your Loan Agreement, or be prepared to make regular loan payments from your own funds, because you could face severe tax consequences if the furlough lasts longer.

What if I already have a TSP loan when I am placed in nonpay status?

Because TSP loan payments are made through payroll deductions, a period without pay will result in missed payments (unless you make payments directly from your own funds). If you go into approved nonpay status, the IRC allows you to suspend TSP loan payments for up to one year of the nonpay period. **A suspension of loan payments is not automatic.** To suspend your payments, you (or your agency or service) **must** provide the TSP with proper documentation of your nonpay status. **A special rule applies if you are a civilian entering nonpay status to perform military service.** In this case, you will be permitted to suspend payments on your loan until you return to pay status, even if your civilian nonpay status lasts longer than one year. (You cannot repay your civilian TSP loan by having loan payments deducted from your uniformed services pay.)

What if I already have a TSP loan and my furlough requires me to work fewer hours?

Occasionally an agency must reduce the hours of many of its employees due to a lack of funds. Instead of furloughing its employees for continuous periods, an agency may furlough its employees for discontinuous periods (e.g., one day every week or one day every pay period). Agencies may choose to use a discontinuous furlough because it reduces the financial impact on employees and lessens the disruption to the agency.

Nevertheless, a discontinuous furlough may cause an employee to not have sufficient pay to cover all deductions. When this occurs, agencies must follow an order of precedence to determine which deductions will be processed.[4] Under this order of precedence, deductions for retirement, social security, Medicare tax, Federal income tax, health insurance, and other items are processed ahead of TSP loan payments. Consequently, employees furloughed for discontinuous periods may not have enough gross pay for the agency to make a deduction for TSP loan payments and these employees may fall behind in their TSP loan payments. Agencies are not permitted to submit partial loan payments.

If you do not have enough gross pay for your agency to make a deduction for your TSP loan payments, you must submit loan payments from your personal funds directly to TSP. Use Form TSP-26, Loan Payment Coupon, which is available on the TSP website. Follow all instructions on the coupon so that your payment can be processed properly.

The TSP will notify you if you have missed more than 2½ loan payments at the end of any calendar quarter. The notice will provide you with the amount needed to bring your loan up-to-date (the "cure" amount). If you do not submit this amount by the required date, the unpaid balance (including any accrued interest) will be declared a taxable distribution. This means the TSP must report to the IRS any outstanding loan balance and interest as income to the you, and you will be required to pay taxes (and potentially a 10% early withdrawal penalty) on the amount.

When do I need to notify the TSP that I am in nonpay status?

If your nonpay status is less than 30 days, you do not need to notify the TSP; however, you are still responsible for ensuring that your loan payments are up-to-date. If your nonpay is expected to last — or has been extended — for more than 30 days, you or your agency or service must contact the TSP and provide the documentation listed in the next section.

How do I notify the TSP that I am in nonpay status?

Ask your **agency or service** to submit one of the following to the TSP:

- Form TSP-41, Notification to TSP of Nonpay Status; or
- Form SF-50, Notification of Personnel Action; or
- a letter on agency or service letterhead, signed by an appropriate agency official (or your commander or adjutant), and containing your name, date of birth, and Social Security number; the beginning date of the nonpay status; the type of nonpay (military or general); and the signature and title of the agency or service representative providing the information.

Or you may submit the following documentation directly to the TSP:

- Form SF-50, Notification of Personnel Action; or
- a copy of your military orders.

[4] See "PPM-2008-01; Order Of Precedence When Gross Pay Is Not Sufficient To Permit All Deductions," at http://www.chcoc.gov/transmittals/TransmittalDetails.aspx?TransmittalID=1477.

When the TSP receives valid documentation that has been properly completed, we will place a nonpay hold on your account. You will receive a confirmation notice when this has been done. When you receive this notice, please verify that the beginning date of the nonpay status and the type of nonpay is correct. If it is not, ask your agency or service to submit corrected information. If you do not receive a confirmation notice within two weeks of when the nonpay documentation was submitted to the TSP, contact the TSP to verify receipt of the properly completed documentation.

What happens if the TSP is not notified that I am in nonpay status?

Until the TSP receives the proper nonpay documentation, loan payments will be required. Thus, it is very important that the TSP receives one of the documents listed in the previous section as soon as you go into nonpay status. If neither you nor your agency or service notifies the TSP promptly, your loan could be declared a taxable distribution.

Once a taxable distribution has been declared, your loan will be considered closed, and you will not be permitted to repay it. This means the TSP must report to the IRS your outstanding loan balance and interest as income to you, and you will be required to pay taxes (and potentially a 10% early withdrawal penalty) on the amount. Also, for 12 months following the date of the taxable distribution, you will not be eligible to apply for another loan from the account. If, during your period of nonpay status, you receive miscellaneous civilian basic pay (e.g., for medical, annual, or military leave, or for a retroactive salary payment) in an amount large enough to cover a loan payment, your agency may deduct a loan payment from that pay.

How do I make direct payments on my loan while I am in nonpay status?

Because interest will accrue while your payments are suspended, you may want to make loan payments from your own funds directly to the TSP. You can do so by sending a personal check or money order to the TSP. Be sure to write your TSP account number and loan number on your check or money order, and send it with a TSP Loan Payment Coupon to the TSP address on the coupon. (If this information is not provided, the payment will be returned to you.) The Loan Payment Coupon is available from the TSP website (www.tsp.gov), or you can call a Participant Service Representative. Any payments you send will be applied first to accrued interest and then to principal. When your loan is reamortized, the TSP will take into account any loan payments you made during the nonpay period.

What happens to my loan when I return to pay status within one year?

Your TSP loan payments **must** resume when you return to pay status. If you have not chosen to make loan payments while in nonpay status, your loan will be reamortized automatically when you, your agency, or your service submits any one of the following documents to inform the TSP that you have returned to pay status:

- Form TSP-41; or
- Form SF-50; or
- a letter from your agency or service, as described on page 2, and containing the date your nonpay status ended; or
- Form DD214, Certificate of Release or Discharge from Active Duty (if you were on active military duty).

If you do not receive a confirmation notice that your loan has been reamortized within two weeks of your return to pay status, please ask your agency or service to submit one of these documents to the TSP, or submit the necessary information yourself. If your loan payment amount at the time of the reamortization is sufficient to repay your loan in full by the maximum time limit allowed by the IRC and TSP regulations (5 years for a general purpose loan or 15 years for a residential loan), your loan payment amount will not be changed, but the term of your loan will be extended (up to the maximum time limit). (See IRC § 72(0)(2)(B) and 5 CFR § 1655.5.) However, if your loan payment amount is not sufficient to repay the loan in full by the maximum time limit, your loan payment will be increased. This increase could be quite large if you did not submit any loan payments during the period of nonpay status and/or your loan was initially taken for the maximum term. You will receive a confirmation notice of the reamortization, which will provide you with your new loan payment amount. If you are a civilian TSP participant and you went into nonpay status to perform military service, the IRC maximum time limit of your loan will be extended by the length of your military service. However, accrued interest may still cause your loan payment amount to increase. (See IRC § 414(u)(4).)

What happens to my loan if I am in nonpay status for more than one year?

Your TSP loan payments **must** resume at the end of one year of nonpay status, **even if you still have not returned to pay status,** unless you are in nonpay status to perform active military duty. Your loan will be automatically reamortized at the end of the calendar quarter (March, June, September, or December) following the expiration of your one-year limit. Once you have received confirmation of your reamortization, **you must make loan payments directly to the TSP from your personal funds.**

Note: The TSP will not automatically remove the nonpay hold on your account when your loan is reamortized after you reach the one-year limit. This will happen only when you return to pay status and you or your agency or service submits one of the documents listed earlier. If you do not make the loan payments on your reamortized loan, your loan will be at risk of default. At the end of each calendar quarter, the TSP will notify you if you missed more than 2½ loan payments or if your loan payments were insufficient. This notice will provide you with the amount needed to bring your loan up-to-date (the "cure" amount). If you do not submit this amount by the required date, the unpaid balance (including any accrued interest) will be declared a taxable distribution, as described earlier.

2. Contributions

Can I contribute to my TSP account while I am in nonpay status?

No. Employee contributions to TSP accounts must be made as deductions from civilian or uniformed services pay. Therefore, if you are in nonpay status for one or more full pay periods, you cannot contribute to your TSP account during that time. If you are a civilian employee in nonpay status to perform military service, you may make contributions to your uniformed services TSP account. Your contributions will be deducted from your uniformed services pay. In addition, when you return to civilian pay status, you may be entitled to make up TSP contributions to your civilian account. See the fact sheet TSP Benefits That Apply to Members of the Military Who Return to Federal Civilian Service for more information about making up TSP contributions.

What if I am receiving Workers' Compensation?

Workers' Compensation benefits are payments made by the Department of Labor's Office of Workers' Compensation Programs (OWCP) and, by law, are not payments from which TSP contributions may be made. Consequently, while you are in nonpay status, you can neither contribute to your TSP account nor make loan payments from OWCP benefits.

I am a FERS[5] participant. Will I receive agency contributions while I am in nonpay status?

No. Agency Automatic (1%) Contributions are calculated based on basic pay earned during each pay period. Agency Matching Contributions are calculated based on employee contributions from that basic pay. Consequently, if you are not earning basic pay for a particular pay period, you will not receive either type of agency contribution for that pay period.

I am a FERS participant performing military service. Will I receive agency contributions for the time I am in nonpay status?

If you are a civilian FERS employee in nonpay status to perform military service, you are entitled to receive restored **Agency Automatic (1%) Contributions** when you return to your civilian job. These contributions are based on the basic pay you would have received as a civilian if you had not been separated or placed in nonpay status to perform military service. You are also entitled to restored **Agency Matching Contributions** for periods of military service if you:

- contributed to your uniformed services TSP account from military basic pay, or
- elected to make up employee contributions when you returned from military service.

See the TSP fact sheet TSP Benefits That Apply to Members of the Military Who Return to Federal Civilian Service for detailed information regarding your rights under the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). For an explanation of how USERRA benefits apply to your specific situation, see your agency Human Resources office. Only your agency can determine your eligibility to receive restored agency contributions to your TSP account.

Can I make interfund transfers and contribution allocations while I am in nonpay status?

Yes. An interfund transfer is the movement of some or all of your **existing** account balance among the TSP investment funds. Therefore, you may make interfund transfers. A contribution allocation affects the investment of **future** contributions (and loan payments) made to your account. You may make a contribution allocation while in nonpay status, but until future contributions and loan

[5] FERS refers to the Federal Employees' Retirement System, the Foreign Service Pension System, and other equivalent Government retirement plans.

payments are made to your account (or you transfer or roll over money from an IRA or other eligible employer plan), your contribution allocation will have no effect.

3. Withdrawals

Can I make an in-service withdrawal while I am in nonpay status?

Yes. While you are in nonpay status, you can request an in-service withdrawal. There are two types of in-service withdrawals: age-based withdrawals for participants who are age 59 ½ or older, and withdrawals for financial hardship. If you request a financial hardship withdrawal, you must be able to certify (under penalty of perjury) that you have a financial hardship and that the amount of your request is not greater than the dollar amount of your financial hardship. Funds withdrawn are taxable, and an early withdrawal penalty tax may apply. For more information, read the TSP booklet *In-Service Withdrawals.*

Can I make a post-separation withdrawal while I am in nonpay status?

No. While you are in nonpay status, you are still a civilian employee or a member of the uniformed services. You are not eligible to make a post-separation withdrawal until the TSP is notified by your agency or service that you have separated from civilian service or the uniformed services.

Summary of Nonpay Status Rules
(Applicable after the TSP has been informed of your nonpay status)

TOPIC	What you need to know	
	If you are in nonpay status for reasons other than military service	If you are in nonpay status to perform military service
Effect of Length of Nonpay Status on TSP Loans	You are allowed to miss loan payments for up to one year of nonpay status.	You are allowed to miss loan payments throughout the entire time you are in nonpay status.
Accrual of Interest	Interest continues to accrue on your loan during the nonpay period.	Interest continues to accrue on your loan during the nonpay period.
Making Loan Payments	Payments are not required during a nonpay period of one year or less. If you want to make loan payments, use a Loan Payment Coupon*, and send payments directly to the TSP.	Payments are not required during a nonpay period. If you want to make loan payments, use a Loan Payment Coupon*, and send payments directly to the TSP.
Returning to Pay Status	You or your agency or service must notify the TSP when you return to pay status, and provide the ending date of your nonpay status.	You or your agency must notify the TSP when you return to pay status, and provide documentation of the ending date of your nonpay status.
Recalculating Your Loan (i.e., reamortizing your loan)	If your loan is not up-to-date, the TSP will recalculate your loan when you return to pay status or at the end of your one-year time limit, whichever comes first.	If your loan is not up-to-date, the TSP will recalculate your loan when you return to pay status. The maximum time allowed to pay off your loan will be extended by the length of your military service.
Effect of Recalculation on Your Loan Payments	If your current loan payments will not pay off your loan by the maximum repayment period, your loan payments will increase, and you will be notified of the new payment amount.	If your current loan payments will not pay off your loan by the extended maximum repayment period, your loan payments will increase, and you will be notified of the new payment amount.
Resuming Loan Payments	If loan payments do not resume through payroll deductions after your loan has been reamortized, you must submit payments yourself (along with Loan Payment Coupons*) to keep your loan from going into default.	If loan payments do not resume through payroll deductions after your loan has been reamortized, you must submit payments yourself (along with Loan Payment Coupons*) to keep your loan from going into default.
Defaulting on a Loan	If you miss payments after you return to pay status, or your loan has been reamortized due to the one-year limit and you default on your loan, a taxable distribution will be declared, and you will be subject to tax on the taxable portion of the outstanding loan balance (including any accrued interest). Any Roth earnings included in the distribution will be subject to tax, **even if** your earnings were already qualified. If you are under age 59½, you may also be subject to an early withdrawal penalty tax.	If you miss payments after you return to pay status and you default on your loan, a taxable distribution will be declared, and you will be subject to tax on the taxable portion of the outstanding loan balance (including any accrued interest). Any Roth earnings included in the distribution will be subject to tax, **even if** your earnings were already qualified. If you are under age 59½, you may also be subject to an early withdrawal penalty tax.

* The Loan Payment Coupon (Form TSP-26) is available under Forms & Publications on the TSP website at www.tsp.gov.

Sequestration and Your TSP Account

If you have been furloughed as a result of sequestration, you may be wondering how to deal with the financial impact. This fact sheet addresses some of the questions you may have about your TSP contributions. It also details alternatives for accessing your TSP funds should you face financial hardship as a result of being furloughed.

How will a furlough affect my TSP contributions?

As you know, your TSP employee contributions are deducted from your pay. If you are currently making contributions based on a percentage of your basic pay, here's what happens: If you earn $1,000 of basic pay every two-week pay period and you contribute 10% of it to the TSP, you'd have a $100 TSP contribution every pay period. If you are furloughed for 2 days per pay period, then your basic pay would decrease to $800 and as a result, your TSP contribution would decrease by an equal percentage so that your contribution would be $80 per pay period. Simply stated, your TSP contribution decreases in direct proportion to the reduction in your basic pay. Therefore, you may find that lowering your contribution percentage is not necessary.

But if you are currently making TSP contributions based on a dollar amount of your pay, that dollar amount will not automatically decrease with your reduction in pay. You may want to revisit whether that amount is still appropriate given the expected impact of your furlough.

If you are a FERS[1] participant, also keep in mind that any reduction in your basic pay will impact your agency contributions. Whether you are contributing a percentage of your pay or a specific dollar amount, your Agency Automatic (1%) and Agency Matching Contributions will decrease proportionally. If you then choose to decrease the amount of your TSP contributions, be sure you understand how it will affect your agency contributions.

For more information, visit Types of Contributions.

[1] FERS refers to the Federal Employees' Retirement System, the Foreign Service Pension System, and other equivalent Government retirement plans.

Should I terminate my TSP contributions?

If you are making traditional contributions, remember that those contributions are subtracted from your pay before tax. Be aware that stopping this type of contribution could potentially increase your adjusted gross income and, as a result, your income tax liability.

Also, think carefully about terminating your contributions. One of the great things about your TSP contributions, no matter how small, is that the earnings compound over time. If you stop your contributions, even for a short time, you'll miss this opportunity altogether. And, if you are a FERS participant, you are leaving free money on the table because if you stop your contributions, your matching contributions stop as well.

Should I consider a financial hardship withdrawal?

For some, sequestration and the resulting furloughs will cause a significant financial hardship. But before you consider a TSP hardship withdrawal, keep in mind a few things:

- If you take a hardship withdrawal, you will not be able to make any TSP contributions for 6 months after having received your funds.
- You may withdraw only **your** contributions and the earnings associated with them, and the total amount cannot exceed your financial hardship.
- You must pay income tax on the taxable portion of any withdrawal, and you may also be subject to a 10% early withdrawal penalty tax.

- If you are a FERS participant, you will not receive Agency Matching Contributions.
- A hardship withdrawal cannot be repaid so your TSP account is permanently reduced by the amount of your withdrawal.
- Taking a loan may be a better option (see below).

For more information, visit Financial Hardship In-Service Withdrawals.

Should I take a loan?

Taking a TSP loan allows you to borrow money from your account while you are still actively employed by the Federal Government. You repay your own TSP account for the amount of the loan (plus interest) and therefore continue to accrue earnings on the money you borrowed after you pay it back. Before you request a loan, you should know the following:

- If you expect to be furloughed on a continuous basis, you can only take a loan if your furlough is expected to last 30 days or less.
- If you expect to be furloughed on a periodic basis (for example, one or two days per pay period), you can take a loan.
- Loan payments are made by payroll deduction. If, because of a furlough, you don't earn enough per pay period for your agency to deduct the required loan payment, you will be responsible for keeping your loan payments up-to-date so that you don't risk a taxable distribution. (Properly repaid TSP loans are not subject to income taxes or penalties.)
- You can continue to contribute to your TSP account and, if eligible, receive Agency Matching Contributions.
- If you already have an outstanding loan when you get furloughed, you need to make sure that you stay up-to-date on your loan payments.

For more information, visit TSP Loans.