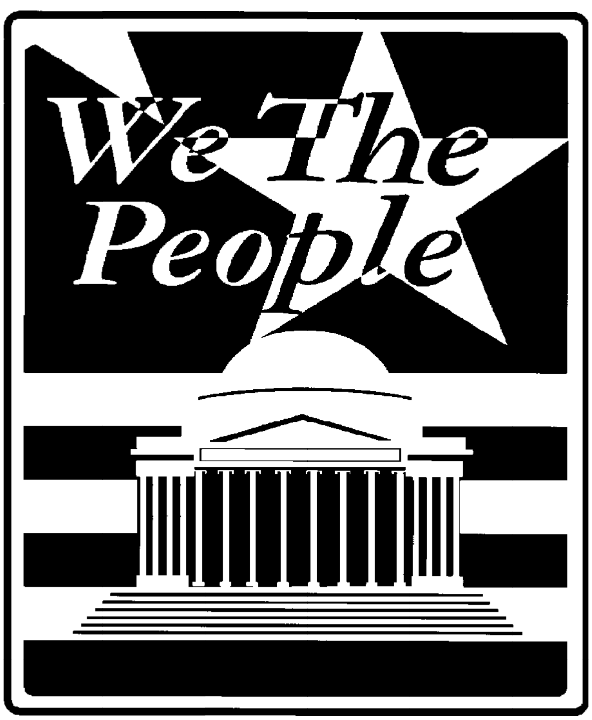
Department of the Treasury
Internal Revenue Service

Publication 721
Cat. No. 46713C

Tax Guide to U.S. Civil Service Retirement Benefits

For use in preparing
1994 Returns



Contents

Important Reminder

Simplified General Rule. If you qualify, you can use the Simplified General Rule instead of the more complex General Rule to figure the taxable part of your retirement annuity. In most cases, the tax is lower using the Simplified General Rule.

Introduction

This publication explains how the federal income tax rules apply to civil service retirement benefits received by retired federal employees (including those disabled) or their survivors. These benefits are paid primarily under the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS).

Tax rules for benefits. All retirees whose annuity starting dates are after July 1, 1986, must use the General Rule or, if they qualify, the Simplified General Rule to figure the taxable and nontaxable parts of their annuities. The Simplified General Rule is explained in Part II of this publication.

The nonsimplified General Rule is not explained in this publication. In most cases, the Simplified General Rule will provide a better tax result and be much easier to figure. For complete information on the nonsimplified General Rule, including the actuarial tables needed to use it, get Publication 939, *Pension General Rule (Nonsimplified Method).*

Part II also discusses the tax treatment of the *lump-sum payment* you receive if you choose the alternative annuity.

Thrift Savings Plan. In addition to the basic retirement systems, CSRS and FERS, a Thrift Savings Plan (TSP)is available. It provides federal employees with the same savings and tax benefits that many private employers offer their employees. This plan is similar to private sector 401(k) plans. You can defer tax on part of your pay by having it contributed to your account in the plan. The contributions and earnings on them are not taxed until they are distributed to you. See *Thrift Savings Plan* in Part II.

Useful Items

You may want to see:

Publication

- ❏ **524** Credit for the Elderly or the Disabled
- ❏ **590** Individual Retirement Arrangements (IRAs)
- ❏ **939** Pension General Rule (Nonsimplified Method)

Form (and Instructions)

- ❏ **1099–R** Statement of Annuity Paid

Ordering publications and forms. To order free publications and forms, call our toll-free telephone number 1–800–TAX–FORM (1–800–829–3676). Or, write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address.

Telephone help for hearing-impaired persons. If you have access to TDD equipment, you can call **1–800–829–4059** with your tax questions or to order forms and publications. See your tax package for the hours of operation.

Part I General Information

This section contains information about provisions that can apply to most recipients of civil service retirement benefits.

Refund of Contributions

If you leave federal government service or transfer to a job not under the retirement system and you are not eligible for an immediate annuity, you can choose to receive a refund of the money to your credit in the retirement fund (your total contributions, both regular and voluntary, plus any interest payable). The amount of the refund that is more than your total contributions to the fund (cost) is taxable. It is taxable in the year the refund is distributed or made available to you. If you only receive your contributions, no part of the refund is taxable.

Generally, some or all of the taxable part of the distribution from active participation in the retirement plan before 1974 may qualify for capital gain treatment. The taxable part from participation after 1973 is taxed as ordinary income, but may be eligible for 5– or 10–year tax option treatment.

The taxable part of the distribution may also be subject to an additional 10% tax on early distributions, if you separate from service before the calendar year in which you reach age 55. For more information, see *Lump-Sum Distributions* and *Tax on Early Distributions* in Publication 575, *Pension and Annuity Income (Including Simplified General Rule).*

Note. This discussion does not apply to the lump-sum payment available to certain retirees who choose the alternative annuity option. See *Lump-Sum Credit* in Part II.

Rollovers. If you leave federal service and receive your contributions *plus* interest, you may be able to roll over all or part of the interest tax free into another qualified plan or an individual retirement arrangement (IRA). Tax will be withheld at a 20% rate unless you roll the interest over by having the Office of Personnel Management (OPM) transfer it directly to an IRA or other plan.

Under the CSRS, but not the FERS, interest is not paid on civil service contributions for service after 1956 unless the refund of contributions covers a period of government service of more than 1 year but less than 5. Many employees who withdraw their contributions under the CSRS do not get interest; consequently, they have nothing to roll over.

If you are the surviving spouse of an employee or retiree and you receive a refund of the contributions plus interest, you may roll over all or part of the interest into an IRA.

See *Rollover Rules* in Part II for more information.

Tax Withholding and Estimated Tax

The annuity you receive is subject to federal income tax withholding based on tables prepared by the Internal Revenue Service, unless you choose not to have tax withheld. If you choose not to have tax withheld, or if you do not have enough income tax withheld, you may have to make estimated tax payments.

For 1994, your withheld tax or estimated tax payments, or the total of both, generally must cover at least 90% of your total tax for the year or 100% of the tax shown on your return for 1993, whichever is less. If it does not, you may owe a penalty. See Chapter 4 in Publication 505, *Tax Withholding and Estimated Tax,* for more information.

These withholding rules also apply to a disability annuity, whether received before or after minimum retirement age. See Part III for rules on disability retirement.

Choosing no withholding. You generally can choose not to have tax withheld from your annuity. The Office of Personnel Management (OPM) will tell you how to make the choice. This choice for no withholding remains in effect until you change it.

Withholding on payments outside United States. The choice for no withholding generally cannot be made for pension or annuity payments to be delivered outside the United States and its possessions.

To choose exemption from withholding if you are a U.S. citizen or resident, you must provide OPM with your home address in the United States or its possessions. Otherwise, OPM has to withhold tax. For example, OPM must withhold if you provide a U.S. address for a nominee, trustee, or agent (such as a bank) to whom the benefits are to be delivered, but you do not provide your own U.S. home address.

You may also choose exemption from this withholding if you certify to OPM that you are ***not*** a U.S. citizen, a U.S. resident alien, or someone who left the United States to avoid tax. But if you so certify, you may be subject to the 30% flat rate withholding that applies to nonresident aliens. For details, see Publication 519, *U.S. Tax Guide for Aliens.*

Withholding certificate. If you give OPM a Form W–4P–A choosing withholding, your annuity will be treated like wages for income tax withholding purposes. If you do not make a choice, OPM must withhold as if you were married with three withholding allowances. To change an election or the amount of tax withholding, call OPM's Retirement Information Office at (202) 606–0500 or write to OPM at the following address:

Office of Personnel Management
Tax Branch
P.O. Box 961
Washington, D.C. 20044

If you want to stop withholding, no special form is needed. You should send your request to waive the withholding to the address shown above. Be sure to include your retirement claim number (CSA or CSF) with any request you send to OPM.

Nonperiodic distributions. If you leave the federal government before becoming eligible to retire and you apply for a refund of your contributions, or you die without leaving a survivor eligible for an annuity, you or your beneficiary will receive a distribution of your contributions to the retirement plan plus any interest payable. Tax will be withheld at a 20% rate on the interest distributed unless you roll it over to an IRA or a qualified plan by having OPM transfer it directly to the IRA or other plan. If you receive only your contributions, no tax will be withheld.

If you retire and elect to receive a reduced annuity and a lump-sum payment under the alternative annuity option, tax will be withheld at a 20% rate on the taxable part of the lump-sum payment received. (See *Lump-Sum Credit* in Part II for information on this option.) However, no tax will be withheld from the lump-sum if you roll the taxable part over to an IRA or a qualified plan by having OPM transfer the taxable part directly to the IRA or other plan.

Estimated tax. Generally, for 1995 you should make estimated tax payments if you estimate that your withholding tax plus your credits will be less than the smaller of:

1) 90% of the tax to be shown on your 1995 income tax return, or
2) 100% of the tax shown on your 1994 income tax return. (The return must cover all 12 months.)

There will be no penalty for the underpayment of 1995 estimated tax if:

1) The total tax due for 1995, minus your withholding and credits, is less than $500, or
2) You had no tax liability for 1994.

Form 1040–ES contains a worksheet that you can use to see if you should make estimated tax payments. For more information, see Chapter 2 in Publication 505.

Form 1099–R. Form 1099–R, *Statement of Annuity Paid,* is mailed to you by OPM each year. It will show any tax you had withheld.

Copy B of Form 1099–R should be filed with your return if any federal income tax was withheld.

Withholding from Thrift Savings Plan payments. A distribution that you receive from the Thrift Savings Plan (TSP) is subject to federal income tax withholding based on whether the distribution is an eligible rollover distribution, a nonperiodic distribution, or a periodic distribution. By January 31 after the end of the year in which you receive a distribution, the TSP will issue Form 1099–R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.,* showing the total distributions you received in the prior year. For a detailed discussion of withholding and reporting on distributions from the TSP, see *Important Tax Information About Payments From Your Thrift Savings Plan Account, (Rev. Nov. 1992),* available from your agency personnel office or from the TSP.

Filing Requirements

If your gross income, including the taxable part of your annuity, is less than a certain amount, you generally do not have to file a federal income tax return. The gross income filing requirements are in the instructions to the Form 1040, 1040EZ, or 1040A that you get each year.

You should check these requirements closely because they change occasionally.

Children. If you are the survivor of a federal employee or retiree and your monthly annuity check includes a survivor annuity for one or more children, each child's annuity counts as his or her own income (not yours) for federal income tax purposes.

If your child can be claimed as a dependent, the amount of income he or she must have before having to file a return depends on whether the child had unearned income for the year. An annuity is unearned income.

If during 1994 the child only had earned income and was not blind, he or she must file a return if the total earned income for the year was more than $3,800. If the child had unearned income of $1 or more and was not blind, however, a return must be filed if the total of the unearned income plus any earned income was more than $600.

Form 1099–R. By January 31 after the end of each tax year, you should receive Form 1099–R, *Statement of Survivor Annuity Paid,* which will show the total amount of the annuity you received in the past year. It may also separately show the survivor annuity for a child or children. If your Form 1099–R does not separately show the amount paid to you for a child or children, you may request a Summary of Benefits, showing the amounts paid to you for your child(ren), from the Office of Personnel Management, P.O. Box 961, Washington, D.C. 20044. Only the part that is each individual's survivor annuity should be shown on that individual's Form 1040 or 1040A. In addition, attach a statement to the return, along with a copy of Form 1099–R, explaining why the amount shown on the tax return differs from the amount shown on Form 1099–R.

Taxable part of annuity. To find the taxable part of each annuity, see the discussion in Part IV, *Rules for Survivors of Federal Employees,* or Part V, *Rules for Survivors of Federal Retirees,* whichever applies.

Part II
Rules for Retirees

This section is for retirees who retired on nondisability retirement. If you retired on disability, see Part III, *Rules for Disability Retirement and Credit for Elderly or Disabled,* later.

Annuity Statement. The statement you received when your annuity was approved shows your ***total contributions*** to the retirement plan (your cost) and the ***gross monthly rate*** of your annuity benefit. The gross monthly rate is the amount you were to get after your annuity was adjusted for electing the survivor's annuity and for electing the lump-sum payment under the alternative annuity option (if either applied) but before income tax withholding, insurance premiums, etc., were deducted.

Your cost. If you are a retired employee, your monthly annuity check contains an amount on which you have previously paid income tax. This amount represents your contributions to the retirement plan. Even though you did not receive the money that was contributed to the fund, it was includible in your gross income for federal income tax purposes in the year it was withheld from your pay. Those amounts are treated as your cost of the annuity.

In general, your cost is your investment in the retirement plan at the annuity starting date (defined later). Your cost is the total of your contributions to the retirement plan. It includes and deemed deposits and deemed redeposits. See *Deemed deposits and redeposits* under *Lump-Sum Credit,* later. When your annuity starts, the Office of Personnel Management (OPM) will tell you what this amount is.

Repayment of contributions plus interest. If you repaid to the retirement plan amounts that you had withdrawn earlier, or if you paid into the plan to receive full credit for service not subject to retirement deductions, the entire repayment, including any interest, is a part of your cost. You may not claim an interest deduction for any interest payments. You may not treat these payments as voluntary contributions; they are considered regular employee contributions.

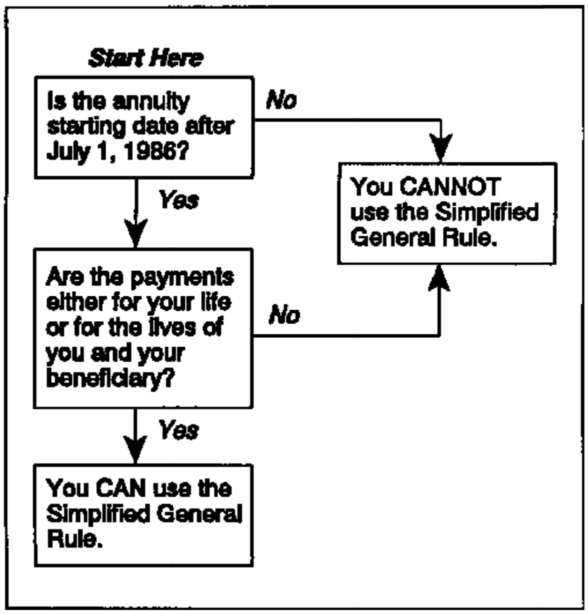
Recovering your cost tax free. If your annuity starting date is after July 1, 1986, you must use the General Rule or, if you qualify, the Simplified General Rule to figure the taxable part of your annuity payments. Under the General Rule or the Simplified General Rule, each of your monthly annuity payments is made up of two parts: the tax-free part that is a return of your cost, and the taxable balance. The tax-free part is a fixed dollar amount. It remains the same, even if your annuity is increased. This rule applies as long as you receive your annuity. However, see *Exclusion limit,* later.

General Rule. Under the General Rule, you figure the tax-free part of each full monthly payment by applying an ***exclusion percentage*** to the initial gross monthly rate of your annuity. The result is the tax-free part of each gross monthly annuity payment. Figuring this percentage is complex and requires the use of actuarial tables. These tables, as well as other information you need to figure the exclusion under the General Rule, are contained in Publication 939, *Pension General Rule (Nonsimplified Method).*

Simplified General Rule. Under the Simplified General Rule, you divide your cost by a certain number of months, based on your age, from a table contained in the worksheet shown later. The result of this division is the monthly tax-free return of your cost. See Figure A to decide if you can use this rule.

Changing the method. If your annuity starting date is after July 1, 1986, you can change the way you figure your pension recovery exclusion (from the General Rule to the Simplified General Rule, or the other way around) by filing amended returns for all your tax years beginning with the year in which you received your first annuity payment. You must use the same method for all years. Generally, you can make the change only within 3 years from the due date of your return for the year in which you received your first annuity payment (or, if later, within 2 years from the date the tax for that year was paid). If your annuity starting date was before July 2, 1986, you cannot choose the Simplified General Rule at any time.

Figure A. Can I Use the Simplified General Rule?



Annuity starting date. Your annuity starting date is important in applying any of the rules to figure the tax on your annuity. The annuity starting date is called the ***commencing date*** on the annuity statement. You should use this date to determine which rule to use, and to make the computation under that rule.

If you retire from federal government service on a regular annuity, your annuity starting date generally is the first day of the month after the month in which you retire. However, if you work the first 3 days (or less) of a month and then retire under the CSRS, your annuity starting date generally is the day after retirement. If you are involuntarily separated from service for reasons other than misconduct or delinquency, your annuity starting date is the day after separation from service.

If something delays payment of your annuity, such as a late application for retirement, it does not affect the date your annuity begins to accrue or your annuity starting date.

Disability retirement. If you retired on disability, see Part III, *Rules for Disability Retirement and Credit for Elderly or Disabled,* later in this publication, to determine the date you will begin to report your disability payments as an annuity.

Exclusion limit. For retirees who have an annuity starting date after 1986, the total amount of annuity income that is excluded over the years as a return of the cost may not exceed their total cost (reduced by the value of any refund feature if using the General Rule). Any unrecovered cost at a retiree's (or last annuitant's) death is allowed as a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) in the last tax year. If the retiree dies before recovering the cost and a survivor annuity is payable, the survivor continues recovering the cost. No deduction is allowed unless the survivor dies before full cost recovery.

Example. Your annuity starting date is after 1986 and you exclude $100 a month under the Simplified General Rule. If your cost is $12,000, the exclusion ends after 10 years (120 months). Thereafter, your entire pension or annuity is taxable.

Annuity starting date before 1987. If your annuity starting date was before 1987, you continue to take your monthly exclusion figured under the General Rule or Simplified General Rule for as long as you receive your annuity. If you choose a joint and survivor annuity, your survivor continues to take the survivor's exclusion figured as of the annuity starting date. The total exclusion may be more than your cost. If your annuity starting date was after July 1, 1986, and the last annuitant dies before the total cost is recovered, the unrecovered cost is still allowed as a deduction in the last tax year.

Choosing a survivor annuity after retirement. If you retired without a survivor annuity and began reporting your annuity under the Simplified General Rule, do not change your reporting method even if you later choose a survivor annuity.

If you retired without a survivor annuity and decided to report your annuity under the General Rule, you must figure a new exclusion percentage if you later choose a survivor annuity. To figure it, reduce your cost by the amount you previously recovered tax free. Figure the expected return as of the date the reduced annuity begins. For details on the General Rule, see Publication 939.

Canceling a survivor annuity after retirement. If you notify the Office of Personnel Management (OPM) that your marriage has ended (by death, divorce, or annulment), your annuity can be increased to remove the reduction for a survivor benefit. The increased annuity does not change the cost recovery you figured at the annuity starting date. If you used the Simplified General Rule, continue excluding the same amount until your cost has been returned to you. After that, if your annuity starting date is after 1986, your annuity payments are fully taxable.

If you used the General Rule, you must continue excluding the same amount as of the annuity starting date of the reduced annuity. The tax-free part of each annuity payment remains the same even though the payment is later increased or you outlive the life expectancy factor used in figuring the exclusion percentage. However, if your annuity starting date is after 1986, your total exclusion cannot be more than your cost minus the value of the refund feature.

Simplified General Rule

If you qualify to use the Simplified General Rule, you will probably find it both simpler and more beneficial than the General Rule in figuring the ***taxable and nontaxable parts of your annuity.***

Who can use it. You may be able to use the Simplified General Rule if you are a retired employee or are the survivor receiving a survivor annuity of a deceased employee. You can use it to figure the taxability of your annuity ***only*** if:

- Your annuity starting date is after July 1, 1986, and
- The annuity payments are for either (a) your life, or (b) your life and that of your beneficiary.

How to use it. If you meet these conditions and you choose the Simplified General Rule, use Table 1, *Worksheet for Simplified General Rule* (near the end of this publication) to figure your taxable annuity. In completing this worksheet, use your age at the birthday preceding your annuity starting date. Be sure to keep the completed worksheet; it will help you figure your taxable amounts for later years. If you chose the lump-sum payment under the alternative annuity option, the lump sum does not reduce your cost to be shown on line 2.

The following example illustrates the simplified method:

Example. Bill Kirkland, age 65, began receiving retirement benefits in January 1994 under a joint and survivor annuity to be paid for the joint lives of Bill and his wife, Kathy. He had contributed $24,000 to the plan and had received no distributions before the annuity starting date. Bill is to receive a retirement benefit of $1,000 a month, and Kathy is to receive a monthly survivor benefit of $500 upon Bill's death.

Bill chooses to use the Simplified General Rule computation. He fills in the worksheet as follows:

Worksheet for Simplified General Rule

1. Enter the total pension received this year. Also add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a $12,000
2. Enter your cost in the plan at annuity starting date, plus any death benefit exclusion* and any deemed deposit or redeposit $24,000
3. Age at annuity starting date: / Enter:

Age at annuity starting date:	Enter:
55 and under	300
56–60	260
61–65	240
66–70	170
71 and over	120

.... 240

4. Divide line 2 by the number on line 3 .... $100
5. Multiply line 4 by the number of months for which this year's payments were made 1,200

   NOTE: If your annuity starting date was **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.
6. Enter the amount, if any, recovered tax free in years after 1986, including any tax-free part of the lump-sum credit payment, if any 0
7. Subtract line 6 from line 2 24,000
8. Enter the smaller of line 5 or line 7. 1,200
9. **Taxable pension for year.** Subtract line 8 from line 1. Enter the result (but not less than zero). Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 11b $10,800
10. Enter the total of lines 6 and 8 1,200
11. Balance of cost to be recovered tax free in future years. Subtract line 10 from line 2 and enter the result $22,800

***Statement for death benefit exclusion**

Cost in plan .... $______

Death benefit exclusion .... ______

Total (enter on line 2 above) .... $______

Signed:______________________

Date:______________________

KEEP FOR YOUR RECORDS

Bill's tax-free monthly amount is $100 (see line 4 of the worksheet). If he lives to collect more than 240 monthly payments, he will have to include in his gross income the full amount of any annuity payments received after 240 payments have been made.

If Bill does not live to collect 240 monthly payments and his wife begins to receive monthly payments, she will also exclude $100 from each monthly payment until 240 payments (Bill's and hers) have been collected. If she dies before 240 payments have been made, a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) will be allowed for the unrecovered cost on her final income tax return.

General Rule

The General Rule applies to all pensions and annuities with an annuity starting date after July 1, 1986, and to pensions and annuities starting by that date if the Three-Year Rule (explained later) could not be used. However, payments from a qualified employee plan or annuity, or a tax-sheltered annuity, that start after July 1, 1986, may qualify to be taxed under the Simplified General Rule.

Compared with simplified rule. If you are able to use the Simplified General Rule (discussed above), it will usually be more beneficial than the General Rule in terms of the tax result and ease of computation. The General Rule is not explained in this publication. If you cannot use the Simplified General Rule, or if you wish to compare results using the two rules, get Publication 939.

Three-Year Rule. If your annuity starting date was before July 2, 1986, you probably had to report your annuity using the Three-Year Rule. Under this rule, you excluded all the annuity payments from income until you fully recovered your cost. After the cost was recovered, all payments became fully taxable. You cannot use another rule to again exclude amounts from income.

The Three-Year Rule was repealed for retirees with an annuity starting date after July 1, 1986.

Lump-Sum Credit

If you (a nondisability annuitant) retire under either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS), you may be able to choose a lump-sum payment under the alternative annuity option. This option is generally only available to those retiring on involuntary retirement or those with certain life-threatening illnesses. If you choose this option, you will receive a lump-sum payment equal to your total regular contributions to the retirement plan plus any interest that applies. Your monthly annuity is then reduced by about 5 to 15 percent to adjust for this payment.

Usually, 85 to 95 percent of the lump sum is taxable income. Figure the taxable portion of the lump sum by using *Table 2, Worksheet for Lump-Sum Payment,* near the end of the publication.

Note. The lump-sum payment discussed here is different from the refund a person may receive when he or she leaves the government before retirement or transfers to a job not under a federal retirement system. Also, the tax treatment of these amounts is different. See *Refund of Contributions* in Part I.

Example. Fran Brown retired from the federal government on December 31, 1993, at age 55. She was entitled to a regular annuity (without survivor benefit) of $1,000 a month if she did not choose the lump-sum credit payment. Her annuity cost (the total of her contributions to the plan) was $21,780. Accrued interest on these contributions totaled $220.

On retirement, Fran elected the lump-sum credit payment, taking a reduction of her monthly annuity to $915. She received the lump-sum payment of $22,000, which equaled her contributions plus the interest that applied.

She figures the taxable part of her lump-sum payment as follows:

Worksheet for Lump-Sum Payment

1)	Largest original monthly annuity payment available (after the reduction for a survivor benefit, if applicable)	$ 1,000
2)	Monthly annuity payment *after* election of lump-sum payment	915
3)	Annuity reduction (subtract line 2 from line 1)	85
4)	Lump-sum credit (contributions plus interest plus deemed deposits or redeposits). Also include the result in the total for line 16a, Form 1040, or line 11a, Form 1040A	22,000
5)	Line 4 minus interest	21,780
6)	Divide line 3 by line 1 (round to 3 decimal places)	.085
7)	Tax-free portion of lump-sum payment (multiply line 5 by line 6)	$ 1,851
8)	Taxable portion of lump-sum payment (subtract line 7 from line 4). Also include the result in the total for line 16b, Form 1040, or line 11b, Form 1040A	$ 20,149

KEEP FOR YOUR RECORDS

In figuring the taxable part of her annuity payments, Fran chooses to use the Simplified General Rule. Under this rule, she divides her total cost of the contract ($21,780) by the number (300) from the Simplified General Rule worksheet based on her age at retirement. The result, $72.60, is her monthly tax-free amount.

The total that Fran can exclude over the years is $21,780, which is made up of $1,851, the tax-free part of her lump-sum credit, and $19,929, the tax-free part of her annuity payments.

Note. The total that can be excluded from gross income is limited to your unrecovered cost (minus the value of the refund feature, if using the General Rule).

Deemed deposits and redeposits. Your lump-sum credit will also include any deemed deposits and deemed redeposits. Deemed deposits (including interest) are for federal employment during which no retirement contributions were withheld from your pay. Deemed redeposits (including interest) are for any refunds of retirement contributions that you received but have not repaid. You will get credit for this prior service without actually making these deposits or redeposits. They are treated (deemed) as if they had been paid by reducing the lump-sum credit payment accordingly. The lump-sum payment actually made to you will not include these amounts. However, your reduced (alternative) annuity will be figured as though, before retirement, you had made these deposits and redeposits to OPM.

Lump-sum payment in installments. If you choose the lump-sum credit, you will usually receive the payment in two installments. The installments will represent a 50%/50% split of the total lump sum. You will receive the first installment after you make the choice on retirement. The remaining installment will be paid to you, with interest, in the next calendar year. (Exceptions to the installment rule are provided for cases of critical medical need.)

Even though the lump-sum payment is made in installments, the overall tax treatment generally remains the same. That is, the tax-free percentage of each installment is the same as would apply to the lump-sum payment as a whole. The tax-free amount of the first installment is 50% of the tax-free portion on line 7 of your *Worksheet for Lump-Sum Payment.* Likewise, the tax-free amount of the second installment is 50% of the amount on line 7. The remainder of each installment is taxable, including the interest on the second installment.

If you have deemed deposits or deemed redeposits (discussed earlier), your lump-sum credit payment is reduced. This will affect the tax-free amount of each installment, as shown in the following example.

Example. Your unadjusted lump-sum credit is $20,000. Your payment, however, is reduced by a $2,000 deemed redeposit of contributions that had been previously refunded to you. You are therefore entitled to an $18,000 lump-sum payment. Because of the date of your retirement, 50% of this, or $9,000, is to be paid to you as the first installment. The remaining $9,000 is to be paid in the second installment.

You are considered to have received the $2,000 redeposit with the first installment, making a total of $11,000 ($9,000 plus $2,000). This is 55% of the total $20,000 lump-sum credit (instead of 50%). Apply this 55% to the tax-free amount of the total lump-sum credit (from line 7 of your *Worksheet for Lump-Sum Payment*). The result is the tax-free part of the first installment. The remaining 45% of the tax-free amount of the total lump-sum credit is the tax-free part of the second installment.

Where to report. As stated on the worksheet, add any lump-sum payment you receive to the total for line 16a, Form 1040, or line 11a, Form 1040A. Add the taxable portion to the total for line 16b, Form 1040, or line 11b, Form 1040A, unless you roll over the taxable portion to an IRA or a qualified retirement plan. Include any interest paid with the second installment on line 8a. Do not report any lump-sum payment or any interest on Form 4972.

Rollovers. If you receive a lump-sum payment, you can roll over the taxable part to an IRA or a qualified retirement plan. OPM must withhold income tax of 20% on the taxable part of the payment unless you have OPM transfer that part directly to an IRA or a qualified retirement plan. See *Rollover Rules* later in this part for more information.

If your lump-sum credit includes a deemed deposit or redeposit, discussed earlier, OPM will make a direct rollover only up to the net lump-sum payment amount. If the taxable amount (line 8 of Table 2, *Worksheet for Lump-Sum Payment*) is more than your net lump-sum payment, you may roll over the difference using your own funds within 60 days. If you do not roll over this difference, you must include it as taxable income on your tax return.

5– or 10–year tax option or capital gain treatment. Your lump-sum payment ***does not*** qualify for 5– or 10–year tax option or capital gain treatment.

Additional tax. If you retire before the calendar year in which you reach age 55 and receive the lump-sum payment, you must pay an additional tax equal to 10% of the taxable amount that you do not choose to roll over to an IRA or a qualified retirement plan. Report the additional tax on line 51, Form 1040. You may also have to complete Form **5329,** *Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts,* and attach it to your Form 1040. If you do not have to attach Form 5329, write ''No'' on the dotted line next to line 51 of your Form 1040.

The 10% additional tax does not apply if you retired because of total and permanent disability. Nor does the additional tax apply to the amount of the lump-sum payment that is equal to your deductible medical expenses for the year (after reduction by 7½% of your adjusted gross income), even if you do not itemize deductions.

Federal Gift Tax

If, through the exercise or nonexercise of an election or option, you provide an annuity for your beneficiary at or after your death, you have made a gift. The gift may be taxable for gift tax purposes. The value of the gift is equal to the value of the annuity.

Joint and survivor annuity. If the gift is an interest in a joint and survivor annuity where ***only*** you and your spouse can receive payments before the death of the last spouse to die, the gift will generally qualify for the unlimited marital deduction. This will eliminate any gift tax liability with regard to that gift.

If you provide survivor annuity benefits for someone other than your current spouse, such as your former spouse, the unlimited marital deduction will not apply. This may result in a taxable gift.

More information. For information on the gift tax, see Publication 448, *Federal Estate and Gift Taxes.*

Retirement During the Past Year

If you have recently retired, the following discussions covering annual leave, voluntary contributions, and community property may apply to you.

Annual leave. Treat a payment for accrued annual leave received on retirement as a salary payment. It is taxable as wages in the tax year you receive it.

Voluntary contributions. Voluntary contributions are those made in addition to the regular contributions to the retirement fund that were deducted from your salary. They also include the regular contributions withheld from your salary after you have the years of service necessary for the maximum annuity allowed by law. If you receive a refund of voluntary contributions, the interest is taxed as explained under *Refund of voluntary contributions,* later in this part. If you choose an additional annuity as a result of these contributions, it is taxed as explained next.

Additional monthly benefit. A monthly annuity benefit that comes from your voluntary contributions is treated separately from a monthly benefit that comes from the regular contributions deducted from your salary. This separate treatment applies for figuring the amounts to be excluded from, and included in, gross income. It does not matter that you receive only one monthly check covering both benefits. Each year you will receive Form1099–R, *Statement of Annuity Paid,* that will show how much of your total annuity received in the past year was from each type of benefit.

You can use either the General Rule or the Simplified General Rule to report additional monthly benefits from voluntary contributions.

Refund of voluntary contributions. If you choose a refund of your voluntary contributions plus accrued interest, the interest is taxable to you in the tax year it is distributed unless you roll it over to an IRA or a qualified retirement plan. If you receive the refund when you separate from service, the interest may qualify for the 5– or 10–year tax option provided you or your beneficiary are not otherwise entitled to benefits under the retirement systems. If you are entitled to receive annuity benefits from your regular contributions at any time, the interest does not qualify for the 5– or 10–year tax option.

Example. You retired in November when you reached the necessary age and years of service to retire. You applied for an annuity based on your regular contributions to the plan. You chose a refund of your voluntary contributions plus interest.

On December 15, you received the refund. The interest is fully taxable (no 5– or 10–year tax option treatment is allowed) unless you roll it over to an IRA or a qualified retirement plan within 60 days.

But you could have a different result if you were not entitled to receive a regular annuity and you chose a refund of all amounts to your credit in the retirement fund (that came from both your regular and voluntary contributions). If this amount is paid to you because you left federal service, and you receive the entire amount within 1 tax year, the interest may qualify for the tax treatment allowed a lump-sum distribution. Generally, you can choose to treat the part of the distribution that comes from active participation in the plan before 1974 as a capital gain. The other part that comes from active participation after 1973 is taxed as ordinary income. However, if you qualify, this ordinary income part may also be taxed under an elective 5– or 10–year tax option.

Form 4972, *Tax on Lump-Sum Distributions,* is used to make the capital gain and 5– or 10–year tax option choices. For more information, get Publication 575.

Additional tax. The accrued interest included in the refund of voluntary contributions and not rolled over to an IRA or qualified retirement plan is generally subject to a 10% additional tax on early distributions if the refund is made to you before the date you reach age 59½. However, the tax does not apply if the refund is made to you after you separate from service if the separation was during or after the calendar year in which you reached age 55.

Also, the 10% additional tax does not apply if the refund is made to you upon separating from service at any age because of total and permanent disability. Nor does the additional tax apply to the accrued interest that is equal to your deductible medical expenses for the year (after reduction by 7½% of your adjusted gross income), even if you do not itemize deductions.

Report the additional tax on line 51, Form 1040. You may also have to complete Form **5329** and attach to your Form 1040. If you do not have to attach Form 5329, write ''No'' on the dotted line next to line 51 of your Form 1040.

Community property laws. State community property laws apply to your annuity.

Generally, the determination of whether your annuity is separate income (taxable to you) or community income (taxable to both you and your spouse) is based on your marital status and domicile when you were working. Regardless of whether you are now living in a community or a noncommunity property state, your current annuity may be community income if it is based on services you performed while married and domiciled in a community property state.

At any time, you have only one domicile even though you may have more than one home. Your domicile is your fixed and permanent home to which, when absent, you intend to return. The question of your domicile is mainly a matter of your intention.

If your annuity is a mixture of community income and separate income, you must divide it between the two kinds of income. The division is based on your periods of service and domicile in community and noncommunity property states while you were married.

For more information, see Publication 555, *Federal Tax Information on Community Property.*

Reemployment After Retirement

If you retired from federal service and were later reemployed by the federal government, you can continue to receive your annuity during reemployment. Your annuity will continue to be taxed just as it was before. If you are still recovering your cost, you continue to do so. If you have recovered your cost, the annuity you receive while you are reemployed is generally fully taxable. The employing agency will pay you the difference between your salary for your period of reemployment and your annuity. This amount is taxable as wages.

Nonresident Alien Retirees

There are some special rules for nonresident alien federal employees performing services outside the United States that affect the taxability of annuities.

Special rule for figuring your total contributions. Your contributions to the retirement plan (your cost) also include the government's contributions to the plan to a certain extent. You include government contributions that would not have been taxable to you at the time they were contributed if they had been paid directly to you. For example, government contributions would not have been taxable to you if, at the time made, your services were performed outside the United States. Thus, your cost is increased by government contributions that you would have excluded as income from foreign services if you had received them directly as wages. This reduces the benefits that you, or your beneficiary, must include in income.

This method of figuring your total contributions does not apply to any contributions the government made on your behalf after you became a citizen or resident of the United States.

Limit on taxable amount. There is a limit on the distributions paid to a nonresident alien retiree or nonresident alien beneficiary that must be included in income. The taxable part of each monthly payment is figured using the following worksheet:

Worksheet for Nonresident Alien Retiree or Beneficiary

1) Portion of monthly annuity otherwise taxable	$
2) Total basic pay for services for the United States	$
3) Total basic pay, minus part of basic pay that was nontaxable as being from sources outside the United States	$
4) Taxable part of monthly annuity [((3) ÷ (2)) × (1)]	$

Basic pay. Basic pay includes your regular pay plus any standby differential. It does not include bonuses, overtime pay, certain retroactive pay, uniform or other allowances, or lump-sum leave payments.

Example 1. You are a nonresident alien who had performed all services for the United States abroad as a nonresident alien. You retired and began to receive a monthly annuity of $200. Your combined basic pay for all services for the United States was $100,000.

Without regard to the limit explained above, you would have had to include $60 of each monthly annuity payment in your gross income. Since you are a nonresident alien, the taxable part of each monthly payment, after use of the limit, is figured as follows:

Worksheet for Nonresident Alien Retiree or Beneficiary

1) Portion of monthly annuity otherwise taxable	$ 60
2) Total basic pay for services for the United States	$ 100,000
3) Total basic pay, minus part of basic pay that was nontaxable as being from sources outside the United States	$ 0
4) Taxable part of monthly annuity [((3) ÷ (2)) × (1)] [($0/$100,000) × $60]	$ 0

Example 2 You are a nonresident alien who retired from your employment with the United States. For your work, performed both within the United States and abroad, you began to receive a monthly annuity of $240.

Your total basic pay for your services for the United States was $120,000; $80,000 was for work done in the United States, and $40,000 was for your work done in a foreign country. You were a nonresident alien during all of your employment.

Under the rules that would otherwise apply to your annuity, you would have had to include $165 of each monthly payment in your gross income. Applying the limit, based on your present rate of annuity, the taxable part of each monthly payment is figured as follows:

Worksheet for Nonresident Alien Retiree or Beneficiary

1) Portion of monthly annuity otherwise taxable	$ 165
2) Total basic pay for services for the United States	$ 120,000
3) Total basic pay, minus part of basic pay that was nontaxable as being from sources outside the United States. ($120,000 – $40,000)	$ 80,000
4) Taxable part of monthly annuity [((3) ÷ (2)) × (1)] [($80,000/$120,000) × $165]	$ 110

Thrift Savings Plan

As a federal employee, you may choose to have contributions made for you to the Thrift Savings Plan (TSP) maintained by the federal government. The TSP is entirely separate from the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS).

If you are covered under the CSRS, all of your TSP contributions are funded through your election to defer receiving up to 5% of your basic pay. If you are covered under the FERS, you can contribute by electing to defer receiving up to 10% of your basic pay. The TSP refers to these contributions as employee contributions, but for tax purposes they are treated as elective deferrals. For FERS employees, agencies also contribute an amount equal to 1% of basic pay and make matching contributions on the first 5% of basic pay contributed.

For federal income tax purposes, contributions to the Thrift Savings Plan are not included in income when made. But your salary of record (before reduction for these contributions) is still used for purposes of social security and Medicare taxes and benefits.

Excess deferrals. If you are covered by another elective deferral plan besides the Thrift Savings Plan, it is possible for your total deferrals for the year to exceed the annual limit on salary deferrals (generally $9,240 for 1994) If you have excess deferrals, see *Treatment of excess deferrals* under *Excess Contributions, Deferrals, and Annual Additions* in Publication 575.

Distributions from Thrift Savings Plan. When you leave or retire from the government, you can ask the TSP to roll over your vested account balance to an IRA or other eligible retirement plan. The TSP refers to this direct rollover as a transfer. If you are eligible for either immediate or deferred retirement benefits, you also have the following withdrawal options:

1) You can leave your money in the plan until a later date, but certain limits apply.
2) You can have the TSP purchase a life annuity for you if your vested account balance is $3,500 or more.
3) You can choose to receive your vested account balance in a single payment or in a series of substantially equal monthly payments. This option cannot start until you are eligible to receive basic retirement benefits. If your distribution is eligible for rollover treatment (see *Distributions eligible for rollover treatment,* later, under *Rollover Rules*) you can ask the TSP to roll over all or part of it to an IRA or other eligible retirement plan.

If your vested account balance is $3,500 or less when you separate or retire, you will receive your money in a single payment unless you choose another withdrawal option for which you are eligible. You can ask the TSP to roll over all or part of this payment to an IRA or other eligible retirement plan.

The TSP will withhold for federal income tax 20% of any distribution that is eligible to be rolled over to an IRA or other eligible retirement plan.

How distributions are taxed. Because you have no cost basis in your account, payments you receive from the TSP are fully taxable unless you roll them over to another qualified plan (including an IRA). If you receive a distribution in a lump sum from the TSP as a surviving spouse, you can roll it over into an IRA. For more information on rollovers, see *Rollover Rules,* later. If a payment from the plan meets the requirements of a lump-sum distribution, it might qualify for the 5– or 10–year tax option. See Publication 575 for details.

Tax on early distributions. If you separate from government service before the calendar year in which you reach age 55 and withdraw your TSP balance in a lump sum, you may have to pay an additional 10% tax on the amount withdrawn. If you separate before the calendar year in which you reach age 55 and withdraw your TSP account in a series of substantially equal monthly payments, you may have to pay the additional 10% tax on any amounts you receive before you become age 59½. This tax is reported on line 51, Form 1040. You may also have to complete Form 5329 and attach it to your Form 1040. If you do not have to attach Form 5329, write "No" on the dotted line next to line 51 of your Form 1040.

The additional tax does not apply if you separate from government service because of total and permanent disability. Nor does it apply to the lump-sum withdrawal to the extent you have, for the year of the withdrawal, deductible medical expenses more than 7½% of your adjusted gross income, even if you do not itemize deductions. Also, the tax does not apply if you choose to purchase a TSP life annuity or receive your account in a series of substantially equal monthly payments based on your life expectancy.

Loans. If you borrow money from the TSP and do not repay it, you may be treated as receiving a taxable distribution. This can happen if you are in an approved nonpay status for a period of 1 year or more, miss payments, make incorrect payments, or leave federal service so that the loan payments can no longer be deducted from your pay. This may also happen in certain other situations. The Thrift Investment Board will declare a distribution in the amount of the unpaid loan balance and any unpaid interest. The account balance you are eligible to withdraw when you leave government service will not include any amount declared as a taxable loan distribution.

The distribution is taxable in the year declared. It also may be subject to the additional 10% tax on early distributions. However, it will not be taxed when it is declared if the distribution is on account of separation from government service and you make a rollover contribution equal to the distribution to a qualified retirement plan or an IRA within 60 days after the declaration.

If you do not leave federal service, the declared distribution is not an eligible rollover distribution for any year.

More information. For more information about the Thrift Savings Plan, see *Summary of the Thrift Savings Plan for Federal Employees,* distributed to all federal employees. Also see *Important Tax Information About Payments From Your Thrift Savings Plan Account,* which is available from your agency personnel office or from the TSP.

Rollover Rules

A rollover is a tax-free withdrawal of cash or other assets from one qualified retirement plan or IRA and its reinvestment in another qualified retirement plan or IRA. You do not include the amount rolled over in your income, and you cannot take a deduction for it. The amount rolled over is taxable later as the new program pays that amount to you. If you roll over amounts into an IRA, subsequent distributions of these amounts from the IRA do not qualify for capital gain or 5– or 10–year tax option treatment. Capital gain or 5– or 10–year tax option treatment will be regained if the IRA contains only amounts rolled over from a qualified plan and these amounts are rolled over from the IRA into a qualified retirement plan.

A qualified retirement plan is a qualified pension, profit-sharing, or stock bonus plan, or a qualified annuity plan. The CSRS, the FERS, and the TSP are considered qualified retirement plans.

Distributions eligible for rollover treatment. You can generally roll over a distribution of any part of the balance to your credit in the CSRS, the FERS, or the TSP except:

1) Any portion of a distribution that is tax free (generally, your after-tax contributions),
2) Any of a series of substantially equal distributions paid at least once a year over:
   a) Your life or life expectancy,
   b) The joint lives or life expectancies of you and your beneficiary, or
   c) A period of 10 years or more,
3) A required minimum distribution generally beginning at age 70½,
4) A TSP loan distribution that is not declared on account of separation from government service (see *Loans* under *Thrift Savings Plan,* earlier).

In addition, a distribution to your beneficiary generally is not treated as an eligible rollover distribution. However, see *Qualified domestic relations order* and *Rollover by surviving spouse,* later.

Withholding requirements. If an eligible rollover distribution is paid to you, the payer must withhold 20% of it. This applies even if you plan to roll over the distribution to another qualified retirement plan or to an IRA. However, you can avoid withholding by choosing the ***direct rollover option,*** discussed later. Also, see *Choosing the right option* at the end of this discussion.

Exception. Withholding from an eligible rollover distribution paid to you is not required if the distributions for your tax year total less than $200.

Direct rollover option. You can choose to have any part of an eligible rollover distribution paid directly to an eligible retirement plan. Under this option, all or part of the distribution can be paid directly to another qualified retirement plan that accepts rollover distributions or to an IRA.

No tax withheld. If you choose the direct rollover option, no tax will be withheld from any part of the distribution that is directly paid to the trustee of the other plan. If any part is paid to you, the payer must generally withhold 20% of it for income tax.

Payment to you option. If an eligible rollover distribution is paid to you, 20% will generally be withheld for income tax. However, the full amount is treated as distributed to you even though you actually receive only 80%. You must include in income any taxable part (including the part withheld) that you do not roll over within 60 days to another qualified retirement plan or to an IRA.

Partial rollovers. If you receive a lump-sum distribution, it may qualify for capital gain or 5– or 10–year tax option treatment. See *Lump-Sum Distributions* in Publication 575. If you roll over any part of the distribution, the part you keep does ***not*** qualify for this treatment.

If you are under age 59½ when a distribution is paid to you, you may have to pay a 10% tax (in addition to the regular income tax) on the taxable part, including any tax withheld, that you do not roll over. See *Tax on Early Distributions* in Publication 575.

Rolling over more than amount received. If the part of the distribution you want to roll over exceeds (due to the tax withholding) the amount you actually received, you will have to get funds from some other source, such as your savings or borrowed amounts, and add them to the amount you actually received.

Example. On January 31, 1995, you receive an eligible rollover distribution of $10,000 from your qualified retirement plan. The payer withholds $2,000, so you actually receive $8,000. If you want to roll over the entire $10,000 to postpone including that amount in your income, you will have to get $2,000 from some other source and add it to the $8,000 you actually received. You must complete the rollover by April 1, 1995.

If you roll over only $8,000, you must include in your 1995 income the $2,000 not rolled over. Also, you may be subject to the 10% additional tax on the $2,000 if it was distributed to you before you reached age 59½.

Time for making rollover. You must complete the rollover of an eligible rollover distribution by the 60th day following the day on which you receive the distribution.

Frozen deposits. If an amount that was distributed to you is deposited in an account from which you cannot withdraw it because of either:

1) The bankruptcy or insolvency of any financial institution, or
2) Any requirement imposed by the state in which the institution is located because of the bankruptcy or insolvency (or threat of it) of one or more financial institutions in the state,

that amount is considered a ''frozen deposit'' for the period during which you cannot withdraw it.

A special rule extends the period allowed for a tax-free rollover for frozen deposits. The period during which the amount is a frozen deposit is not counted in the 60–day period allowed for a tax-free rollover to a qualified plan or an IRA. Also, the 60–day period does not end earlier than 10 days after the deposit is no longer a frozen deposit. To qualify under this rule, the deposit must be frozen on at least one day during the 60–day rollover period.

Qualified domestic relations order. You may be able to roll over tax free all or part of a distribution you receive from the CSRS, the FERS, or the TSP under a court order in a divorce or similar proceeding. You must receive the distribution as an employee's spouse or former spouse (not as a nonspousal beneficiary). The rollover rules apply to you as if you were the employee. You can roll over the distribution if it is an eligible rollover distribution and it is made under a qualified domestic relations order (QDRO) or, for the TSP, a qualifying order. For the TSP, a QDRO may be a qualifying order, but an order may be a qualifying order even if it is not a QDRO. The distribution is not an eligible rollover distribution to the extent it is a return of your prorated share of the employee's after-tax contributions.

A QDRO is a judgment, decree, or order relating to payment of child support, alimony, or marital property rights. The payments must be made to a spouse, former spouse, child, or other dependent of a participant in the plan. For the TSP, a qualifying order may include a payment of attorney's fees to the attorney for the spouse, former spouse, or child of the participant.

The order must contain certain information, such as the amount or percentage of the participant's benefits to be paid to each payee. It may not change the amount or form of the plan's benefits. A distribution that is paid to a child or dependent under a QDRO generally is taxed to the plan participant. A distribution that is paid to a child, dependent, or, if applicable, an attorney for fees, under a qualifying order is taxed to the plan participant.

Rollover by surviving spouse. You may be able to roll over tax free all or part of the CSRS, FERS, or TSP distribution you receive as the surviving spouse of a deceased employee. The rollover rules apply to you as if you were the employee, except that you can roll over the distribution only into an IRA. You cannot roll it over into a qualified retirement plan. A distribution paid to a beneficiary other than the employee's surviving spouse is not an eligible rollover distribution.

You cannot roll over into an IRA any part of the distribution to which you apply the death benefit exclusion.

How to report. On your Form 1040, report the total distribution on line 16a. Report the taxable amount of the distribution minus the amount rolled over, regardless of how the rollover was made, on line 16b. If you file Form 1040A, report the total distribution on line 11a and the taxable amount minus the amount rolled over on line 11b.

Written explanation to recipients. OPM must, provide a written explanation to you within a reasonable period of time before making an eligible rollover distribution to you. It must tell you about:

1) Your right to have the distribution paid tax free directly to another qualified retirement plan or to an IRA,
2) The requirement to withhold tax from the distribution if it is not paid directly to another qualified retirement plan or to an IRA,
3) The nontaxability of any part of the distribution that you roll over to another qualified retirement plan or to an IRA within 60 days after you receive the distribution, and
4) If they apply, the other qualified retirement plan rules, including those for lump-sum distributions, alternate payees, and cash or deferred arrangements.

Reasonable period of time. OPM must provide you with a written explanation no earlier than 90 days and no later than 30 days before the distribution is made. However, you can choose to have a distribution made less than 30 days after the explanation is provided as long as the following two requirements are met:

1) You must have the opportunity to consider whether or not you want to make a direct rollover for at least 30 days after the explanation is provided.
2) The information you receive must clearly state that you have the right to have 30 days to make a decision.

Contact OPM if you have any questions regarding this information.

Choosing the right option. The following comparison chart may help you decide which distribution option to choose. Carefully compare the tax effects of each and choose the option that is best for you.

Comparison Chart

Direct Rollover	Payment To You
No withholding.	Payer must withhold income tax of 20% on the taxable part even if you roll it over to another plan or to an IRA.
No 10% additional tax.	If you are under age 59½, a 10% additional tax may apply to the taxable part, including the tax withheld, that you do not roll over.
Not income until later distributed to you from the other plan or the IRA.	Taxable part, including the tax withheld, is income to the extent not rolled over.
Not eligible for capital gain or 5– or 10–year tax option treatment*	May be eligible for capital gain or 5– or 10–year tax option treatment if no part is rolled over.

*May be eligible for capital gain or 5– or 10–year tax option treatment when later distributed to you from the plan that accepts the rollover.

Note. If you decide to roll over any part of the distribution, the ***direct rollover*** option generally will be to your advantage.

How To Report Benefits

If you receive annuity benefits that are not fully taxable, report the total received for the year on Form 1040, line 16a, or on Form 1040A, line 11a. Also include on that line the total of any other pension plan payments (even if fully taxable, such as those from the Thrift Savings Plan) that you received during the year in addition to the annuity. Report the taxable amount of these total benefits on line 16b (Form 1040) or line 11b (Form 1040A). If you use Form 4972, *Tax on Lump-Sum Distributions,* however, to report the tax on any amount, do not include that amount on lines 16a and 16b or lines 11a and 11b; follow the Form 4972 instructions. You cannot use Form 4972 to report the lump-sum payment you receive if you choose the alternative annuity option.

If you receive only fully taxable payments from your retirement, the Thrift Savings Plan, or other pension plan, report on Form 1040, line 16b, or Form 1040A, line 11b, the total received for the year (except for any amount reported on Form 4972); no entry is required on line 16a (Form 1040) or line 11a (Form 1040A).

Part III Rules for Disability Retirement and Credit for Elderly or Disabled

If you retired on disability, the disability pension you receive is taxable as wages until you reach ***minimum retirement age.*** Beginning on the day after you reach minimum retirement age, your payments are treated as a retirement annuity. At that time, you begin to recover your cost of the annuity under the Simplified General Rule or the General Rule, discussed earlier.

Minimum retirement age (MRA). This is the age at which you could first receive an annuity were you not disabled. This is generally based on your age and length of service. In most cases under the Civil Service Retirement System (CSRS), the minimum combinations of age and service for retirement are:

- Age 55 with 30 years of service.
- Age 60 with 20 years of service.
- Age 62 with 5 years of service.
- For those with covered law enforcement or firefighter duties or air traffic controller service, age 50 with 20 years of covered service.

Retirement under Federal Employees Retirement System (FERS). Your MRA under FERS is between 55 and 57 with at least 10 years of service. With at least 5 years of service, your MRA cannot be later than age 62. Specifically, your MRA with at least 10 years of service is shown in the following table:

If you were born in	Your MRA is
1947 or earlier	55 years
1948	55 years, 2 months
1949	55 years, 4 months
1950	55 years, 6 months
1951	55 years, 8 months
1952	55 years, 10 months
1953 to 1964	56 years
1965	56 years, 2 months
1966	56 years, 4 months
1967	56 years, 6 months
1968	56 years, 8 months
1969	56 years, 10 months
1970 or later	57 years

How to report. You must report all your disability payments received before minimum retirement age on line 7, Form 1040 or line 7, Form 1040A.

Withholding. For income tax withholding purposes, a disability annuity is treated the same as a nondisability annuity. This treatment also applies to disability payments received before minimum retirement age when such payments are shown as wages on your return. See *Tax Withholding and Estimated Tax in Part I,* earlier.

Credit for Elderly or Disabled

You may be able to take the credit for the elderly or the disabled if:

1) You were age 65 or older at the end of the tax year, or
2) You were under age 65 at the end of the tax year and you meet all of the following tests:
   a) You are retired on permanent and total disability, or if you retired before January 1, 1977, you were permanently and totally disabled on January 1, 1976, or January 1, 1977,
   b) You received taxable disability income in the tax year, and
   c) You did not reach ***mandatory retirement age*** (explained later) before the beginning of the tax year.

You are retired on permanent and total disability if you were permanently and totally disabled when you retired, are still permanently and totally disabled, and received disability income because of the disability. If you retired on disability before 1977, you did not have to be permanently and totally disabled at the time you retired, provided you were permanently and totally disabled on January 1, 1976, or January 1, 1977.

Permanently and totally disabled. You are permanently and totally disabled if you cannot engage in any ***substantial gainful activity*** because of your physical or mental condition. Substantial gainful activity is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay or profit.

The substantial gainful activity is not limited to your job activity performed before you retired, or a similar activity. A physician must determine that your condition is expected to result in death or has lasted, or can be expected to last, for a continuous period of at least 12 months. For further information, see *Substantial gainful activity* in Publication 524, *Credit for the Elderly or the Disabled.*

Mandatory retirement age. This is the age set by your employer at which you must retire. There is no mandatory retirement age for most federal employees. However, there is a mandatory retirement age for the following employees:

1) An air traffic controller appointed after May 15, 1972, by the Department of Transportation or Defense generally must retire by the last day of the month in which he or she reaches age 56.
2) A firefighter employed by the U.S. Government who is otherwise eligible for immediate retirement generally must retire on the last day of the month in which he or she reaches age 55 or, if later, completes 20 years of firefighter service.
3) A law enforcement officer employed by the the U.S. Government who is otherwise eligible for immediate retirement generally must retire on the last day of the month in which he or she reaches age 57 or, if later, completes 20 years of law enforcement service.

Physician's statement. If you are under 65 and retired on permanent and total disability, have your doctor complete the *Physician's Statement* in either Part II of Schedule R (Form 1040) or Part II of Schedule 3 (Form 1040A). If due to your continued disabling condition you were unable to engage in any substantial gainful activity in the tax year and you either filed a physician's statement for the same disability with your return for 1983 or an earlier year, or you filed a statement for tax years after 1983 and your physician signed line B on the statement, check the box in Part II. You do not have to file another physician's statement this year. If you have not filed a physician's statement in a previous year, or you filed a statement for tax years after 1983 and your physician signed line A, you must have your physician complete a statement.

Figuring the credit. If you want the Internal Revenue Service to figure your tax and credits, including the credit for the elderly or the disabled, see the instructions for your Form 1040 or Form 1040A.

For detailed information on this credit, get Publication 524.

Other Benefits

The tax treatment of certain other benefits is explained in this section.

Federal Employees' Compensation Act (FECA). FECA payments you receive for personal injuries or sickness resulting from the performance of your duties are like workers' compensation. They are tax exempt and are not treated as disability income or annuities. However, payments you receive while your claim is being processed, including pay while on sick leave and "continuation of pay" for up to 45 days, are taxable.

If you "buy back" sick leave in order to be eligible for nontaxable FECA benefits for the period you took the leave, the amount you spend to "buy back" sick leave you used in the ***same year*** reduces your taxable sick leave pay and is not separately deductible. The amount you spend to "buy back" sick leave you used in an ***earlier year*** is deductible only as a miscellaneous itemized deduction, subject to the 2%-of-adjusted-gross-income limit, on Schedule A (Form 1040) in the year you pay it.

The deduction is the same whether you made the ''buy back'' yourself or had the FECA payment sent directly to your employing agency. The deduction is considered a business loss and may create a net operating loss. Get Publication 536, *Net Operating Losses,* for more information. The special provisions for repayments of more than $3,000 of amounts received under a claim of right do not apply to the deduction for the ''buy back'' of sick leave.

Treat disability benefits you received and agree to pay back in order to be eligible for FECA benefits the same way as payments to ''buy back'' sick leave.

Terrorist attack. Disability benefits you receive for injuries resulting from a violent attack are tax exempt and are not treated as disability income or annuities if (1) the Secretary of State determines it to be a terrorist attack, and (2) the attack took place while you were a federal employee performing official duties outside the United States.

Department of Veterans Affairs. If you received payments from the Department of Veterans Affairs for personal injuries resulting from active service in the armed forces and later receive disability payments from the Civil Service Retirement and Disability Fund for disability arising from the same injuries, you may not treat the annuity payments as tax-exempt income. They are treated as disability income or annuities subject to the rules described earlier.

Payment for annual leave. When you retire, any payment for your unused annual leave is taxed as a salary payment. It is not treated as disability or annuity pay, but is taxed as wages in the tax year you receive the payment.

Part IV Rules for Survivors of Federal Employees

Salary or wages earned by a federal employee but paid to the employee's survivor or beneficiary after the employee's death are ''income in respect of the decedent.'' This income is taxable to the survivor or beneficiary. This treatment also applies to payments for accrued annual leave.

Dependents of public safety officers. The death benefit payable to surviving dependents of public safety officers (law enforcement officers or firefighters) who die in the performance of duty is not taxable. The benefit applies to public safety officers who died from injuries sustained after September 28, 1976, and is administered through the Bureau of Justice Assistance.

The Bureau may pay the surviving dependents a temporary benefit up to $3,000 if it finds that the death of a public safety officer is one for which a final benefit will probably be paid. If there is no final payment, the recipient of the temporary benefit is liable for repayment. However, the Bureau may not require all or part of the repayment if it will cause a hardship. If that happens, that amount is tax free.

The death benefit is not includible in the decedent's gross estate for federal estate tax purposes.

Death Benefit Exclusion

You can exclude from income up to $5,000 paid to you as beneficiary of an employee or former employee if it was paid because of his or her death. The maximum total exclusion is $5,000 regardless of the number of employers paying death benefits or the number of beneficiaries. If more than one person is entitled to death benefits, they must allocate the $5,000 exclusion among themselves in proportion to the relative value of their benefits. The exclusion applies to the beneficiaries of a TSP participant if all the beneficiaries are paid their shares of the benefits within the same calendar year.

The exclusion is treated as additional contributions by the employee. Add the amount of the allowable exclusion to the employee's unadjusted cost in figuring your taxable CSRS or FERS annuity under the General Rule or the Simplified General Rule. This is explained later under *How To Report Your Survivor Annuity.* However, if you are entitled to the special FERS death benefit, you may have to first allocate part of the death benefit exclusion to that benefit, as explained next.

Special FERS death benefit. You are entitled to a special FERS death benefit if you were the spouse of an active FERS employee who: (a) died after at least 18 months of federal service or of a former FERS employee who had at least 10 years of federal service, (b) did not withdraw his or her contributions, and (c) died before becoming eligible for an annuity. At your option, you can take the benefit in the form of a single payment or in the form of a special annuity payable over a 3–year period.

Death benefit exclusion. The death benefit exclusion of up to $5,000 applies in figuring the tax treatment of this death benefit. The exclusion applies as follows:

1) If you receive only the single payment (and do not receive either the special annuity or regular annuity for life), add the death benefit exclusion to your cost basis, if any, in figuring the taxable portion of the payment.
2) If you receive only the special annuity (and do not receive the regular annuity), add the death benefit exclusion to your cost basis, if any, in figuring the tax-free portion of each payment.
3) If you receive the single payment and, additionally, receive the regular annuity, add the death benefit exclusion to your cost basis, if any, in figuring the taxable portion of your annuity.

4) If you receive the special annuity and the regular annuity, allocate the total of the death benefit exclusion and your cost basis, if any, to each annuity in the same proportion that the expected return of each bears to the total expected return.

Tax treatment. Figure your tax on the FERS death benefit as follows:

1) If you receive the single payment only, the taxable portion is the difference between the payment and the total of the death benefit exclusion and your cost basis, if any.
2) If you receive only the special annuity, the tax-free portion of each payment is the total of the death benefit exclusion and your cost basis, if any, divided by 36.
3) If you receive the single payment and the regular annuity for life, the single payment (received after the annuity starting date) is taxable in full. Figure the taxable portion of your regular annuity using the Simplified General Rule, discussed earlier. Your cost for that rule includes the death benefit exclusion and your cost basis, if any.
4) If you receive the special annuity and the regular annuity, figure the tax-free portion of each payment under the special annuity as explained in (2). Figure the taxable portion of your regular annuity using the Simplified General Rule, discussed earlier. The total of your cost basis and death benefit exclusion is allocated to the two annuities in the same proportion that the expected return from each bears to the total expected return.

How To Report Your Survivor Annuity

Depending on your annuity starting date, you must use the Simplified General Rule or the General Rule to report your CSRS or FERS survivor annuity. Your annuity starting date is the day after the date of death.

The General Rule is not discussed in detail in this publication. For information on it, see Publication 939. The following covers how to apply the Simplified General Rule to your survivor annuity. If your annuity starting date is after July 1, 1986, you generally can choose to report your survivor annuity under the Simplified General Rule.

Three-Year Rule. If your annuity starting date was before July 2, 1986, you probably had to report your annuity using the Three-Year Rule. Under this rule, you excluded all the annuity payments from income until you fully recovered your cost. After the cost was recovered, all payments became fully taxable. You cannot use another rule to again exclude amounts from income.

The Three-Year Rule was repealed for survivors with an annuity starting date after July 1, 1986.

Surviving spouse with no children receiving annuities. If you are a surviving spouse who qualifies to use the Simplified General Rule and you want to use it, complete the worksheet discussed in Part II and printed near the end of the publication. Increase the employee's cost by the allowable death benefit exclusion.

You must attach a signed statement to your income tax return stating that you are entitled to the death benefit exclusion in making the Simplified General Rule computation. Or, you may use the statement shown at the bottom of the worksheet. This statement is required every year until an amount equal to the cost in the annuity plus the death benefit exclusion is recovered tax free.

Example. Diane Greene, age 48, began receiving a $1,500 monthly annuity in 1994 upon the death of her husband. Her husband was a federal employee when he died. She received 10 payments in 1994. Her husband had contributed $25,000 to the retirement plan. In addition, Diane finds that she is entitled to a $5,000 death benefit exclusion for the annuity payments. She adds that amount to her husband's contributions to the plan, making a total annuity cost of $30,000.

Diane chooses to use the Simplified General Rule. She fills out the worksheet as follows :

Worksheet for Simplified General Rule

1.	Enter the total pension received this year. Also add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a	$15,000
2.	Enter your cost in the plan at annuity starting date, plus any death benefit exclusion* and any deemed deposit or redeposit	$30,000
3.	Age at annuity starting date: / Enter: 55 and under — 300 56–60 — 260 61–65 — 240 66–70 — 170 71 and over — 120	300
4.	Divide line 2 by the number on line 3	$100
5.	Multiply line 4 by the number of months for which this year's payments were made	1,000
	NOTE: If your annuity starting date was **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.	
6.	Enter the amount, if any, recovered tax free in years after 1986, including any tax-free part of the lump-sum credit payment, if any	0
7.	Subtract line 6 from line 2	30,000
8.	Enter the smaller of line 5 or line 7	1,000
9.	**Taxable pension for year.** Subtract line 8 from line 1. Enter the result (but not less than zero). Also add this amount to the total for Form 1040, line 16b, or Form 1040A, line 11b	$14,000
10.	Enter the total of lines 6 and 8	1,000

11. Balance of cost to be recovered tax free in future years. Subtract line 10 from line 2 and enter the result $29,000

***Statement for death benefit exclusion**

Cost in plan (contract)	$25,000
Death benefit exclusion	5,000
Total (enter on line 2 above)	$30,000

Signed: Diane Greene

Date: 2-15-95

KEEP FOR YOUR RECORDS

Diane completes and signs the statement at the bottom of the worksheet and attaches it to her income tax return to show that she is entitled to the death benefit exclusion in making the Simplified General Rule computation. She keeps a copy for her records.

Surviving spouse with child. If the survivor benefits include both a life annuity for the surviving spouse and one or more temporary annuities for the employee's children, you can report the annuities under the Simplified General Rule. However, an additional step is needed to allocate the monthly exclusion among the beneficiaries correctly.

Begin the computation by completing lines 2 through 4 of the *Worksheet for Simplified General Rule* to figure the total monthly exclusion for all the beneficiaries. In completing line 3, use the age of the oldest beneficiary (usually the surviving spouse) at the annuity starting date. Then, to figure the monthly exclusion for each beneficiary, take the monthly exclusion from line 4 of the worksheet and multiply it by a fraction. The numerator of the fraction is that beneficiary's monthly annuity, and the denominator of the fraction is the total of the monthly annuity payments to all the beneficiaries.

Child's temporary annuity. Each surviving child will receive a temporary annuity until the child reaches age 18, marries, or dies, whichever comes first. There are two exceptions to this. If the child is a full-time student after reaching age 18, the annuity will continue until the child stops being a student, reaches age 22, marries, or dies, whichever occurs first. If the child is incapable of self-support after age 18 due to a medical condition that began before age 18, the annuity will continue until the child becomes capable of self-support, marries, or dies.

The ending of a child's temporary annuity does not affect the total monthly exclusion figured under the Simplified General Rule. The total exclusion merely needs to be reallocated at that time among the remaining beneficiaries. If only the surviving spouse is left drawing an annuity, the surviving spouse is entitled to the entire monthly exclusion as figured in the worksheet.

Example. Assume the same facts as in the Diane Greene example, above, except that the Greenes had a son, David, who was age 15 at the time of his father's death. David is entitled to a $500 per month temporary annuity until he reaches age 18 (age 22, if he remains a full-time student and does not marry until that time).

In completing the Simplified General Rule worksheet, Diane fills out the entries through line 4 exactly as shown above. That is, she includes on line 1 only the amount of the pension she herself received, she adds on line 2 the $5,000 death benefit exclusion to the cost of the contract, and she uses on line 3 the 300 factor for her age. After arriving at the $100 monthly exclusion on line 4, however, Diane allocates it between her own annuity and that of her son.

To find how much of the monthly exclusion to allocate to her own annuity, Diane multiplies the $100 monthly exclusion by the fraction $1,500 (her monthly annuity) over $2,000 (the total of her $1,500 and David's $500 annuities). She enters the result, $75, just below the entry space for line 4. She completes the worksheet by entering $750 on lines 5 and 8 and $14,250 on line 9.

A second worksheet should be completed for David's annuity. On line 1, he enters $5,000 as the total pension received. Lines 2, 3, and 4 are the same as those on his mother's worksheet. In allocating the $100 monthly exclusion on line 4 to his annuity, David multiplies it by the fraction $500 over $2,000. His resulting monthly exclusion is $25. His exclusion for the year (line 8) is $250 and his taxable pension for the year (line 9) is $4,750.

Diane and David only need to complete lines 10 and 11 on a single worksheet to keep track of their unrecovered cost for next year. These lines are exactly as shown in the earlier example.

When David stops getting his temporary annuity at age 18 (or age 22, if applicable), the computation of the total monthly exclusion will not change. The only difference will be that Diane will then claim the full exclusion against her annuity alone.

Annuity for a surviving child only. A method similar to the Simplified General Rule can also be used to report the taxable and nontaxable parts of a temporary annuity (or annuities) for one or more surviving children when there is no surviving spouse. To use this method, simply divide the deceased employee's cost of the annuity contract plus any death benefit exclusion by the number of months from the child's annuity starting date until the date the child will reach age 22. The result is the monthly cost recovery exclusion. (But the monthly exclusion cannot be more than the monthly annuity payment. You can carry over unused cost recovery amounts to apply against future annuity payments.) If the surviving child is entitled to a temporary annuity regardless of age because he or she is disabled, see *Disabled child,* below.

More than one child. If there is more than one child entitled to a temporary annuity (and no surviving spouse), divide the cost plus the death benefit exclusion by the number of months of payments until the date the ***youngest*** child will reach age 22. This monthly cost recovery exclusion must then be allocated among the children in proportion to their monthly annuity payments, like the distribution shown in the previous example.

Disabled child. If a child otherwise entitled to a temporary annuity was permanently disabled at the annuity starting date (and there was no surviving spouse), that child is treated for tax purposes as receiving a lifetime annuity, like a surviving spouse. The child can complete the Simplified General Rule worksheet using the recovery factor on line 3 corresponding to the child's age at the annuity starting date. If, besides the disabled child, there is another child, or children, entitled to temporary annuities, an allocation like the one shown under *Surviving spouse with child,* earlier, must be made to determine each child's share of the exclusion.

Limit on tax-free amount. If your annuity starting date is before 1987, the tax-free part of each whole monthly payment remains the same each year you receive payments—even if the ***amount received is increased*** or if you outlive the number of months used on line 3 of the Simplified General Rule worksheet.

If your annuity starting date is after 1986, the most that can be recovered tax free is the unrecovered cost of the annuity. Once the total of your exclusions equals the cost when annuity payments began, your entire annuity is taxable. If the annuity starting date is after July 1, 1986, and death occurs before the investment is recovered tax free, a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit) may be taken for the beneficiary's last tax year.

Lump-Sum Payment

If the federal employee dies before retiring and leaves no one eligible for a survivor annuity, the estate or other beneficiary will receive a lump-sum payment from the Civil Service Retirement and Disability Fund. This single payment is made up of the regular contributions to the retirement fund plus accrued interest, if any, to the extent not already paid to the employee.

The beneficiary will be taxed in the year a lump sum is distributed or made available. The tax is on any amount by which the lump-sum payment exceeds the total of the employee's contributions to the fund and up to $5,000 as a death benefit exclusion if this exclusion applies. In many cases, because of the exclusion, the lump-sum payment will be tax free.

Lump-sum payment at end of survivor annuity. If an annuity is paid to the federal employee's survivor and the survivor annuity ends before an amount equal to the deceased employee's contributions plus any interest has been paid out, the rest of the contributions plus any interest will be paid in a lump sum to the employee's estate or other beneficiary. Generally, this beneficiary will not have to include any of the lump sum in gross income because, when it is added to amounts previously received under the contract that were excludable, it still will be less than the employee's total contributions plus the death benefit exclusion of up to $5,000.

Example. At the time of your brother's death, he was employed by the federal government and had contributed $5,000 to the Civil Service Retirement and Disability Fund. His widow received $3,000 in survivor annuity payments before she died. She had used the General Rule for reporting her annuity and properly excluded $600 from gross income, based upon an exclusion percentage of 20%. In figuring the exclusion percentage, she increased the employee's contributions by the allowable death benefit exclusion of $5,000.

Since only $3,000 of the guaranteed amount of $5,000 (your brother's contributions) was paid as an annuity, the balance of $2,000 is paid to you in a lump sum as your brother's sole beneficiary. You figure the taxability of this payment as follows:

Lump-sum payment	$ 2,000
Plus: Amount previously excludable	600
Total	$ 2,600
Minus: Employee's total cost ($5,000 contribution plus $5,000 death benefit exclusion)	10,000
Taxable amount (not less than zero)	$ 0

Voluntary contributions. If a federal employee dies before retiring from government service, the voluntary contributions to the Civil Service Retirement and Disability Fund cannot be used to provide an additional annuity to the survivors. Instead, the voluntary contributions plus any accrued interest will be paid in a lump sum to the estate or other beneficiary. The beneficiary reports this payment as income for the year distributed or made available to the extent it exceeds the employee's total voluntary contributions. If this excess is received within 1 tax year, it may qualify for capital gain or 5– or 10–year tax option treatment.

Generally, the part of a lump-sum distribution from active participation in a year before 1974 may qualify for capital gain treatment. The part from active participation after 1973 is taxed as ordinary income. The beneficiary may choose to have this distribution taxed under the 5– or 10–year tax option. This treatment applies only if (1) regular annuity benefits cannot be paid under the system and (2) the beneficiary also receives a lump-sum payment of the compulsory contributions plus interest within the same tax year as the voluntary contributions. For more information, see *Lump-Sum Distributions* and *5– or 10–Year Tax Option* in Publication 575.

Thrift Savings Plan

The payment you receive as the beneficiary of a decedent's Thrift Savings Plan (TSP) account is fully taxable except to the extent you used the death benefit exclusion. However, if you are the decedent's surviving spouse, you can generally roll over the otherwise taxable part of the payment to an IRA tax free. (You cannot make a rollover to another qualified plan.) If you do not choose a direct rollover of the decedent's TSP account, mandatory 20% income tax withholding will apply. For more information, see *Rollover Rules,* in Part II. If you are not the surviving spouse, the payment is not eligible for rollover treatment.

The death benefit exclusion applies if you receive a lump-sum payment as the beneficiary of the decedent's TSP account. Treat the exclusion as the cost basis of the payment. The taxable portion is the difference between the payment and the cost basis. If you receive annuity payments as the beneficiary of the decedent's TSP account that start after the death of the employee, use the death benefit exclusion as the cost basis to determine the taxable portion of the annuity.

If you receive, as the beneficiary of the decedent, other non-TSP payments that qualify for the death benefit exclusion, allocate the total of the death benefit exclusion to each annuity in the same proportion that the expected return of each bears to the total expected return.

If the entire account balance is paid to the beneficiaries in the same calendar year, the payments might qualify for the 5– or 10–year tax option. See Publication 575 for details.

Federal Estate Tax

Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* must be filed for the estate of a citizen or resident of the United States if the gross estate is more than $600,000. Included in this $600,000 would be any taxable gifts made by the decedent after 1976, and the specific exemption allowed for gifts by the decedent after September 8, 1976, and before 1977.

The gross estate generally includes the value of all property beneficially owned by the decedent at the time of death. Examples of property included in the gross estate are salary or annuity payments that had accrued to an employee or retiree, but which were not paid before death, and the balance in the decedent's Thrift Savings Plan account.

The gross estate usually also ***includes the value of the death and survivor benefits payable under the CSRS or the FERS.*** If the federal employee died leaving no one eligible to receive a survivor annuity, the lump sum (representing the employee's contribution to the system plus any accrued interest) payable to the estate or other beneficiary is included in the employee's gross estate.

Marital deduction. The estate tax marital deduction is a deduction from the gross estate of the value of property that is included in the gross estate but that passes, or has passed, to the surviving spouse. Generally, there is no limit on the amount of the marital deduction. Community property passing to the surviving spouse qualifies for the marital deduction.

More information. For detailed information, get Publication 448, *Federal Estate and Gift Taxes.*

Part V Rules for Survivors of Federal Retirees

Retirement benefits accrued and payable to a CSRS or FERS retiree before death, but paid to you as a survivor, are taxable in the same manner and to the same extent such benefits would have been taxable had the retiree lived to receive them.

How To Report Your Survivor Annuity

Annuity payments you receive as the surviving spouse of a federal retiree are fully taxable or are partly taxable under either the General Rule or the Simplified General Rule.

Cost recovered. If the retiree had been reporting the annuity under the Three-Year Rule and had recovered tax free all of his or her cost of the contract before dying, your survivor annuity payments are fully taxable. This is also true if the retiree had an annuity starting date after 1986, had been reporting the annuity under the General Rule or the Simplified General Rule, and had fully recovered his or her cost tax free. But see the discussions about the death benefit exclusion later in this part under *Retiree survived by spouse and children* and *Retiree survived only by children.*

General Rule. If the retiree was reporting the annuity under the General Rule, you should apply the same exclusion percentage that the retiree used. Apply the exclusion percentage to the amount specified as your survivor annuity at the retiree's annuity starting date. Do not apply the exclusion percentage to any cost-of-living increases made after that date. Those increases are fully taxable. For information on the General Rule, get Publication 939.

Simplified General Rule. If the retiree had chosen to report the annuity under the Simplified General Rule, the monthly exclusion (from line 4 of the *Worksheet for Simplified General Rule)* remains fixed (even if the monthly payment is increased or decreased). You continue to claim this exclusion each month until the entire cost of the contract has been recovered tax free. This is shown in the example for Bill Kirkland under *Simplified General Rule* in Part II.

Limit on tax-free amount. A cost-of-living increase in your survivor annuity payments does not change the amount you can exclude from gross income under either the General Rule or the Simplified General Rule. The tax-free amount remains the same. The number of payments from which you can exclude a tax-free amount may be limited, however, depending on the annuity starting date.

If the retiree's annuity starting date was before 1987, you can exclude the tax-free amount from all the annuity payments you receive. This includes any payments received after you recover the annuity cost.

If the retiree's annuity starting date is after 1986, you can exclude a tax-free amount only from a limited number of payments: those you receive until you recover the annuity cost tax free. The annuity payments you receive after you recover the annuity cost tax free are fully taxable.

Death Benefit Exclusion

The death benefit exclusion does not apply to the CSRS or FERS annuity paid to the surviving spouse of a deceased retiree. (But see *Survivors of Disability Retirees,* later in this part.) However, a child getting a temporary annuity can get the exclusion.

Retiree survived by spouse and children. If the retiree is survived by a child or children entitled to temporary annuities, and a spouse is entitled to an annuity for life, the temporary annuities are treated separately from the life annuity. The children recover the allowable death benefit exclusion (which becomes their cost) by allocating it over the number of months from their annuity starting date until the youngest child reaches age 22. See *Annuity for a surviving child only* under *How To Report Your Survivor Annuity* in Part IV. The life annuity is taxed as already explained.

If there is more than one child entitled to a temporary annuity, each child is entitled to a portion of the death benefit exclusion. This portion is based on the value of the child's annuity in proportion to the total value of all the temporary annuities.

Example. A deceased retiree left a widow entitled to a survivor's annuity for life and two children, Sam and Lou, entitled to temporary annuities. Sam's annuity is valued at $6,000 and Lou's at $2,000. There are no other death benefits payable and the allowable death benefit exclusion is $5,000. The exclusion allocable to Sam's interest is $3,750 [($6,000/$8,000) x $5,000]; and the exclusion allocable to Lou's interest is $1,250 [($2,000/$8,000) x $5,000].

Retiree survived only by children. If the retiree is survived only by a child or children entitled to temporary annuities, the children recover their cost, which is equal to the retiree's unrecovered cost plus the allowable death benefit exclusion, by allocating it over the number of months from their annuity starting date until the youngest child reaches age 22. See *Annuity for a surviving child only* under *How To Report Your Survivor Annuity* in Part IV.

If there is more than one child and one or more of the children qualifies for an annuity after reaching age 22 because of the lack of ability to be self-supporting, a determination of the proper exclusion for each child should be obtained by writing to the Internal Revenue Service. There is a $50 fee for this service.

Survivors of Disability Retirees

If you are receiving a CSRS or FERS survivor annuity as either the spouse or child of an employee who died after retiring on disability but before reaching the employee's ***minimum retirement age*** (explained next), the ***death benefit exclusion*** will apply to your survivor annuity. The allowable death benefit exclusion must be used to increase your cost of the contract in the same manner as if the retiree had died while still a federal employee. See *Death Benefit Exclusion* in Part IV.

Minimum retirement age. This is the age at which a person would first be eligible to receive an annuity without regard to disability.

Lump-Sum Payment

If a deceased retiree has no beneficiary eligible to receive a survivor annuity, the unrecovered contributions to the Civil Service Retirement and Disability Fund plus accrued interest, if any, will be paid in a lump sum to the estate or other beneficiary. The estate or other beneficiary will rarely have to include any part of the lump sum in gross income. The taxable amount is figured as follows:

1) Lump-sum payment	$	
2) Amounts received under contract that were excludable by retiree	$	
3) (1) plus (2)		$
4) Employee's total contributions	$	
5) Death benefit exclusion (up to $5,000)	$	
6) (4) plus (5)		$
7) Taxable amount (not less than zero) ((3) minus (6))		$

The taxable amount, if any, may qualify for capital gain or 5– or 10–year tax option treatment. Generally, that part of a lump-sum distribution from active participation in a year before 1974 may qualify for capital gain treatment, while the part from active participation after 1973 is taxed as ordinary income. A taxpayer may choose to have this ordinary income part taxed under the 5– or 10–year tax option. This treatment applies only if additional annuity benefits are not payable under the system and the lump-sum payment makes up all of the funds (including any voluntary contributions plus interest) to the credit of the decedent in the retirement system. For more information, see *Lump-Sum Distributions* and *5– or 10–Year Tax Option* in Publication 575.

Voluntary Contributions

If, before death, the retiree was receiving additional annuity payments from voluntary contributions to the Civil Service Retirement and Disability Fund and was reporting them under the General Rule, you should apply the retiree's exclusion percentage to your additional survivor annuity benefits, figured to be payable as of the annuity starting date. If the retiree was reporting the payments under the Simplified General Rule, use the same monthly exclusion amount that the retiree used. If the annuity starting date was after 1986, the total exclusion is limited to the amount of the voluntary contributions. After the total of these contributions has been recovered tax free, the additional annuity payments are fully taxable. Your additional annuity increases your monthly benefits.

A monthly benefit that comes from voluntary contributions is treated separately from a monthly benefit that comes from regular contributions. This separate treatment applies for figuring the amounts to be excluded from, and included in, gross income. It does not matter that you receive only one monthly check covering both benefits. Each year you will receive Form 1099–R, *Statement of Survivor Annuity Paid,* that will show how much of your total annuity received in the past year was from each type of benefit.

The death benefit exclusion does not apply to an additional survivor annuity from voluntary contributions.

Lump-sum payment. If at the time of the retiree's death there was no one eligible to receive a survivor annuity, the retiree's unrecovered voluntary contributions plus any interest would have been paid in a lump sum to the estate or other beneficiary. The lump-sum payment is taxable to the beneficiary to the extent that, when added to excludable amounts received by the retiree, it exceeds the retiree's total voluntary contributions. This excess, if any, is taxable as explained earlier under *Voluntary contributions* in the *Lump-Sum Payment* section of Part IV.

Thrift Savings Plan

If you receive a payment from the TSP account of a deceased federal retiree, the payment is fully taxable except to the extent you used the death benefit exclusion. However, if you are the retiree's surviving spouse, you generally can roll over the otherwise taxable part of the payment to an IRA tax free. (You cannot make a rollover to another qualified plan.) For information, see *Rollover Rules* in Part II, earlier. If you are not the surviving spouse, the payment is not eligible for rollover treatment. The death benefit exclusion applies to the lump-sum payment you receive from the TSP.

If the retiree chose to receive his or her account balance as an annuity, the payments you receive as the retiree's survivor are fully taxable when you receive them, whether they are received as annuity payments or as a cash refund of the remaining value of the amount used to purchase the annuity. The death benefit exclusion does not apply to the annuity payments you receive as the retiree's survivor.

Federal Estate Tax

A federal estate tax return may have to be filed for the estate of the retired employee. See *Federal Estate Tax* in Part IV.

Income Tax Deduction for Estate Tax Paid

Any income that a decedent had a right to receive and could have received had death not occurred that was not properly includible in the decedent's final income tax return is treated as ***income in respect of a decedent.*** This includes retirement benefits accrued and payable to a retiree before death, but paid to you as a survivor.

If you are required to include income in respect of a decedent in gross income for any tax year, you may deduct for the same tax year the portion of the federal estate tax imposed on the decedent's estate that is from the inclusion in the estate of the right to receive that amount. This also is true if you are required to include income in respect of a prior decedent. For this purpose, if the retiree died after the annuity starting date, the taxable portion of a survivor annuity you receive (other than a temporary annuity for a child) is considered income in respect of a decedent.

The federal estate tax you may deduct is determined by comparing the actual federal estate tax and the tax that would have been paid if the income in respect of the decedent were not included in the gross estate.

Income tax deductions for the estate tax on the value of your survivor annuity will be spread over the period of your life expectancy. The deductions cannot be taken beyond your life expectancy. Moreover, if you should die before the end of this period, there is no compensating adjustment for the unused deductions.

If the income in respect of the decedent is ordinary income, the estate tax must be deducted as a miscellaneous itemized deduction (not subject to the 2%-of-adjusted-gross-income limit).

For more information, see *Income in Respect of the Decedent* in Publication 559, *Tax Information for Survivors, Executors, and Administrators*.

Table 1. **Worksheet for Simplified General Rule** (Keep For Your Records)

1. Enter the total pension received this year. Also, add this amount to the total for Form 1040, line 16a, or Form 1040A, line 11a .... $________

2. Enter your cost in the plan at annuity starting date, plus any death benefit ex clusion* and any deemed deposit or redeposit. ________

3. Age at annuity starting date: / Enter:

Age at annuity starting date:	Enter:
55 and under	300
56–60	260
61–65	240
66–70	170
71 and over	120

.... ________

4. Divide line 2 by the number on line 3 .... ________

5. Multiply line 4 by the number of months for which this year's payments were mad e .... ________

   NOTE: If your annuity starting date was **before 1987,** enter the amount from line 5 on line 8 below. Skip lines 6, 7, 10, and 11.

6. Enter the amount, if any, recovered tax free in years after 1986, including any tax-free part of the lump-sum credit payment, if any .... ________

7. Subtract line 6 from line 2 .... ________

8. Enter the smaller of line 5 or line 7 .... ________

9. **Taxable pension for year.** Subtract line 8 from line 1. Enter the result (but not less than zero). Also add this amount to the total for Form 1040, line 16b, or Form 1040 A, line 11b $________

10. Enter the total of lines 6 and 8 .... ________

11. Balance of cost to be recovered in future years. Subtract line 10 from line 2 a nd enter the result .... $________

***Statement for death benefit exclusion**

Cost in plan .... $________

Death benefit exclusion .... ________

Total (enter on line 2 above) ..... $________

Signed:________

Date:________

Table 2. **Worksheet for Lump-Sum Payment** (Keep For Your Records)

1.	Largest original monthly annuity payment available (after the reduction for a survivor benefit, if applicable)	$
2.	Monthly annuity payment *after* election of lump-sum credit payment	
3.	Annuity reduction (subtract line 2 from line 1)	
4.	Lump-sum credit (contributions plus interest plus deemed deposits or redeposit s). Also include the result in the total for line 16a, Form 1040, or line 11a, Form 1040 A	
5.	The amount on line 4 minus interest	
6.	Divide line 3 by line 1 (round to 3 decimal places)	
7.	Tax-free portion of lump-sum payment (multiply line 5 by line 6)	$
8.	Taxable portion of lump-sum payment (subtract line 7 from line 4). Also inclu de the result in the total for line 16b, Form 1040, or line 11b, Form 1040A	$

How to Get IRS Forms and Publications

You can visit your local IRS office or order tax forms and publications from the IRS Forms Distribution Center listed for your state at the address on this page. Or, if you prefer, you can photocopy tax forms from reproducible copies kept at participating public libraries. In addition, many of these libraries have reference sets of IRS publications that you can read or copy.

Where To Mail Your Order Blank for Free Forms and Publications

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Alaska, Arizona, California, Colorado, Hawaii, Idaho, Kansas, Montana, Nevada, New Mexico, Oklahoma, Oregon, Utah, Washington, Wyoming, Guam, Northern Marianas, American Samoa	Western Area Distribution Center Rancho Cordova, CA 95743-0001
Alabama, Arkansas, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Texas, Wisconsin	Central Area Distribution Center P.O. Box 8903 Bloomington, IL 61702-8903
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Other locations:

Foreign Addresses—Taxpayers with mailing addresses in foreign countries should mail this order blank to either: Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107; or Western Area Distribution Center, Rancho Cordova, CA 95743-0001, whichever is closer. Mail letter requests for other forms and publications to: Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107.

Puerto Rico—Eastern Area Distribution Center, P.O. Box 25866, Richmond, VA 23286-8107.

Virgin Islands—V.I. Bureau of Internal Revenue, Lockhart Gardens, No. 1-A Charlotte Amalie, St. Thomas, VI 00802

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We will send you 2 copies of each form and 1 copy of each publication or set of instructions you circle. Please cut the order blank on the dotted line above and **be sure to print or type your name and address accurately on the bottom portion.**

Enclose this order blank in your own envelope and address your envelope to the IRS address shown above for your state.

To help reduce waste, please order only the forms, instructions, and publications you think you will need to prepare your return.

Use the blank spaces to order items not listed. If you need more space, attach a separate sheet of paper listing the additional forms and publications you may need.

You should either receive your order or notification of the status of your order within 7-15 work days after we receive your request.

1040	Schedule F (1040)	1040EZ	2441 & Instructions	8822 & Instructions	Pub. 505	Pub. 554	
Instructions for 1040 & Schedules	Schedule R (1040) & Instructions	Instructions for 1040EZ	3903 & Instructions	8829 & Instructions	Pub. 508	Pub. 575	
Schedules A&B (1040)	Schedule SE (1040)	1040-ES (1995) & Instructions	4562 & Instructions	Pub. 1	Pub. 521	Pub. 590	
Schedule C (1040)	1040A	1040X & Instructions	4868 & Instructions	Pub. 17	Pub. 523	Pub. 596	
Schedule C-EZ (1040)	Instructions for 1040A & Schedules	2106 & Instructions	5329 & Instructions	Pub. 334	Pub. 525	Pub. 910	
Schedule D (1040)	Schedule 1 (1040A)	2106-EZ & Instructions	8283 & Instructions	Pub. 463	Pub. 527	Pub. 917	
Schedule E (1040)	Schedule 2 (1040A)	2119 & Instructions	8582 & Instructions	Pub. 501	Pub. 529	Pub. 929	
Schedule EIC (1040A or 1040)	Schedule 3 (1040A) & Instructions	2210 & Instructions	8606 & Instructions	Pub. 502	Pub. 550	Pub. 936	

Name		
Number and street		
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List of Tax Publications for Individuals

General Guides

1 ...... Your Rights as a Taxpayer
17 ..... Your Federal Income Tax
225 .. Farmer's Tax Guide
334 .. Tax Guide for Small Business
509 .. Tax Calendars for 1995
553 .. Highlights of 1994 Tax Changes
910 .. Guide to Free Tax Services (Includes a list of publications)

Specialized Publications

3 ...... Tax Information for Military Personnel (Including Reservists Called to Active Duty)
54 ..... Tax Guide for U.S. Citizens and Resident Aliens Abroad
378 .. Fuel Tax Credits and Refunds
448 .. Federal Estate and Gift Taxes
463 .. Travel, Entertainment, and Gift Expenses
501 .. Exemptions, Standard Deduction, and Filing Information
502 .. Medical and Dental Expenses
503 .. Child and Dependent Care Expenses
504 .. Divorced or Separated Individuals
505 .. Tax Withholding and Estimated Tax
508 .. Educational Expenses
513 .. Tax Information for Visitors to the United States
514 .. Foreign Tax Credit for Individuals
516 .. Tax Information for U.S. Government Civilian Employees Stationed Abroad
517 .. Social Security and Other Information for Members of the Clergy and Religious Workers
519 .. U.S. Tax Guide for Aliens
520 .. Scholarships and Fellowships
521 .. Moving Expenses
523 .. Selling Your Home
524 .. Credit for the Elderly or the Disabled
525 .. Taxable and Nontaxable Income
526 .. Charitable Contributions
527 .. Residential Rental Property
529 .. Miscellaneous Deductions
530 .. Tax Information for First-Time Homeowners
531 .. Reporting Tip Income
533 .. Self-Employment Tax
534 .. Depreciation
537 .. Installment Sales
541 .. Tax Information on Partnerships
544 .. Sales and Other Dispositions of Assets
547 .. Nonbusiness Disasters, Casualties, and Thefts
550 .. Investment Income and Expenses
551 .. Basis of Assets
552 .. Recordkeeping for Individuals
554 .. Tax Information for Older Americans
555 .. Federal Tax Information on Community Property
556 .. Examination of Returns, Appeal Rights, and Claims for Refund
559 .. Survivors, Executors, and Administrators
560 .. Retirement Plans for the Self-Employed
561 .. Determining the Value of Donated Property
564 .. Mutual Fund Distributions
570 .. Tax Guide for Individuals with Income from U.S. Possessions
571 .. Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations
575 .. Pension and Annuity Income (Including Simplified General Rule)
584 .. Nonbusiness Disaster, Casualty, and Theft Loss Workbook
587 .. Business Use of Your Home
590 .. Individual Retirement Arrangements (IRAs)
593 .. Tax Highlights for U.S. Citizens and Residents Going Abroad
594 .. Understanding The Collection Process
596 .. Earned Income Credit
597 .. Information on the United States-Canada Income Tax Treaty
721 .. Tax Guide to U.S. Civil Service Retirement Benefits
901 .. U.S. Tax Treaties
907 .. Tax Highlights for Persons with Disabilities
908 .. Tax Information on Bankruptcy
911 .. Tax Information for Direct Sellers
915 .. Social Security Benefits and Equivalent Railroad Retirement Benefits
917 .. Business Use of a Car
919 .. Is My Withholding Correct for 1995?
925 .. Passive Activity and At-Risk Rules
926 .. Employment Taxes for Household Employers
929 .. Tax Rules for Children and Dependents
936 .. Home Mortgage Interest Deduction
938 .. Real Estate Mortgage Investment Conduits (REMICs) Reporting Information
945 .. Tax Information for Those Affected by Operation Desert Storm
946 .. How To Begin Depreciating Your Property
947 .. Practice Before the IRS and Power of Attorney
950 .. Introduction to Estate and Gift Taxes
1244 .. Employee's Daily Record of Tips and Report to Employers
1542 .. Per Diem Rates
1544 .. Reporting Cash Payments of Over $10,000
1546 .. How to use the Problem Resolution Program of the IRS

Spanish Language Publications

1SP .. Derechos del Contribuyente
556SP .. Revisión de las Declaraciones de Impuesto, Derecho de Apelación y Reclamaciones de Reembolsos
579SP .. Cómo Preparar la Declaración de Impuesto Federal
594SP .. Comprendiendo el Proceso de Cobro
596SP .. Crédito por Ingreso del Trabajo
850 .. English–Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service

Tax forms, publications and instructions listed on the order blank

You can get the following forms, schedules, and instructions at participating banks, post offices, or libraries.

Form 1040
Instructions for Form 1040 & Schedules
Schedule A for itemized deductions
Schedule B for interest and dividend income if over $400; and for answering the foreign accounts or foreign trusts questions
Schedule EIC for the earned income credit
Form 1040A
Instructions for Form 1040A & Schedules
Schedule 1 for Form 1040A filers to report interest and dividend income
Schedule 2 for Form 1040A filers to report child and dependent care expenses
Form 1040EZ
Instructions for Form 1040EZ

You can photocopy the items listed below (as well as those listed above) at participating libraries or order them from the IRS.

Schedule 3, Credit for the Elderly or the Disabled for Form 1040A Filers
Schedule C, Profit or Loss From Business
Schedule C-EZ, Net Profit From Business
Schedule D, Capital Gains and Losses
Schedule E, Supplemental Income and Loss
Schedule F, Profit or Loss From Farming
Schedule R, Credit for the Elderly or the Disabled
Schedule SE, Self-Employment Tax
Form 1040-ES, Estimated Tax for Individuals
Form 1040X, Amended U.S. Individual Income Tax Return
Form 2106, Employee Business Expenses
Form 2106-EZ, Unreimbursed Employee Business Expenses
Form 2119, Sale of Your Home
Form 2210, Underpayment of Estimated Tax by Individuals and Fiduciaries
Form 2441, Child and Dependent Care Expenses
Form 3903, Moving Expenses
Form 4562, Depreciation and Amortization
Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
Form 5329, Return for Additional Taxes Attributable to Qualified Retirement Plans, Annuities, and Modified Endowment Contracts
Form 8283, Noncash Charitable Contributions
Form 8582, Passive Activity Loss Limitations
Form 8606, Nondeductible IRA Contributions, IRA Basis, and Nontaxable IRA Distributions
Form 8822, Change of Address
Form 8829, Expenses for Business Use of Your Home