Early Retirement (VERA) Planning For FERS Employees

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About the Author

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Early retirement under FERS – general rules and benefits.

A. General rules.

1. An agency or a segment of an agency that is undergoing a major RIF or a major transfer of function may ask the office of Personnel Management (OPM) to permit voluntary retirement for its employees.

2. Employee prerequisites to take early retirement.

   a. Be at least 50 years old with at least 20 years of creditable service. Be any age with at least 25 years of service.
   b. Meet the minimum civilian service requirement – at least 5 years of creditable FERS service.

B. Types of early retirement.

3. VSIP (Voluntary Separation Incentive Payment) - an employee is eligible to receive a severance payment as an incentive for retiring.

   a. Incentive payment is the amount of severance pay an employee would get ($25,000 to $40,000) or an amount determined by the agency head, whichever is less (servicing personnel office can calculate exact amount).

   b. Incentive payment is fully taxable – subject to Federal income withholding, applicable state and local taxes, and FICA/Medicare payroll taxes.

   c. A direct rollover of the incentive payment to an individual retirement account (IRA) or to the traditional TSP or Roth TSP is <u>not</u> permitted.

4. VERA (Voluntary Employee Retirement Authority).

   a. Eligibility – employee is aged 50 or older with a minimum 20 years of creditable FERS service, or any age with a minimum 25 years of creditable FERS service. .

   b. There is usually a VERA option "window;" a set period of time during which an eligible employee must make a decision to accept the VERA offer.

   d. FERS employees who accept the VERA will not have their annuities reduced as a result of retiring before they have reached their minimum retirement age (MRA).

C. **FERS benefits under a VERA.**

1. **FERS annuity.** .An FERS employee who retires under a VERA will have his or her FERS annuity calculated based on the number of years of creditable service he or she has on the day the employee retires, and his or her high-3 average salary based on the day he or she officially retires. Unused sick leave hours on the retirement day will be converted into months and days of service and added to the existing creditable service time for the purpose of calculating the FERS annuity (unused sick leave hours cannot be used for *retirement eligibility purposes*). Since the employee will most likely be under age 62 (or if the employee is over age 62 the employee has less than 20 years of service), the formula for calculating the starting FERS gross annuity will be:

1 percent times number of years/months of creditable service times high-3 average salary

The following example illustrates:

Frank, aged 46, has 26 years of creditable service, including five years of bought-back active-duty military service, and a high-3 average salary of $100,000. He also has 6 months of unused sick leave. Frank accepts the VERA offer.

Frank's starting FERS annuity is equal to **1 percent x 26.5 x $100,000 = $26,500.**

Note that although there is no age reduction penalty due to the fact that Frank is younger than his minimum retirement age (57), Frank is taking about a 75 percent reduction in income by retiring early at age 46. Also, as discussed next, Frank is not eligible for his first FERS annuity COLA until the year after he becomes age 62.

2. **FERS annuity COLA** A FERS employee who retires before age 62 via any type of immediate retirement (regular, early or "MRA + 10") is not eligible to receive his or her first FERS annuity COLA until the year after he or she becomes age 62.

3. **Retirement annuity supplement**. A FERS employee who retires under a VERA before his or her minimum retirement age (MRA) will not be eligible to receive the retirement annuity supplement until the FERS annuitant reaches the month he or she reaches his or her minimum retirement age (MRA). The retirement annuity supplement stops the month the FERS annuitant becomes age 62.

4.**FEHB program health insurance benefit and FEGLI life insurance benefit.**
A FERS employee who is eligible to retire under a VERA and who has been enrolled in the Federal Employees Health Benefits (FEHB) program may retain their FEHB health insurance benefits in retirement if the employee has been enrolled in the FEHB program continuously during at least the five-year period ending on the effective date of the employee's retirement. A retired FERS employee (a FERS annuitant) pays the same percentage of the FEHB program premiums (on average, 25 to 28 percent) as they did as an employee. The federal government pays on average 72 to 75 percent of the FEHB program insurance premiums for both employees and retirees, no matter which FEHB program health insurance plan the employee is enrolled in. An employee who is eligible to keep their FEHB insurance coverage in retirement is also able to keep FEHB insurance coverage for eligible family members, such as a spouse and children under the age of 26.

The same five-year continuous enrollment rule applies for keeping FEGLI life insurance applies to retiring employees who want to keep their FEGLI life insurance throughout retirement.

5.Thrift Savings Plan. FERS employees can make penalty-free (no 10 percent early withdrawal penalty) withdrawals from their traditional TSP account if they leave federal service, or if they retire from federal service, sometime during the year or after the year they become age 55. If they leave or retire from federal service before the year they become age 55 via a VERA, then they will have to wait until age 59.5 to make penalty-free withdrawals from their traditional TSP account.

If a retiring FERS employee under age 55 needs to make withdrawals from their traditional TSP account, then there are two ways a FERS employee can make penalty-free withdrawals from a portion of their traditional TSP account. The three ways are:

- (1) Purchase a TSP annuity using all or a portion of their traditional TSP account, and
- (2) Elect to receive monthly TSP distributions based on the TSP participant's life expectancy.
- (3) Direct rollover of a portion of the traditional TSP to a traditional IRA and set up a "72(t) distribution" from the traditional IRA. A monthly withdrawal from the IRA under IRS Code Section 72(t) can be made penalty-free (no 10 percent early withdrawal penalty) in one of three ways: (a) Life expectancy; (b) Amortization; and (c) Annuitization.

Note the following:

(1) Once a TSP annuity is purchased, annuity monthly payments will continue for the life of the TSP participant, and

(2) TSP monthly distributions based on life expectancy must continue for the *later* of five years or age 59.5. If payments are stopped by the TSP participant five years before they have elapsed, then the TSP participant will pay a retroactive 10 percent early withdrawal penalty. For more explanations about TSP distributions based on life expectancy, go to the Appendix and read the section entitled: "TSP Penalty-Free Withdrawal Options" for Early Retirement."

With respect to the Roth TSP, the earliest age a Roth TSP participant can withdraw from their Roth TSP account without penalty is the later of age 59.5 and five years since January 1st of the year the TSP participant made his or her first Roth TSP contribution.

Federal employees who retire via a VERA are permitted to request a direct rollover of their traditional TSP to a traditional IRA. If a retired employee finds new employment from a private employer who offers a qualified retirement plan such as a 401(k) or 403(b) retirement plan, then the retired federal employee may have the option of a direct rollover of their TSP accounts into the employer's qualified retirement plan. The purpose of these direct rollovers is to consolidate qualified retirement plan accounts.

6.Survivor Benefits.

An employee who applies for early retirement via a VERA is eligible to provide FERS survivor benefits for eligible family members, including:

- **A FERS survivor annuity to one person**. That person has to have an insurable interest in the FERS employee. The most logical and most often designated beneficiary is a current spouse. The cost to give the maximum spousal survivor annuity (50 percent) is 10 percent of the starting FERS gross annuity. Annual reduction is permanent and remains the same, even when the FERS annuitant is receiving FERS COLAs.
- **Children survivor annuities paid to children under the age of 18 (ages 18 to 22 if the children are full-time students);forever if a child was disabled before age 18.**.
- **FEHB program and Federal Employee Dental and Vision Insurance Program (FEDVIP) benefits.**

7. Other things FERS employees eligible for a VERA should do:

Retiring employees should make sure that all beneficiary forms are completed and current. These beneficiary forms include:

- **Form SF 3102 (Designation of Beneficiary, FERS contributions*)***
- **Form TSP 3 (Designation of TSP beneficiary*),*** and

• **Form SF 2823 (Designation of FEGLI life insurance**)

Retiring employees are advised to meet with their estate attorney to establish or update an estate plan which should include a will or living trust, financial power of attorney, health care power of attorney, and a living will.

Employees who are considering early retirement via a VERA are also advised to have a sufficient amount of liquid savings (cash). With what could be a high number of early retirees as well as an above average number of regular (normal) retirements in the next five to seven months, it will likely take OPM's Retirement Office longer than average to adjudicate all of these retirement applications. The result is a delay of as much as a year before a retiring employee receives his or her first full FERS annuity check.

Those employees who accept early retirement via the VERA and who are in their mid-40's to early 50's are encouraged to seek new employment in order to save additionally for their retirement. They are also advised to contribute to IRAs and start or add to existing non-retirement brokerage accounts.

Appendix

Special Tax Section

Many, if not most, employees have questions regarding the impact an early retirement has on their taxes. OPM has worked in cooperation with the Internal Revenue Service to provide the following general information on taxes.

It is critical to note that the information provided here is general in nature and in no way is intended to apply to every employee's situation. Employees are urged to seek the assistance of a trained and experienced tax advisor or personal financial counselor on any matters related to the employee's income, finances, taxes, or retirement.

IS THE VSIP (BUYOUT PAYMENT)) TAXABLE INCOME OR A SPECIAL ONE-TIME PAYMENT WITH DIFFERENT TAX CONSEQUENCES?

Buyouts are included as an item of "gross income" and are considered as fully taxable income under IRS tax laws. Section 451(a) of the Internal Revenue Code (the "Code") provides that the amount of any item of gross income must be included in the gross income for the taxable year in which it is *received* by the taxpayer. *Thus, a buyout is considered taxable income in the year of payment, regardless of the year in which the buyout is authorized, unless the employee is required to repay the buyout in the same tax year. The buyout is not a special one-time payment with different tax consequences.*

OTHER DEDUCTIONS

Where applicable, agencies may also make deductions for certain types of indebtedness. The following are some circumstances in which deductions for debts may be made:

- The balance of any commercial garnishment plus supplemental fees or court-ordered interest related to the garnishment.
- The balance of any child support/alimony arrearage when included in the court order.
- The balance of any debt owed to the agency.

FURTHER INFORMATION:

Many of the deductions taken from buyout payments by servicing payroll offices vary depending on agency regulations. More detailed information on how your servicing payroll office processes incentive payments may be obtained from your servicing personnel office.

HOW MUCH WILL MY BUYOUT BE AFTER TAXES?

TAX DEDUCTIONS FROM BUYOUT PAYMENTS

Voluntary separation incentive payments are considered supplemental wages and are treated similarly to cash awards, bonuses, and allowances for withholding purposes. Most agencies automatically withhold the following taxes from supplemental payments.

All Employees

Federal Income Tax	Many agencies withhold a flat 20% of the buyout payment for Federal income tax. In some cases, this may be higher than your normal withholding rate and you may want to reexamine your tax planning for withholding purposes.
State Income Tax (when applicable)	Agencies make deductions based on a specified rate. for supplemental payments or the applicable standard rate.
Local Income Tax (when applicable)	Agencies make deductions based on a specified rate. for supplemental payments or the applicable standard rate.

CSRS Employees

Medicare Hospitable Insurance Tax (HIT) 1.45%

FERS & CSRS Offset Employees

FICA	Federal Insurance Contributions Act - 6.2% subject to annual income limitations ($176,100 during 2025)

Medicare Hospitable Insurance Tax (HIT) 1.45%

EXAMPLES

CSRS EMPLOYEE

Buyout amount		$25,000.00
Payroll Deductions		
Federal Tax (20%)	$5,000.00	
State Tax (8%) (when applicable)	2,000.00	
Local Tax (1%) (when applicable)	250.00	
Medicare (1.45%)	362.50	
Total deductions	($7,612.50)	
Net payment after deductions		**$17,387.50**

FERS AND CSRS OFFSET EMPLOYEES

Buyout amount		$25,000.00
Payroll Deductions		
Federal Tax (20%)	$5,000.00	
State Tax (8%) (when applicable)	2,000.00	
Local Tax (1%) (when applicable)	250.00	
Medicare (1.45%)	362.50	
FICA (Social Security)	1,550.00	
Total deductions	($9,162.50)	
Net payment after deductions		**$15,837.50**

Note: No portion of a buyout amount may be directly rolled over to the traditional TSP or to a traditional IRA.

PLANNING FOR A VERA OR A VSIP

PREPARE IMMEDIATELY. Plan for a VERA or VSIP offer and be prepared to act quickly if you get one. With the focus of the nation on downsizing, consolidating and eliminating the entire functions now performed by the Federal government, VERAs and VSIPs may be a major consideration for employees as new incentives are authorized. There is never a bad time to begin planning for the future and often employees may not have substantial amounts of time to consider an offer.

Because of purposed budget cuts and agency reductions, employees who have not yet received a buyout offer should begin careful planning in the event that a future buyout offer is made to them.

Because of the fundamental changes in an employee's life that voluntary separations present, and because employees may not have copious amounts of time to make decisions when offers are made, EMPLOYEES SHOULD TAKE STEPS NOW TO BE PREPARED FOR ANY OFFERS THAT MAY BE MADE. OPM's Workforce Restructuring Office has available copies of **"The Employee's Guide to Buyouts Under Public Law 104-208,"** which gives employees an overview of how buyouts work and answers many commonly asked questions on buyouts.

THE FOLLOWING STEPS ARE RECOMMENDED FOR ANYONE CONSIDERING AN EARLY RETIREMENT VIA A VERA OR VSIP:

► REVIEW YOUR PERSONNEL FILE TO ENSURE THAT ALL PERIODS OF FEDERAL SERVICE ARE DOCUMENTED.

Having all of this documented is critical because your annuity and your buyout amount will be computed based on this information.

► OBTAIN AN ESTIMATE OF YOUR ANNUITY FROM YOUR RETIREMENT COUNSELOR.

Your servicing personnel office has retirement counselors available to assist you. They can give you an estimate of your annuity and explain your benefits to you. Be careful to determine what impact retirement or separation will have on your insurance coverage. Carefully consider whether you can live on a reduced income.

► OBTAIN AN ESTIMATE OF YOUR BUYOUT AMOUNT.

Calculation sheets are available in "The Employees Guide to Buyouts" (see above for information on how to obtain a copy). The calculation sheets are useful for getting an ESTIMATE of the buyout amount. Also, it is important to remember that buyouts are fully taxable and that the take-home (net) amount of the buyout will be significantly less than the gross amount of the buyout.

► IF YOU SERVED IN THE MILITARY AFTER 1956, SEND FOR YOUR PAY RECORDS.

It is probably in your best interest to pay a retirement contribution to cover any post-1956 military service. <u>You must do this before you retire</u>. Start the process by requesting your military pay records from the military finance center for your branch of service. Your personnel office can tell you where to apply. Begin the process immediately - it is not unusual for the processing of these changes to take as much as 8 weeks.

► DISCUSS YOUR PLANS WITH YOUR SPOUSE AND FAMILY.

A buyout represents a major change in your way of life. Your spouse and family should be involved in this life-changing decision. Retirement means more free time at home, and often, lower earnings. Discuss these issues with your family and allow them to take an active role in your planning. The choice to leave your job will affect them as much as it affects you.

► CONSIDER MEETING WITH A PERSONAL FINANCIAL ADVISOR.

Because retirement often means smaller paychecks, it may be useful to speak with a personal advisor or accountants. These individuals can help you figure out what tax advantages may be open to you, how much your income will be, what debts you can reduce, and what your standard of living would be like with your annuity.

► LOOK TO THE FUTURE.

Remember that the buyout law requires employees returning to work for the government of the United States within a period of 5 years to repay the entire amount of the buyout prior to the first day of work. The employee must repay the ENTIRE AMOUNT OF THE BUYOUT (not the amount you received (net) but the gross amount. *Buyout takers are urged not to make plans that involve returning to work with the government* either by appointment or a personal services contract unless you are prepared to repay the entire amount of the buyout prior to the first day of work. There are no waivers or exceptions to this repayment requirement.

Immediate and thorough preparation and planning NOW will make your decision much easier when early retirement via a VERA or VSIP is made.

Traditional TSP Penalty-Free Withdrawal Options for Early (Pre-age 55) Retirement

Option 1: Use a portion or the entire traditional TSP account to purchase a TSP annuity and receive monthly income (guaranteed for life).

A TSP life annuity is a monthly benefit paid to the TSP account owner for life. There are several types of annuities and additional features from which to choose. An account owner may choose to use some or all of their TSP accounts to purchase the annuity. Currently, only TSP accounts of more than $3,500 are eligible for a TSP life annuity.

All traditional TSP annuity payments are subject to federal (and in most cases, state) income taxes. But TSP annuity payments are not subject to early withdrawal penalties. TSP account owners who choose to purchase a life annuity should note the following: (1) Once the life annuity is purchased, it cannot be changed; and (2) A survivor annuity can be purchased; however, a joint and survivor annuity will result in lower monthly payments to the TSP annuity owner.

Option 2. Request monthly payments from their traditional TSP based on life expectancy. Monthly payments must continue for the *later of 5 years or age 59.5.*

Under the monthly payment computed by the TSP based on life-expectancy table method, the TSP owner's initial payment will be based on the account balance at the time of the first monthly payment and one's life expectancy. The TSP will recalculate the amount of the TSP owner's monthly payments every year based on the account balance at the end of the current year and the TSP owner's recomputed life expectancy for the new year.

The following is a step-by-step description of the traditional TSP life expectancy monthly payment procedure.

Step 1: Determine the life expectancy factor.

Those participants who use single life expectancy in order to determine their monthly payment each year will look up their ages each year in the table below. If a participant has one traditional TSP beneficiary, then the joint life expectancy may be used to calculate the appropriate factor (see the joint and survivor life expectancy table in **IRS Publication 590-B**, available for download at **www.irs.gov**).

IRS Single Life Expectancy Table

Age	Life Expectancy	Age	Life Expectancy
29	52.3	58	28.9
30	55.3	59	28.0
31	53.4	60	27.1
32	53.4	61	26.2
33	52.5	62	25.4
34	51.5	63	24.5
35	50.5	64	23.7
36	49.6	65	22.9
37	48.6	66	22.0
38	47.7	67	21.2
39	46.7	68	20.4
40	45.7	69	19.6
41	44.8	70	18.8
42	43.8	71	18.0
43	42.9	72	17.2
44	41.9	73	16.4
45	41.0	74	15.6
46	40.0	75	14.8
47	39.0	76	14.1
48	38.1	77	13.3
49	37.1	78	12.6
50	36.2	79	11.9
51	35.3	80	11.2
52	34.3	81	10.5
53	33.4	82	9.9
54	32.5	83	9.3
55	31.6	84	8.7
56	30.6	85	8.1
57	29.8	86	7.6

Step 2: Determine the account balance.

Participants must use their entire traditional TSP account balance. IRS guidelines state that the account balance that is used to calculate the payment must be determined in a reasonable manner. While that statement alone is not terribly useful, the IRS also offers an example that demonstrates the reasonableness of using the account balance as of Dec. 31 of the year before periodic payments are to begin. Also, according to the IRS, it is reasonable to use the account balance for any date "within a reasonable period before the distribution." For example, if a TSP participant wants to start receiving a monthly distribution starting March 15, 2025, the IRS states that it would be reasonable to choose a traditional TSP account balance as of any date between December 31,2024 and March 14, 2025.

Step 3: Calculate the annual payment and the monthly payment.

Divide the account balance by the factor determined in Step 1 above. The result is the amount that must be distributed during the first year. For the second year, the TSP account owner will follow a similar procedure, using the account balance as of December 31 of the first distribution year.

Here is an example:

Example. Sarah, age 52, had $735,600 in her traditional TSP account as of December 31, 2024. She is eligible for early retirement via VERA and retires on April 1, 2025. Sarah fills out online Form TSP 70 and requests TSP withdrawals based on life expectancy. At age 52, Sarah's life expectancy according to the TSP's single life expectancy table is 34.3.

Her total distribution for 2025 (spread over 9 months April through December 2025) will be: $735,000/34.3 = $21,429 or $1,786 per month.

On December 31, 2025, Sarah's traditional TSP balance is $719,625. For the year 2026, when Sarah is 53 years old and her life expectancy is 33.4 years, the TSP Service Office will send Sarah a total annual (12 months) distribution of:

$719,625/33.4 = $21,545 or $1,795 per month.

Sarah is required to take these distributions until she is at least age 59.5. Note that her monthly payments can vary from year to year based on account balance as of December 31 of the previous year and smaller life expectancy in the new year. Also, if she misses any payments, then she will be subject to a retroactive 10 percent early withdrawal penalty on any previous monthly payments she may have received.

Here are the rules with respect to traditional TSP payments based on life expectancy: (1) There are no age restrictions—a participant could be as young as age 45 and start receiving monthly payments based on life expectancy; (2) Payments will be recomputed each year based on the participant's account balance as of the previous Dec. 31 and the participant's next year life expectancy (or over a joint life expectancy if there is beneficiary); (3) Payments must continue for the later of five years or age 59.5—if the participant discontinues payments, then the IRS' early distribution tax penalty plus interest charges will apply retroactively to all payments previously received; (4) Any payments made to the TSP account are subject to automatic 20 percent federal income tax withholding. Account owners will therefore actually receive 80 percent of the computed monthly payment. They are responsible for paying any state income taxes if they reside in a state that taxes traditional TSP withdrawals.

Upon reaching the later age 59.5 or five years from the time one has commenced this series of payments based on life expectancy, the TSP owner may request that these monthly payments cease and that a final single payment be issued. The payment may be sent directly to the participant, or all or part of it can be transferred to a traditional IRA or to an eligible employer plan.

The TSP will report to the IRS all payments that are made directly to the TSP owner. Annuity purchases are not reported by the TSP to the IRS or to the TSP owner's state of residence. TSP annuity payments are reported for tax purposes by the annuity provider (Metropolitan Life Insurance Co.).

Finally, each January following the year that the TSP account owner receives payments from the TSP, the TSP will send to the owner **Form 1099-R (Distribution from Pensions, Annuities, Retirement Plans)** Form 1099-R will show the gross distribution for the year. Assuming the recipient is younger than age 59.5 and receiving payments based on life expectancy, the 1099-R will be coded so that the taxable amounts shown will not be subject to an early withdrawal penalty. These taxable amounts should be reported as income on the TSP owner's income tax return for the year in which distributions were received.