The New Military Thrift Savings Plan: Worth Consideration

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Introduction

Who does not want to be a millionaire? People fantasize about how they would spend the money. Each week, record numbers of television viewers watch while the host of a popular game show asks contestants question after question, leading up to "million-dollar questions."[2] Imagine you, a military attorney, are a contestant. The host asks you a finance question, "What savings program may soon be available to service members to amass substantial wealth?" Will you falter with your answer? Will you lose your chance to become an instant millionaire? No, you will not fail because you read this article. You will correctly answer the host's question and win a million dollars!

When your fantasy about appearing on a game show ends, you realize you will probably not be a millionaire. You sigh because you know you must work for a living and try to save for retirement. While disappointed, you may remember reading this discussion about a "savings program" designed to help you save for retirement. The "savings program" is the Thrift Savings Program (TSP) with over two and one half million participants.[3] Participants are primarily civilian federal employees, but soon military members may also take advantage of the TSP's benefits.

Attorneys need to know about the TSP and related issues in order to offer sound advice to their clients. Service members will question whether they should invest in the TSP, individual retirement accounts (IRAs), or unrestricted investment accounts. Members trying to decide which military retirement program to select will want to know how the TSP affects their decision.[4] Undoubtedly, their primary source of information will be military personnel or finance clerks. Members, however, will turn to their legal assistance attorneys for answers to complicated questions involving investments, military retirement programs, and estate planning. If attorneys do not educate themselves about these issues, the tragedy will not be the loss of a million dollars. The misfortune will be the absence of sound counsel resulting in the loss of significant financial benefits for clients.

This article informs attorneys about the TSP. The introduction contains a discussion of background issues surrounding the TSP. Those issues include the need for a military savings program and various significant entities' positions on the TSP. A discussion of the TSP follows the discourse on the background issues. The reader, after familiarization with the issues and the program itself, should understand the application of the TSP to military members. Finally, the author makes several recommendations regarding service members' retirement investments.

The Military Needs a Savings Program for Service Members

Advocates of the military have long maintained that the services need a retirement savings program[5] similar to those found in the civilian sector for sound reasons. A savings program would enhance the military's recruiting efforts in a competitive job market. In January of 1973, the military began to vie for employees when President Nixon adopted the all-volunteer force.[6] In 1973, recruiters competed successfully because of economic and social conditions. Now, the labor market is extraordinarily tight and competition is stiff.[7] Fewer young people are available and more of those youths are attending college.[8] Young adults seeking jobs compare benefits and reject employers with poor benefits packages.[9] The services find it hard to meet recruiting goals.[10]

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1. MAJ Richard Rousseau, TJAGSA, provided technical oversight on all tax issues within this article. LTC Thomas K. Emswiler, Armed Forces Tax Council, Office of the Assistant Secretary of Defense Force Management Policy, (Military Personnel Policy), provided technical oversight on the Department of Defense's position on implementation of the Thrift Savings Plan (TSP) and the political environment surrounding implementation. MAJ David Snyder offered counsel on investment issues regarding the funds available in the TSP.

2. Popular game-show host Regis Philbin asks contestants questions on ABC Network Television's show "Who Wants to Be a Millionaire." Johnnie L. Roberts, *How to Use a Lifeline*, NEWSWEEK, Feb. 28, 2000, at 46.

3. *See* FEDERAL RETIREMENT THRIFT INVESTMENT BOARD, THRIFT SAVINGS PLAN HIGHLIGHTS 1 (2000) [hereinafter TSP HIGHLIGHTS], *available at* http://www.tsp.gov/cgi-bin/byteserver.cgi/forms/ochigh0005.pdf; FEDERAL RETIREMENT THRIFT INVESTMENT BOARD, SUMMARY OF THE THRIFT SAVING PLAN 2 (1997) [hereinafter TSP SUMMARY], *available at* http://www.tsp.gov/cgi-bin/byteserver.cgi/forms/tspsumw.pdf.

4. *See* Major Vivian C. Shafer, *Choosing Between the High-Three and the Redux Retirement Programs: Thrift Savings Plan Participation a Valuable Option*, ARMY LAW., Sept. 2000, at 18 (providing information on deciding between the two retirement programs).

Military proponents argue that the services need a TSP to help retain members once they join the service. People entering service are better educated[11] and older than in years past.[12] In 1997, the RAND Corporation completed a study on enlisted career intentions. The study's authors found a relationship between savings opportunities and retention. Enlisted members overwhelmingly indicated savings opportunities would influence their decisions to reenlist.[13] Only twenty-eight percent of survey respondents were satisfied with current savings opportunities in the military.[14] While attrition is necessary to shape the force, excessive losses of trained and experienced individuals constitute a readiness issue. The TSP would enhance members' opportunities to save and lead to higher retention rates.[15]

It is well accepted that employers who "take care" of their employees retain their employees. Service members (1.4 million) constitute the largest workforce in the United States not covered by an employer-sponsored, tax-advantaged payroll savings plan.[16] About 182,600 people a year leave service without any employer-sponsored retirement benefits.[17] The only retirement savings they may have are IRAs or private savings. Many military families' financial situations do not allow them to save for retirement. Department of Defense (DOD) surveys reveal fifty percent of members do not have any appreciable levels of savings.[18] Exacerbating their poor financial situations is a low rate of home ownership.[19] Homes often represent significant retirement assets. People who choose to serve their country should not have to compromise their future retirement. Service members deserve better financial benefits. Their sacrifices are too great and a savings plan is relatively inexpensive. A savings plan is a basic benefit this country should provide to service members according to John Dalton, former Secretary of the Navy.[20] Legislators should take care of service members by enhancing their savings opportunities with implementation of the TSP as soon as possible.

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5. Interestingly, a savings plan existed for the various services from the late 1800s (1872-Army, 1889-Navy, 1906-Marine Corps) until 1966. Unfortunately, the plan had no tax advantages and members earned no more than 4% interest. Because few members participated in the plan, the Department of Defense proposed substitution of the long-term savings plan with a short-term savings plan for overseas members. Congress responded and adopted the recommendation in the 1966 Appropriations Act. Information Paper, Office of the Judge Advocate General, United States Army, Legal Assistance, DAJA-LA, subject: Armed Forces Savings Programs (6 Mar. 1997) (on file with the author) [hereinafter DAJA-LA (6 Mar. 1997)]. The savings plan still exists, but it is limited to members involved in contingency operations or combat zones. Further, deposits are limited to $10,000, and interest rates are set at 10% per annum. 10 U.S.C. § 1035 (Supp. V 2000); U.S. Dep't of Defense, Reg. 7000.14-R, Financial Management Regulation, vol. 7a, ch. 51 (IO15-99, 12 May 1999).

6. M. Thomas Davis, *Operation Dire Straits: Here's Why the Military is Failing to Attract the Right Recruits*, Wash. Post, Jan. 16, 2000, at B1.

7. *Id.* In 1973, about 13.7% of sixteen to nineteen year-olds were unemployed. Two years later the rate was 20%. Today however, the unemployment rate is 4%, the lowest rate in three decades. Sheri Prasso, *A Shrill Sermon Against U.S. Globalism*, Bus. Wk., Mar. 27, 2000, at 19.

8. Michael D. Towle, *Pentagon Seeking Ways to Increase Enlistments*, Fort Worth Star-Telegram, Sept. 13, 1999, at News 1. Army and Air Force officials expected to miss recruiting goals for 1999 by 7,000 and 2,500 respectively. Navy officials planned to meet their goals after lowering their educational requirements. Marine Corps officials estimated that they would meet their goals. *Id.* Army officials will try to meet their goals with an enlistment/education program. The program enables dropouts to earn a high school diploma and offers other recruits two years of college education. Roberto Suro, *Army to Recruit Dropouts, Help Them Earn Diploma,* Wash. Post, Feb. 4, 2000, at A2.

9. Office of Assistant Secretary of Defense, Force Management Policy, Assessment of the Costs and Benefits of a Uniformed Services Thrift Savings Plan 9 (May 21, 1998) (undelivered report to Congress) (on file with author) [hereinafter OASD Report (May 21, 1998)].

10. Davis, *supra* note 6.

11. Mr. Davis provided interesting statistics. In 1980, 54% of the Army's recruits had high school diplomas, and 57% scored below average (known as Category IV) on the Armed Forces Qualification Test. In 1986, 91% of the Army's recruits were high school graduates, and the number of Category IVs dropped to 4%. At the end of the 1980s, 89% of Army enlistees had high school diplomas and 11% were Category IVs. Davis, *supra* note 6.

12. Office of Assistant Secretary of Defense, Force Management Policy, A Report to Congress Concerning the Proposal for a Uniformed Services Thrift Savings Plan 9 (Dec. 17, 1997) (undelivered report to Congress) (on file with author) [hereinafter OASD Report (Dec. 17, 1997)]. Only about 17% of service members retire from the service. *Id.* at 11.

13. OASD Report (Dec. 17, 1997), *supra* note 12, at 11.

14. Id.

15. OASD Report (May 21, 1998), *supra* note 9, at 11.

16. *Id.* at 3.

17. OASD Report (Dec. 17, 1997), *supra* note 12, at 7.

18. Armed Forces Financial Network, Survey of Armed Forces Financial Needs and Behaviors 16 (1996), *cited in* OASD Report (May 21, 1998), *supra* note 9, at 4. Service members save one half of the amount saved by the average citizen. *Id.*

19. OASD Report (May 21, 1998), *supra* note 9, at 7.

The Services' and the Military Associations' Positions Regarding an Employer-Sponsored, Tax-Advantaged Payroll Savings Plan

The Navy has long supported an employer-sponsored, tax-advantaged payroll savings plan for sailors. John Dalton, former Secretary of the Navy, stated that a tax-advantaged savings plan was "the minimum thing we could do" for sailors.[21] The Marine Corps also supports such a plan.[22] In contrast, Air Force officials urged Congress to develop a Roth IRA type plan with no tax-deferment.[23] Air Force officials argued that such a plan would be easier for Congress to adopt because legislators already fought the battle for Roth IRAs. Air Force officials maintained that the future loss of tax revenue from a Roth IRA type plan would be more acceptable to Congress than the up-front loss of tax revenue from a TSP. Air Force and Army officials were concerned that Congress would seek compensation for the loss in tax revenues by attacking the current retirement system.[24]

Members of various military associations and coalitions also disagree on the possible merits of an employer-sponsored, tax-advantaged payroll savings plan. Members of the National Association for the Uniformed Services support an employer-sponsored, tax-advantaged payroll savings plan.[25] Members of The Retired Officers Association originally took an opposing position, sharing the concerns of Air Force and Army officials regarding congressional attacks on the current military retirement system.[26] The Retired Officers Association now supports the TSP and is lobbying Congress for prompt implementation of the program for the military.[27]

Expansion of the Thrift Savings Plan to Service Members

Congress approved the provisions of the National Defense Authorization Act for fiscal year 2000 (hereinafter Act) thereby authorizing service members to participate in the TSP.[28] According to the Act, the implementation of the TSP is dependent upon passage of "offsetting" legislation.[29] The President must propose an "offset" for the TSP that Congress will approve for fiscal year 2001.[30] In other words, the President must propose an acceptable revenue source to make up for tax revenues lost due to military participation in the TSP. Pentagon officials estimate the reduction in tax revenues will be about $95 million over five years.[31] After the TSP "ramps up" for military members, DOD officials estimate the reduced tax revenue will be about $484 million over nine years.[32] Other authorities provide higher and lower estimates.[33] While various groups cannot agree on the amount of the offset needed, all

20. Susanne M. Schafer, *Navy Considers Plan for 401(k) Accounts*, Austin American-Statesman, July 26, 1998, at A20 (quoting John Dalton, former Secretary of the Navy).

21. *Id.*

22. Tom Philpott, *A Military 401(k) Program Up for Study*, Colo. Springs Gazette Telegraph, Apr. 11, 1998, at News 6.

23. Tom Philpott, *Pentagon Ponders Options for Members' Payroll Savings*, Colo. Springs Gazette Telegraph, May 23, 1998, at News 2.

24. *Id.*

25. Tom Philpott, *Panel Chief Backs Retirement Savings Plan*, Colo. Springs Gazette Telegraph, Mar. 7, 1998, at News 5.

26. *Id.*

27. E-mail from Paul Acari, The Retired Officers Association, to author (June 29, 2000) (on file with the author).

28. Specifically, the Act amended 37 U.S.C. § 211 (Supp. IV 1999). The amendment expanded the definition of "member" to include members of uniformed services serving on active duty and members of the Ready Reserve. The Act also amended pertinent sections of 5 U.S.C. §§ 8401-8479 (Supp. V 2000) to accommodate service members. National Defense Authorization Act of 2000, Pub. L. No. 106-65, § 661, 113 Stat. 512 (1999).

29. The Act provides for implementing the TSP after the passage of offsetting legislation, or one year after the enactment date of October 5, 1999, whichever occurs later. *Id.*

30. *Id.* § 663.

31. Philpott, *supra* note 25.

32. Fact Sheet, Armed Forces Tax Council, Office of the Assistant Secretary of Defense Force Management Policy, subject: Thrift Savings Facts (14 Oct. 1999) [hereinafter DOD TSP Facts] (on file with the author). Officials assumed participation rates would increase from 12.5% in 2001 to 32.5% in 2009. *Id.*

33. Officials from the Pentagon planned to submit a report to President Clinton's National Security Council indicating that the TSP would cost $77 million over five years. Tom Philpott, *Report Touts Military Savings Plan*, Colo. Springs Gazette Telegraph, June 13, 1998, at News 5. The Retired Officers Association indicated that the TSP would cost $100 million in one year. Philpott, *supra* note 25. An economist trying to project the loss in tax revenues due to service member TSP participation would have to make many assumptions. He would have to assume how many members would participate in the program and how much money they would contribute. Further, he would have to assume how long the members would participate in the plan. Because there are so many variables, different authorities will have very different cost projections.

would probably agree that legislators will have difficulty selecting the source of the offset.

Finding an offset may not be necessary. Recent developments in Congress indicate the Senate and House Armed Services Committees support military participation in the TSP. Congressmen are pushing for legislation that would eliminate the requirement for an offset. DOD officials expect the National Defense Authorization Act for fiscal year 2001 to contain the necessary language for full implementation of the TSP for military members.

The Thrift Savings Plan

Purpose and Nature of the Thrift Savings Plan

Congress created the TSP for federal civilian employees in 1986[34] to supplement employees' retirement programs.[35] The TSP, with its 401(k)-like features,[36] augments underlying retirement programs by enhancing savings opportunities. Those opportunities complement the retirement programs because TSP is a defined "contribution" plan. The size of a defined contribution plan's benefits or "payouts" correlates directly to the amount of an employee's contributions.[37] In contrast, federal annuity retirement programs are defined "benefit" plans. The magnitude of the benefits or "payouts" depends upon defined criteria such as an employee's years of service and salary.[38]

Federal employees can participate in both their annuity retirement programs and the TSP.[39] Participation in one program does not interfere with participation in the other program.[40] Participation in TSP is voluntary and only available to civilian federal employees.[41] As discussed previously, however, the TSP may soon be available for military personnel.[42] As such, the legislation governing the current TSP for federal employees will apply to the future service members' TSP.[43]

Organization and Administration of the Thrift Savings Plan[44]

The Federal Retirement Thrift Investment Board (hereinafter Board) oversees operations of the TSP.[45] The Board has two related administrative entities assisting it in carrying out its mission. For advice on administration and investment policies, the Board selected an advisory council.[46] For day-to-day operations, the Board appointed an Executive Director.[47] The Director is responsible for the investing and management of

34. The primary implementing and governing legislation for the TSP is found at 5 U.S.C. §§ 8400-8479 (Supp. V 2000). The relevant portions are subchapter III (entitled "Thrift Saving Plan") and subchapter VII (entitled "Federal Retirement Thrift Investment Management System"). Pertinent regulations regarding pay, allowances, and compensations are found at 37 U.S.C. §§ 201-210 (Supp. IV 1999). Finally, 5 C.F.R. §§ 1600-1690 (2000) provide further guidance on the TSP.

35. The federal government provides retirement systems for the majority of civilian employees. The two systems are the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). *See* The Office of Personnel Management, *Federal Retirement Programs, at* http://www.opm.gov/retire/index.htm (last modified July 28, 2000). The TSP serves as an attractive supplement to both retirement programs by providing participants the same type of savings and tax benefits enjoyed by corporate employees with 401(k) plans. *See* TSP SUMMARY, *supra* note 3, at 2.

36. Retirement plans commonly called "401(k) plans" meet the requirements of section 401(k) of the Internal Revenue Code. These plans allow employees to choose to have their employers pay part of their compensation into a retirement fund. Often employers match employees' contributions. Within limits, there is no tax liability on any contributions during the year the employee or employer contributed the funds. I.R.C. § 401(k) (1999).

37. The payouts directly correlate to the total contributions and any earnings.

38. TSP SUMMARY, *supra* note 3, at 2.

39. For federal employees under the FERS, the TSP is an integral part of their total retirement program. The annuity component, the TSP component, and social security benefits constitute the entire retirement program. TSP Summary, *supra* note 3, at 2

40. Under current legislation, military members' participation in the TSP will not interfere with their military annuity retirement program.

41. TSP SUMMARY, *supra* note 3, at 2.

42. *See supra* note 28.

43. *See supra* note 34. Civilian employees are divided into two groups for TSP purposes: employees eligible for the CSRS and employees eligible for the FERS. Both groups can participate in TSP, but under different provisions. TSP SUMMARY, *supra* note 3, at 2.

44. *See* ARMY LAW., Sept. 2000, at app. B. (Operation and Administration of the Thrift Savings Plan), *at* http://www.jagcnet.army.mil/TJAGSA (Publications, 2000, September, Miscellaneous Administrative Information).

45. 5 U.S.C. § 8472(f) (Supp. V 2000).

46. *Id.* § 8473(e).

47. The Board must seek an individual with "substantial experience, training, and expertise in the management of financial investments and pension benefit plans" to serve as the Executive Director. *Id.* § 8472(a)(2). Mr. Roger Mehle is the current Director.

funds. Finally, the Board contracts out record keeping to an independent agency.[48]

Eligibility for the Thrift Savings Plan

The National Defense Authorization Act for fiscal year 2000 authorized service members on active duty and members of the Ready Reserve to participate in the TSP.[49] The phrase "Ready Reserve" has broad implications. By using the phrase, Congress authorized all Ready Reservists,[50] regardless of pay statuses, to contribute to TSP. Other language in the Act however, effectively limits participation by referring to basic pay, pay periods, compensations, and special or incentive pay. Most Ready Reservists do not routinely receive these monies.[51] Most likely, only Ready Reservists who are members of the Selected Reserve will participate in any future TSP.[52] Selected Reservists commonly train on weekends and during annual two-week periods.

Contributions to the Thrift Savings Plan

If legislators fund the TSP for military participation, active duty service members could contribute up to five percent of their basic pay per pay period.[53] For TSP purposes, members cannot include allowances for housing, food, and the like as part of their basic pay.[54]

Ready Reservists could also contribute up to five percent of the compensation they receive per pay period.[55] Statutory language defines compensation as 1/30 of the basic pay authorized for active members.[56] Generally, reservists[57] drill (perform training, administrative duties, and the like) for four periods per month. Reservists receive compensation for each drill or

48. TSP Summary, *supra* note 3, at 3.

49. National Defense Authorization Act of 2000, Pub. L. No. 106-65, § 661, 113 Stat. 512 (1999). *See supra* note 28. The Act allows about 1,406,830 active duty service members and 1,353,284 Ready Reservists to participate in the TSP. Department of Defense, *Defense Almanac, Active Forces File*, *at* http://www.defenselink.mil/pubs/almanac/almanac.html (data as of Sept. 30, 1998). *Id*. Of those eligible to participate, 175,853 active duty service members and 88,907 Ready Reservists are expected to contribute to TSP in the first year of the program. Department of Defense officials expect the participation rates to increase from 12.5% in 2001 to 32.5% in 2009 for active duty members. For reservists, officials expect the rates to increase from 10% to 17% over a 7-year period. DOD TSP Facts, *supra* note 32. In June 2000, DOD officials started to rely on a study completed by the RAND Corporation on TSP participation by reservists. The authors of the study estimate 6.8% of selected reservists will participate in the TSP. Beth J. Asch & John T. Warner, The Thrift Savings Plan: Will Reservists Participate, Mar. 2000 (unpublished report on file with author). The number of TSP participants could swell by ten percent in the first year with a potential increase of over twenty percent based on the total possible military participants, the estimated participation rates, and the total participants currently in TSP. *See supra* note 3. *See also infra* note 50.

50. The language in the National Defense Authorization Act § 661 does not contain any qualifiers for the phrase "Ready Reserve." Without qualifiers, the reader should use the common meaning of the phrase. Officials at the DOD plan to use the common and most inclusive meaning of the phrase. Interview with LTC Thomas K. Emswiler, Armed Forces Tax Council, Office of the Assistant Secretary of Defense Force Management Policy, (Military Personnel Policy) in Arlington, Va. (7 June 2000). The common meaning encompasses all types of Ready Reservists.

There are three manpower management categories within the Reserve components: Ready Reserve, Standby Reserve, and Retired Reserve. The Ready Reserve contains three subgroups: the Selected Reserve, the Individual Ready Reserve (IRR), and the Inactive National Guard (ING). The Selected Reserve can be further broken down into Reserve unit members, Individual Mobilization Augmentee members, and Active Guard and Reserve and Training and Administration of Reserve members.

Members of the Selected Reserve are either Category A Reservists (forty-eight four-hour drills plus annual training) or full-time reservists (365 days a year). These members receive regular "paychecks" because they drill or work on established schedules. The other subgroups of the Ready Reserve are not actively performing military service, but may receive compensation. Members of the IRR and ING are subject to involuntary active duty, but members of the Selected Reserve should be recalled before members of the IRR or ING.

As of September 30, 1998, there were 1,353,428 Ready Reservists. Selected Reservists comprised approximately 66% (889,078) of the Ready Reservists. Full time Selected Reservists comprised approximately 7% (64,314) of the Selected Reservists and approximately 5% of the Ready Reservists. Category A Reservists make up 93% (824,764) of the Selected Reservists and approximately 61% of the Ready Reservists. Thus, the majority (66%) of Ready Reservists (the Selected Reservists) receive regular "paychecks," but only 5% receive compensation as full-time employees. Reserve Forces Policy Board, Reserve Component Programs: The Annual Report of the Reserve Forces Policy Board 50-55 (1999).

51. All Reservists can receive compensation and special pays depending upon their status. *See supra* note 50.

52. *Id.*

53. National Defense Authorization Act § 661. The basic pay scale established by Congress for service members can be found at 37 U.S.C. §§ 201-210 (Supp. IV 1999).

54. The various allowances established by Congress are set out in 37 U.S.C. §§ 400-434.

55. National Defense Authorization Act § 661.

56. 37 U.S.C. § 206.

period. The usual Reservist could contribute approximately 0.67% of a comparable active member's basic monthly pay.[58] The Executive Director of the Federal Retirement Thrift Investment Board[59] estimates that the average reservist would contribute about $200 a year to a TSP account.[60] The DOD officials estimate the average reservist will contribute about $228 a year.[61]

Active and reserve members could put more funds in their TSP accounts by contributing money from special or incentive pay. Members could also contribute monies received as bonuses for enlistment and reenlistment.[62] The ability to contribute from these funds enhances the recruiting and retention value of these bonuses and the investment value of the TSP.

Congress provided an additional retention incentive for members serving in critical specialties. Congress authorized Service Secretaries to form contracts with service members who agree to serve for six years on active duty in their critical specialties. In exchange for the members' services, the Secretaries will match the members' contributions to their TSP accounts, up to certain limits.[63] Note however, members cannot contribute, from any pay source or combination of sources, more than the Internal Revenue Code limitation. For calendar year 2000, the limit is $10,500.[64]

Additional contributions are possible for Redux [65] participants. Last year Congress responded to complaints about the inadequacy of the Redux retirement program and the need for retention incentives. [66] The National Defense Authorization Act for fiscal year 2000 authorized a retirement option for service members who entered service after 1 August 1986 (Redux). Military personnel with fifteen years of service may receive a $30,000 career-status bonus if they agree to serve an additional five-year tour and remain under the Redux retirement system. If members do not take this option, they can elect to retire under the pre-1986 retirement system[67] (commonly called "High-Three"[68]). An additional benefit may be available to those members choosing the Redux option. If legislators implement the TSP for the military, Redux participants may contribute portions of their bonuses to their TSP accounts within limits established by the Internal Revenue Code.[69]

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57. A Selected Reservist will be the most probable Ready Reserve participant in a future TSP. *See supra* notes 50-52 and accompanying text. Thus, any discussion of reserve participation generally refers to participation by Selected Reservists.

58. Four times 1/30 equals approximately 0.133. Five percent of 0.133 equals approximately 0.0067. This result considered as a percentage of basic pay would be 0.67%.

59. *See supra* note 44.

60. Karen Jowers & Rick Maze, *Short of Funding, Thrift Plan Fading to Red*, MARINE CORPS TIMES, Jan. 24, 2000, at 18.

61. DOD TSP Facts, *supra* note 32. The authors of a recent RAND Corporation study estimated that the average contribution by a selected reservist would be $324. Asch & Warner, *supra* note 49.

62. National Defense Authorization Act of 2000, Pub. L. No. 106-65, § 661, 113 Stat. 512 (1999). Various special and incentive payments established by Congress are set out in 37 U.S.C. §§ 301-317 (Supp. IV 1999).

63. *Id.* at § 662. Congress limited this incentive by requiring the service secretaries to make monthly contributions that match members' contributions from their basic pay and not from special pay or incentive payments. *Id*.

64. Practitioners refer to contributions to 401(k) type plans as elective deferrals. *See generally infra* note 74 and accompanying text. Legislation provides limits on the amount of elective deferrals not subject to tax. I.R.C. § 402(g) (1999). Based on underlying legislation, the IRS adjusts those limits for the cost of living. I.R.C. § 402(g)(5). For calendar year 2000, the limit is $10,500. Tax Notes Today, *1999 TNT 233-9 IRS Announces COLA Adjustments to Pension Plan Limitations for 2000*, TAX ANALYSTS, Dec. 6, 1999, LEXIS, All Sources Library, Tax Analysts Tax Notes Today File.

65. *See generally* Shafer, *supra* note 4, at 18.

66. The retirement program commonly termed Redux was created when Congress made major changes to the military retirement program in the Military Retirement Reform Act (MRRA) of 1986. Supposedly troops bitterly called the new retirement program "Redux." Sydney J. Freedberg Jr., *Smart Salute*, NAT'L J., Jan. 30, 1999, at 265. Legislators apparently did not use the term. A search of the legislative history surrounding the passage of MRRA failed to find the use of the word. The term probably is not an acronym, although it often appears in capital letters. Further, the meaning of the word, redux, seemingly did not to apply in 1986. Redux means to bring back or restore. THE COMPACT OXFORD ENGLISH DICTIONARY (2nd ed. 1991). The 1986 legislation reduced benefits, so perhaps troops misapplied the word. However, the term is appropriate under current legislation. The latest legislation allowing members to choose to return to the High-Three program makes the term Redux applicable to the choice of programs. Members can "restore" their benefits by choosing the High-Three program. Finally, Ms. Toni Hustead used the term "REDUX" on page 8 of an Office of the Actuary report entitled "Valuation of the Military Retirement System" (Sept. 8, 1987). She used the term as follows, "members first entering the Armed services on or after August 1, 1986, are subject to a reduction (REDUX) if they retire with less than 30 years of service." Interestingly, she seemed to have misapplied the word and used capital letters. Perhaps, the word was in common usage before Ms. Hustead caused the word to be used in print.

67. National Defense Authorization Act §§ 641-643.

68. *See supra* note 4.

69. *See supra* note 64.

Contributing to TSP accounts would be simple because finance agencies would make monthly withdrawals from participants' pay. Contributors would not have to write checks, address envelopes, or go to the post office. In fact, participants would not need to take many actions at all regarding their accounts.[70]

Tax Advantage of the Thrift Savings Plan: Deferment[71]

The tax code does not treat contributions that TSP[72] participants make from their pay as income during the year participants earn the income. The tax code provides that those contributions will be included as income in the year when the contributions are withdrawn or "distributed"[73] from the TSP.[74] Taxes are effectively "deferred" until funds are distributed.

Participants benefit from tax deferral in several ways. The immediate benefit lies in the reduced tax liability for the service member. Consider a service member who contributed $950 a year[75] to his TSP account. Assume he has a federal tax liability of sixteen percent.[76] Because of his contribution, he would owe $152 less in taxes for that year. Granted, the $152 in taxes must be paid in the future, but the tax reduction may be important to the member in the year he contributed the money. The member should note another benefit of deferral when considering his contributions only "cost" him $798 ($950 minus $152). In effect, the member expended $798 of his resources for a $950 investment.[77]

Participants also benefit from tax deferment combined with inflation, and general reduction in income (lower tax brackets). Consider our service member again. The $152 he saved in taxes represent current-year dollars. If he incurs the $152 tax liability in thirty-five years, the purchasing power of that tax liability would be about $53 in current year dollars.[78] Additionally, the member's tax liability may be lower because he may have less income during retirement.

Finally, the member also benefits because the tax on his earnings on the contributions is tax-deferred. The tax code imposes tax liability when the TSP distributes the earnings.[79] A participant does not need to remove funds from his TSP account or his personal savings to pay tax during the years his TSP account accrues the earnings. Thus, the final amount of the participant's overall savings will be greater because no monies were devoted to taxes. As evidence, compare the future value of an investment without tax-deferral and with tax deferral. A $950 investment, earning 10%, over thirty-five years, taxed at 16% would be worth $15,986 (assuming the member paid the taxes from his investment).[80] The same investment would yield $26,697 if the investor could defer taxes.[81] The difference is $10,711.

Thrift Savings Plan Investment Options[82]

Participants in the TSP choose how their savings will be invested among various funds. The Federal Retirement Thrift Investment Board[83] offers five types of investment funds.

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70. Participants do have to choose between various investment options. *See infra* notes 82-87 and accompanying text.

71. The benefits of tax-deferral are magnified if participants' states of domicile also defer state income taxes on contributions and earnings.

72. The TSP is a "qualified" retirement plan pursuant to I.R.C. § 401(a) (1999).

73. The drafters of the Internal Revenue Code use the term "distributed" versus "withdrawn" when referring to funds removed from retirement programs.

74. I.R.C. § 401(k).

75. Assume the member is an E-4 over 6 years. Nine hundred and fifty dollars represents slightly less than 5% (4.97%) of his basic pay.

76. Mr. Saul Pleeter, an economist, indicated he used a tax rate of 16% in his calculations regarding the military and the TSP. He based the 16% on a study done on marginal tax rates in the military. Researchers completed the study as part of the Seventh Quadrennial Review of Military Compensation. Telephone Interview with Saul Pleeter, Assistant Director of Compensation, Office of the Assistant Secretary of Defense Force Management Policy (Jan. 24, 2000). The 16% figure is in keeping with a report done by the Congressional Research Service. Authors of that report reviewed data on individual federal income tax returns for 1995, 1996, and 1997. The average tax rate expressed as a percentage of adjusted gross income was 14.7%, 15.2%, and 15.4% for the three years respectively. *Tax Notes Today, #22 2000 TNT 18-22 CRS Report on Individual Tax Returns for 1995-1997*, Jan. 27, 2000, LEXIS, All Sources Library, Tax Analysts Tax Notes Today File.

77. The $798 represents about 4.2% of the base pay of an E-4 over 6 years.

78. The author used the online services of FinanCenter, Tucson, Arizona, in making various calculations. For more detail, see ARMY LAW., Sept. 2000, at app. A, (Assumptions Underlying Comparisons of TSP, Roth, and Taxable Investment Accounts), *at* http://www.jagcnet.army.mil/TJAGSA (Publications, 2000, September, Miscellaneous Administrative Information)..

79. I.R.C. § 402(a) (1999).

80. This assumption is only for comparison purposes. Removing monies from a TSP account is not possible without taking out a loan or making a withdrawal. *See infra* notes 139-46 and accompanying text.

81. The author used the online services of FinanCenter, Tucson, Arizona, in making various calculations. *See supra* note 78.

Those fund types are government securities, fixed income, common stock, small capitalization stock, and international stock.[84] All of the funds, except for the government securities fund, are essentially index mutual funds.[85] The funds vary in their holdings, risk of investment, and rates of return. Counselors should be able to teach military members the rudiments of the investment funds and basic principals of proper asset allocation with a minimum expenditure of resources.[86] Given minimal education, most members should be able to tailor their TSP accounts, or portfolios, based on the nature of the funds, their investment goals, their tolerance for risk of loss of savings,[87] and their other assets.

Government Securities Fund or "G Fund"

The G Fund is comprised of investments in specially issued United States Treasury securities. Given the nature of its investments, the G Fund is comparable to a cash or money market fund in terms of risk. There is virtually no risk of losing principal with government securities. Market or interest risk is eliminated by the brief maturity periods used by the Executive Director.[88] Despite the extremely low risk, the G Fund provides a decent rate of return because of statutory provisions. Rates of return, by statute, equal average market rates on Treasury securities with four or more years to maturity.[89] Thus, the G Fund's rate of return compares to intermediate bond fund rates.[90] The G Fund's rate will be comparable to the F Fund, but probably lower than the C, S, and I Funds discussed below.[91] The G Fund had a 7.0% compound annual rate of return over the ten-year period encompassing 1990-1999.[92] People who use G Fund types of mutual funds seek conservative additions to their investment portfolios[93] or are "risk averse."[94]

Fixed Income Index Fund or "F Fund"

Congress directed that the F Fund would be composed of insurance contracts, certificates of deposits, or other bond instruments.[95] To meet Congress' requirement, the Executive

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82. A discussion of investment strategies is beyond the scope of this article. Counselors should seek further guidance before advising clients as to asset allocation, estate planning, and similar investment issues.

83. *See supra* note 44.

84. TSP HIGHLIGHTS, *supra* note 3, at 4.

85. Index mutual funds track a particular market index. For an interesting and informative article on the history of mutual funds and a discussion of index mutual funds, see Joseph Nocera, *The Age of Indexing; Indexing has won. But has it won for the right reason? Or are investors merely doing what they've always done – chasing the hot thing?* MONEY, Apr. 1999.

86. The process of educating service members about the TSP and its role in estate planning presents a challenge to administrators. Judge advocates are not normally involved in administration of military finance matters, but they are involved in estate planning. Staff judge advocates should consider how their attorneys will contribute to the educational process within their limited resources.

87. Determining the overall risk of loss, or volatility, of a portfolio, is not a simple calculation. An investor needs to consider not only the risk each entity brings to his portfolio, but also the risk generated by the composition of his portfolio. The composition of an investment portfolio is commonly termed "asset allocation." A thorough discussion of asset allocation is beyond the scope of this article, but counselors should understand one important concept. The risks of investment instruments are not directly correlated, nor are they additive. For example, a mutual fund with a high level of volatility combined with one of low volatility does not necessarily equal a moderate risk level. Investors should seek guidance in allocating their assets among investments.

88. At present, maturities range from one to four days. Federal Retirement Thrift Investment Board, *Thrift Savings Plan Investment Options, at* http://www.tsp.gov/features/tsp7f.html (last modified June 28, 2000).

89. 5 U.S.C. § 8438 (b)(1)(A) (Supp. V 2000).

90. Intermediate bond fund rates of return are about 7%, while money market rates are typically 4-5%. Telephone Interview with David M. Snyder, Vice President, Trust Division, Key Bank, Bloomington, Ind. (Jun. 23, 2000).

91. *Thrift Savings Plan Investment Information, in* TSP HIGHLIGHTS, *supra* note 3, at 3.

92. *Id.* Note that administrators calculated the rates of return after removing fund administrative expenses, management fees, and trading costs from the calculations. *Id.* The twelve month yield (June 1999–May 2000) was 6.5%. Federal Retirement Thrift Investment Board, *Thrift Savings Plan Rates of Return* [hereinafter TSP Returns], *at* http://www.tsp.gov/rates/index.html (last modified Aug. 7, 2000).

93. The G Fund serves as a valuable conservative asset in many TSP participants' portfolios. Counselors should encourage clients to consider their entire portfolios when determining how they will invest their TSP contributions. *See supra* note 87.

94. Risk averse individuals are not willing to risk loss of their investment in exchange for possible higher earnings on their money. Such individuals may need their savings in the near future and cannot risk loss due to market declines. Other risk averse individuals may simply be more comfortable with steady, guaranteed rates of return.

95. 5 U.S.C. § 8438 (b)(1)(B) (Supp. V 2000).

Director chose the Barclays U.S. Debt Index Fund.[96] Managers for the Barclays U.S. Debt Index Fund invest in U.S. government, corporate, and mortgage-backed securities. The managers choose securities representative of items included in the Lehman Brothers Aggregate Index.[97] As such, the U.S. Debt Index Fund's rate of return reflects the bond market's rate of return. Because the F Fund relies on the U.S. Debt Index Fund, the F Fund reflects the rate of return of the bond market.

Bond funds are more volatile than money market funds because corporate and mortgage-backed securities carry a higher risk of loss of principal than U.S. government backed securities. Bond fund managers affect the level of risk through bond selection. The F Fund does not contain any high-risk or "junk-bonds" because the Lehman Brothers Aggregate Index does not contain such bonds. An additional, greater risk inherent in the F Fund is the risk due to changes in interest rates. As interest rates rise, bond values fall and vice versa. Falling bond values can result in overall negative returns.[98]

Investors should weigh the risks[99] associated with the F Fund against the probable returns. The F Fund had a 7.7% compound annual rate of return over the ten-year period encompassing 1990-1999.[100] Individuals who choose the F Fund must not be totally risk averse. Generally, bond fund investors seek low to moderate investment risks. They balance investment risks against higher yields and the "cost" of inflation eroding their savings. These investors usually can withstand some risk of loss because they do not need their savings in the near future. Alternatively, these investors may use the F Fund to balance other investment risks as a more conservative aspect of their investment portfolios.[101]

Common Stock Index Investment Fund or "C Fund"

For the C Fund, Congress directed Board members to chose an index representative of the United States' equity market. Congress further directed that the C Fund would mirror the chosen index in terms of composition and performance.[102] The Executive Director chose the Standard & Poor's 500 stock index (S&P 500) and a corresponding index fund (Barclays Equity Index Fund).[103]

Given that the C Fund is primarily composed of corporate or "equity" stocks, the fund is inherently volatile. The value of an individual company's stock depends on variables relating to the company: product quality, advertising, labor conditions, equipment conditions, cost of raw materials, and the like. Conditions outside of the company, such as economic conditions, also affect stock prices. Given the large number of variables, the inherent risk of equity stocks should be obvious to a potential C Fund investor. However, the risk is lessened because index funds hold stocks of many companies. The C Fund is more volatile than the G or F Fund, but it has yielded greater returns. It had a 18.2% compound annual rate of return over the ten-year period encompassing 1990-1999.[104] Participants should consider volatility and return when building their investment portfolios.

Investors in the C Fund should also plan for possible periods of poor economic conditions and low returns. Investors should invest in the C Fund for long periods and not plan to withdraw C Fund investments in the near future. For example, the C Fund in 1990 decreased in value by 3.15%. In 1991, the fund increased by 30.77%.[105] If an investor withdrew his money in 1990, he would have been disappointed. If that same investor could have waited until 1991, he would have had a much greater yield. The C Fund is for long-term investments; while, the G Fund is more suitable for short-term investing.[106]

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96. *See* TSP SUMMARY, *supra* note 3, at 21.

97. *Id.*

98. *Id.* at 24. The F Fund had a negative rate of return of 2.96% in 1994 and 0.85% in 1999. *Id.*

99. For a more thorough discussion of F Fund risks, consult informational materials provided by the TSP. *Id.* at 21-22.

100. *Thrift Savings Plan Investment Information, in* TSP HIGHLIGHTS, *supra* note 3, at 4. Note that administrators calculated the rates of return after removing fund administrative expenses, management fees, and trading costs from the calculations. *Id.* The twelve month yield (June 1999–May 2000) was 2.15%. TSP Returns, *supra* note 92.

101. The F Fund, with its longer maturities, carries a greater risk of loss due to changing interest rates than the G Fund. Investors desiring conservative instruments might find the G Fund more suitable for their needs. *See supra* note 87.

102. 5 U.S.C. § 8438(b)(1) (Supp. V 2000).

103. The Director also invests a portion of the C Fund in S&P 500 index futures contracts and a lending program. TSP SUMMARY, *supra* note 3, at 18-19.

104. *Thrift Savings Plan Investment Information, in* TSP HIGHLIGHTS, *supra* note 3, at 3. Note administrators calculated the rates of return after removing fund administrative expenses, management fees, and trading costs from the calculations. *Id.* The twelve month yield (June 1999 – May 2000) was 10.35%. TSP Returns, *supra* note 92.

105. *Your Investment Options, in* TSP SUMMARY, *supra* note 3, at 21.

Small Capitalization Stock Index Investment Fund or "S Fund"

The Executive Director will offer the S Fund beginning October 2000.[107] The Director will invest in an another index fund managed by Barclays Global Investors,[108] but this fund tracks the Wilshire 4500 index.[109] The Wilshire 4500 index represents approximately twenty-five percent of the stock market's value in the United States. All of the stocks comprising the Wilshire 4500 index are actively traded in the American stock market,[110] but are not included in the S&P 500 index.[111] Thus, an index fund tracking the Wilshire 4500 would not overlap a fund tracking the S&P 500. Consequently, the S Fund's investments do not overlap the C fund's investments.

The base investment in the S Fund, similar to the C Fund, is an index fund comprised of stocks of various companies. The change in value of companies' stocks is the primary source of earnings for these index funds. Dividend income also contributes to earnings. The S Fund, however, is more volatile than the C Fund because the Wilshire 4500 index fluctuates more than the S&P 500 index. The Wilshire 4500 tracks the stocks of smaller companies, which tend to react strongly to economic changes. The Wilshire 4500 index had a 16.2% compound annual rate of return over the ten-year period encompassing 1990-1999.[112] The S Fund carries more risk to investments than the G, F, or C funds.[113] Investors need to decide whether the higher level of risk is appropriate and acceptable given their investment portfolios.[114]

International Stock Index Investment Fund or "I Fund"

The Executive Director chose Barclays EAFE Index Fund tracking the European, Australian, and Far East (EAFE) stock index for the I Fund. The EAFE index represents stocks of companies from twenty countries and forty-six percent of the world stock market's value.[115]

The I Fund, like the C and S Funds, derives its earnings from the increased value of the underlying foreign companies' stocks and from dividends.[116] International investments tend to be more volatile than domestic investments because worldwide conditions affect markets. Everything from droughts, wars, economic embargoes, to the American political scene can affect the international market. The EAFE Index ranged from an annual rate of return of a negative 23.6% in 1990 to a high of 32.7% in 1993. The EAFE Index had a seven-percent compound annual rate of return over the ten-year period encompassing 1990-1999.[117] Clearly, the I Fund will be a volatile TSP investment. Investors must decide whether their circumstances will allow them to tolerate the volatility.[118]

Low Investment Costs

Investment instruments have operating costs usually borne by investors in some manner. Mutual fund administrators often charge investors a "load" or a set percent when investing in funds. Other fund managers charge loads when funds are distributed from accounts.[119] Almost all administrators charge investors some percentage of their account balance for management or administration fees (an "expense ratio").[120] Money market or cash type funds usually have the lowest management

106. Investors need to choose funds based on their future needs among other factors. *See supra* note 87.

107. *Two New Investment Funds*, *in* TSP HIGHLIGHTS, *supra* note 3, at 4.

108. *Late Breaking News, in* TSP HIGHLIGHTS, *supra* note 3, at 4.

109. For an informative discussion on market indices, see Walter Updegrave, *Ins and Outs of Indexes; First Rule of Tracking the Market: Know thy Benchmarks*, MONEY, Feb. 2000, at 57.

110. *Two New Investment Funds*, *in* TSP HIGHLIGHTS, *supra* note 3, at 4.

111. *Id.*

112. *Id.*.

113. *Id.*

114. *See supra* note 87.

115. *Two New Investment Funds*, *in* TSP HIGHLIGHTS, *supra* note 3, at 4.

116. *Id.*

117. *Id.*

118. *Id.*

119. The administrators of the TSP do not charge loads of any kind.

costs and the lowest fees. Index mutual funds are also inexpensive to manage and consequently usually have low fees.[121]

By their nature, the fund types used by the TSP—four index funds and one fund similar to a money market fund—should have low investment expenses. Participants however, must consider the TSP's administrative expenses or fees. The operating costs of the servicing office, of the record keeper's computer system, and of printing and mailing publications are major expenses.[122] These expenses add to the underlying costs of the funds. Fortunately, the TSP's Executive Director offsets expenses by using forfeitures of non-vested agency contributions to help pay these administrative expenses.[123] Consequently, the TSP funds have competitive administrative fees. Consider the data provided in Chart 1.

Fund Type	**TSP's Fees**[a]	**Average Fees**	**Vanguard's Fees**
Money Market	G Fund - 0.146%	0.46%[b]	0.33%[c]
Bond Index	F Fund - 0.16%	1.08%[d]	0.20%[e]
Stock Index	C Fund - 0.149%	1.55%[f]	0.20%[g]

Chart 1

a. These figures represent the average rates from 1988 to 1996. TSP SUMMARY, *supra* note 3, at 12.
b. *Mutual Fund Investment Costs Decrease*, LIMRA's Market Facts, Mar./Apr. 1999, *available at* LEXIS, All Sources Library, Magazine Stories, Combined File.
c. The figure represents Vanguard Prime Money Market Fund's expense ratio as of 30 November 1999. Vanguard, *Vanguard Funds File Library* (1999), *at* http//:www.vanguard.com.
d. Jeffrey M. Laderman & Amy Barrett, *What's Wrong*, BUS. WK., Jan. 24, 2000, at 66.
e. The figure represents Vanguard Total Bond Market Fund's expense ratio as of 31 December 1999. Vanguard, *Vanguard Funds File Library* (1999), *at* http://www.vanguard.com.
f. Laderman & Barrett, *supra* note d.
g. The figure represents Vanguard Total Stock Market Index Fund's expense ratio as of 31 December 1999. Vanguard, *Vanguard Funds File Library* (1999), *at* http://www.vanguard.com.

Chart 1 presents the fees of the TSP, average mutual funds, and Vanguard mutual funds. Vanguard is a popular, large mutual fund family[124] known in the industry for its low administrative expenses. A brief review of the chart reveals the very low fees paid by TSP participants. Unsophisticated investors may tend to discount investment costs because the percentage rate seems so low. It is a costly mistake to ignore investment costs. If a participant has $10,000 invested in the C Fund, the yearly management cost would be about $15. In contrast, the average cost for the industry would be $155. The investor could lose the yearly difference of about $140. The accumulated yearly differences could be quite substantial depending on how many years the investor left his savings in the TSP. The effect of compound interest increases the loss because the money spent on higher administrative fees would have remained invested in the TSP account. The TSP's low investment costs are a significant benefit for participants.

Loan Program

Participants can borrow funds (contributions and earnings) from their TSP retirement savings accounts,[125] if they borrow at least $1000 per loan.[126] Participants can use the funds for general purposes or for residential purchases.[127] For both types of loans, TSP managers will charge interest for the life of the loan at the G Fund rate[128] at the time of loan application.[129] Repayment is administratively easy because participants make payments through payroll deductions.[130]

The loan feature of the TSP is beneficial for TSP participants for two reasons. First, participants have access to retirement savings without incurring penalties or tax liabilities.[131] In contrast, members with IRAs cannot borrow their own funds from their IRAs.[132] The tax code however, does allow IRA investors to withdraw money for unreimbursed medical expenses, a first

120. For an informative discussion on expense ratios, see David Harrell, *Mutual Fund Expenses* (June 19, 1998), *available at* http://news.morningstar.com/news/MS/Investing101/mfexpenses.html.

121. *Id.*

122. TSP SUMMARY, *supra* note 3, at 12.

123. Federal civilian employees who qualified for matching agency contributions who left service before their funds vested, forfeited the agency's contributions. Those forfeitures reduce the overall expense for TSP participants. *Id.*

124. For more information about Vanguard mutual funds, see Vanguard, *Funds Directory, at* http://majestic.vanguard.com/FP/DA (last modified Sept. 6, 2000).

125. 5 C.F.R. § 1655.2 (2000). Participants must be in an active pay status. *Id.* The tax code also places various restrictions on the loans. I.R.C. § 72(p) (1999).

126. 5 C.F.R. § 1655.6.

127. *Id.* § 1655.4. Participants can have two loans at once, as long as both loans are not for residential purchases. *Id.* Participants must repay general-purpose loans in one to four years and home purchase loans in one to fifteen years. *Id.* § 1655.5.

home,[133] higher education expenses, and other limited circumstances.[134] But, the code requires the IRS to treat funds withdrawn from traditional IRAs as income. Consequently, the fund manager must withhold money for taxes.[135]

The second advantage enjoyed by TSP borrowers is that they pay the interest on their loans into their own TSP accounts.[136] The borrower pays himself for the use of his own money. IRA investors cannot return any monies withdrawn from their accounts.

Participants can encounter disadvantages borrowing money from their TSP accounts. The borrower may incur a loss of earnings if the interest rate on the G Fund is lower than the rate of return on the borrower's investment. Consider for example a participant who borrows money at a G Fund rate of six percent. If the participant previously had the money invested in the C fund earning nineteen percent, the participant would lose thirteen percent a year on the remaining loan principal. Borrowers should balance this possible loss against the cost of a commercial loan.

Borrowers may also do themselves a disservice if they fail to pay back their loans. The purpose of TSP accounts is to amass funds for retirement. If borrowers do not pay back their funds, they have fewer resources for retirement, and incur penalties and tax liabilities.[137] Members should realistically consider whether they can repay their loans.

Portable Benefits

One of the major reasons Congress approved the TSP for service members was the feature of portability. Advocates successfully argued that the military needed a portable retirement savings program for the eighty-three percent of members who leave service without any retirement benefits.[138] The TSP will allow service members to take their retirement savings with them when they transition to civilian employment. Contributors leaving federal service may leave their savings in their TSP accounts, or roll their savings into an IRA or other retirement program. By rolling savings into another retirement vehicle, members can continue to defer taxes on their savings.[139]

Withdrawal Options: During and After Federal Service

In accordance with the Internal Revenue Code, the TSP is a qualified retirement program with restrictions on early withdrawals.[140] Current rules, established in the Code of Federal Regulations, allow participants who are in federal service to make age-based and financial hardship withdrawals.[141] Pre-

128. The G Fund interest rate on TSP loans is reasonable and competitive because it reflects Treasury securities with four or more years to maturity. 5 U.S.C. § 8438(b)(1)(A) (Supp. V 2000). Bankers also base their mortgage rates on Treasury debt securities. Richard Leong, *U.S. Treasury Moves Keeping Lid on Mortgage Rates*, Reuters, Mar. 24, 2000, *available at* http://www.yahoo.com/rf/000324/2t.html. Real estate loans usually have lower rates than personal loans. Recent rates (23 May 2000) were 8.82% on 30-year fixed-rate mortgages and 9.24% on car loans. *Money Monitor*, MONEY, July 2000, at 143. The TSP loan rate for new loans was 6.0% on 5 September 2000. Federal Retirement Thrift Investment Board, *TSP Current Information, at* http://www.tsp.gov/curinfo/index.html (last modified Sept. 5, 2000). Obviously, the interest rate on a TSP loan is very reasonable and competitive. Thus, participants in the TSP can save money on interest by borrowing from themselves.

129. 5 C.F.R. § 1655.7.

130. *Id.* § 1655.11.

131. I.R.C. § 72(p) (1999).

132. Premature distributions or withdrawals from traditional IRAs or Roth IRA are subject to a 10% penalty. *Id.* § 72(t). Further, 20% of the distributions are withheld to ensure sufficient funds are withheld for tax liabilities. *Id.* § 3405(c).

133. A "first-time homebuyer" is an individual, or such individual's spouse, that has no interest in a principal residence for two years prior to the purchase of the home for which IRA moneys are withdrawn. *Id.* § 72(t)(8)(D)(i). Moneys withdrawn from the individual's IRA must be used within 120 days to purchase the individual's principal residence. *Id.* § 72(t)(8)(A).

134. *Id.* § 72(p). Roth IRA investors must also fulfill a five-year holding period. *Id.* § 1.408A(d).

135. *Id.* § 72(t). The IRA investor may have to withdraw more money than desired in order to pay for the increased taxes.

136. 5 C.F.R. § 1655.9 (2000).

137. I.R.C. § 72(q) (2000).

138. DAJA-LA (6 Mar. 1997), *supra* note 5.

139. I.R.C. § 402(c).

140. I.R.C. § 72(t).

141. 5 C.F.R. § 1650. For detailed information, see Federal Retirement Thrift Investment Board, *TSP In-Service Withdrawals* [hereinafter TSP In Service Withdrawals], *at* http://www.tsp.gov/features/tsp10Af.html (last modified June 28, 2000).

sumably, the rules will be the same for service members although few members will make age-based withdrawals.

Age-based withdrawals allow participants who are at least age 59½ to withdraw their savings or to roll them over into another retirement vehicle. They can withdraw all or part of their savings for any reason.[142] Participants however, can only make one age-based withdrawal.[143] The IRS will consider the money withdrawn as income and subject to mandatory withholding of funds for tax liability.[144] In contrast, if participants rollover entire amounts withdrawn into IRAs or other retirement programs, they avoid tax withholding.[145]

Finally, participants can withdraw money from their TSP accounts for financial hardships. They may withdraw all or part of their savings.[146] Medical expenses; sudden property losses due to fire, storm, or other casualties; and legal costs associated with separation or divorce may create qualifying financial hardships.[147]

Participants in the TSP should think very carefully before making withdrawals that result in taxes and penalties. The money withheld for taxes (mandatory twenty percent for federal income tax) and the penalties (ten-percent)[148] reduce funds available for intended purposes. If a participant needed $1000, he would have to withdraw $1430 to yield $1000 after taxes and penalties. Depending on the state of domicile, the participant may need to remove more money to pay state income tax. If instead of withdrawing the $1000, the member borrowed it using the loan program, he would not incur a cost for the use of the money.[149] Granted the member faces some possible disadvantages when borrowing from his TSP account,[150] but the loan is less costly than withdrawing funds from a TSP account. The participant however, may have no choice if he is ineligible for a loan or he cannot afford loan payments.

Participants leaving federal service will be able to keep their retirement savings in their TSP accounts, or roll them over into IRAs or other eligible retirement vehicles. These options have no adverse tax consequences and savings continue to increase tax-deferred. Rather than rolling their TSP savings over into another retirement program, participants can also remove their savings. For service members, however, withdrawals would be ill advised because of tax consequences due to their relatively young ages.[151] The tax code provides a 10% penalty on savings withdrawn by participants who are not fifty-five years old when they separate or retire and who are not age 59½ upon receipt of the monies.[152] Service members should seek tax advice before making withdrawals from their TSP accounts.

Participants who decide to withdraw their money may use one of three options. They can elect to receive a single payment, life annuity payments, or a series of monthly payments.[153] Annuities are insurance contracts that guarantee payment for life. An annuity can be based upon a participant's life expectancy, the participant and participant's spouse's joint life expectancies, or the participant and another individual's (not the spouse's) joint life expectancies.[154] Members who elect to receive monthly payments can choose the basis for those payments. A member can base payments upon a fixed monthly amount, a fixed number of months, or on his life expectancy. Regardless of the payment basis, the participant will not receive any further monies when his account is depleted.[155]

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142. The participant must request at least $1000. If the participant's vested account balance is less than $1000, he can request the entire amount. *Id. at* 7.

143. 5 C.F.R. § 1650.30 (2000).

144. *See supra* note 132. The participant's state of domicile may also consider the funds withdrawn as income for tax purposes.

145. I.R.C. § 402(c) (1999).

146. The participant's circumstances must qualify him for, and he must withdraw, at least $1000. If he does not qualify for at least $1000, administrators will deny his request. TSP In Service Withdrawals, *supra* note 140, at 11.

147. 5 C.F.R. § 1650.31.

148. The TSP is a qualified retirement program. Early withdrawals from such programs may result in 10% penalties and will be subject to 20% withholding. *See supra* note 132. The participant may not be in the 20% income bracket, and could later receive some of the money withheld.

149. *See supra* notes 125-30 and accompanying text.

150. *See supra* notes 136-37 and accompanying text.

151. The average age for non-disability retirements for enlisted and officers was 41.1 and 46.4 years respectively. E-mail from Mike A. Dove, Defense Management Data Center (West), to author (Mar. 27, 2000) (on file with author).

152. I.R.C. § 72(t) (1999).

153. 5 C.F.R. § 1650 (2000). For detailed information see TSP SUMMARY, *supra* note 3, at 28.

154. 5 C.F.R. § 1650. For detailed information see TSP SUMMARY, *supra* note 3, at 32. The TSP administrators will purchase a life annuity for a participant if that option is elected. *Id.*

Should Service Members Use the Thrift Savings Plan?

A service member will have basic questions regarding how to invest for retirement. Which savings instrument or instruments should he use? How does the TSP compare to IRAs and regular savings or investment accounts (hereinafter taxable investment accounts)? If funds are limited, how should he prioritize his investments? How should he use the TSP with an overall estate plan? An attorney offering advice will need a thorough understanding of the benefits and tax implications of TSP[156] and IRA participation. The attorney should prepare to answer the member's bottom-line question: which program yields the greatest amount of money in the future? To assist the attorney, the discussion below compares TSP, Roth IRA,[157] and taxable investment accounts as to future "bottom-line" values and tax implications. Various assumptions underlie the discussion.[158] Presumably, the service member makes regular contributions to a retirement program earning ten percent a year. The member presumably continues investing throughout his military career and has a sixteen-percent tax liability.[159]

Tax implications directly affect which investment vehicle yields the greatest future monetary value.[160] Based on the author's assumptions,[161] a TSP and a Roth account will yield the same values upon distribution.[162] The values are the same because the participant presumably pays the tax liability on Roth IRA contributions from resources other than those available for investing. If the investor had to use part of his IRA contribution to pay taxes, a TSP account would yield greater values because he would have more funds invested in the TSP.

The effect of lost investment dollars due to taxes is evident when comparing the values of the TSP and Roth accounts to taxable investment accounts.[163] The values of the TSP and Roth accounts are eight to twenty-two percent greater than the values of taxable investment accounts. Presumably, the tax liability on contributions and earnings was satisfied from funds available to invest in taxable investment accounts. The tax liability is significant as indicated in Chart 2 below. The power of compounding investments magnifies the loss due to taxes.

Taxes due on Contributions and Earnings			
Contribution Rate	Rank	Twenty Years	Thirty Years
3%	Enlisted	$5,319	$16,56
3%	Officer	$11,009	$32,927
5%	Enlisted	$5,442	$16,355
5%	Officer	$11,137	$32,954

Chart 2

155. TSP Summary, *supra* note 3, at 28.

156. *See supra* notes 71-81 and accompanying text.

157. For a thorough discussion of the history of IRAs and the Roth IRA, see Jolie Howard, Comment, *The Roth IRA: A Viable Savings Vehicle for Americans?*, 35 HOUS. L. REV. 1269 (1998).

158. For details, see ARMY LAW., Sept. 2000, at app. A (Assumptions Underlying Comparisons of TSP, Roth, and Taxable Investment Accounts), *at* http://www.jagcnet.army.mil/TJAGSA (Publications, 2000, September, Miscellaneous Administrative Information).

159. *See supra* note 76.

160. *See supra* notes 71-81 and accompanying text. This discussion applies to federal income taxes. The author did not consider state income taxes. The general principles, however, apply to both federal and state income tax.

161. *See supra* note 158.

162. *See* ARMY LAW., Sept. 2000, at tbl. 1 (TSP Comparison), *at* http://www.jagcnet.army.mil/TJAGSA (Publications, 2000, September, Miscellaneous Administrative Information).

163. *Id.*

Chart 2 also illustrates the tax advantage of Roth IRAs over TSP accounts.[164] When investors receive distributions from Roth IRAs, they do not incur any tax liability. In contrast, TSP participants must pay tax on distributions.[165] If a service member leaving service withdrew his TSP funds, he would have a tax bill of the magnitude presented in Chart 2. Roth IRA investors would not have any tax bill.[166] If considering tax implications alone, Roth accounts are obviously more advantageous than TSP and taxable investment accounts.[167]

Finally, the tax deferment aspect of the TSP combined with inflation provides an additional advantage over taxable investment accounts. The Internal Revenue Code allows tax deferment on the contributions[168] and earnings in the TSP.[169] When the member finally pays taxes, inflation will have eroded the purchasing power of the dollars used to pay the tax liability. The dollars used to pay taxes in the year of distribution will purchase less than the dollars that would have been used if taxes were due in the year contributions and earnings were deposited into the TSP account. In contrast, investors using taxable investment accounts pay taxes in the year they receive the income and pay with dollars at "full-value" for that year. Chart 3 presents the accumulation of deferred taxes on the contributions alone. Chart 4 presents the savings in purchasing power due to inflation on those contributions.[170] The savings in purchasing power are significant, between forty-three to fifty-nine percent.[171]

Taxes Due on Contributions			
Contribution Rate	Rank	Twenty Years	Thirty Years
3%	Enlisted	$ 2,084	$ 3,874
3%	Officer	$ 4,503	$ 8,411
5%	Enlisted	$ 3,473	$ 6,457
5%	Officer	$ 7,505	$14,019

Chart 3

Savings in Purchasing Power			
Contribution Rate	Rank	Twenty Years	Thirty Years
3%	Enlisted	$1,228	$1,910
3%	Officer	$2,407	$3,592
5%	Enlisted	$2,406	$3,187
5%	Officer	$4,015	$5,991

Chart 4

164. *Id.* at Table 2.

165. *See supra* note 71-81 and accompanying text.

166. Roth IRA investors do not incur a tax bill if they take distributions after they are age fifty-nine and one-half and their funds have been invested in the Roth IRA for a minimum of five years. I.R.C. §§ 72(t), 408A (1999).

167. An additional ten percent tax penalty for withdrawing funds before age fifty-nine and one-half is not considered because the participant in a Roth account would also incur a penalty upon early distribution of funds. Realize participants will probably not withdraw their funds when they leave service because of early withdrawal penalties. Therefore their TSP accounts will increase in value and consequently their tax liability will increase. Eventually when TSP participants withdraw their funds, they will owe taxes on the distributions.

168. I.R.C. § 401(k).

169. *Id.* § 402(a).

170. *See supra* note 162.

171. Calculations are based upon the assumption that participants will withdraw their funds at age sixty (no early withdrawals) and the inflation rate is 3%.

In summary, the tax implications of the various investment vehicles directly affect their future yields. If accumulation of wealth for retirement is the primary objective, TSP and Roth accounts are superior to taxable investment accounts.[172] A TSP account will yield greater values than a taxable investment account. For accumulating future wealth however, Roth IRAs are more advantageous than TSP accounts.

Advice for Service Members Regarding Retirement Funds

Basic Financial Planning a Prerequisite

Service members should take full advantage of Army Community Service's educational materials and classes regarding financial planning. Members who use these resources may learn the basic principals of financial planning and turn to their attorneys for information on the more difficult topic of saving for retirement.[173]

Maximum Use of Roth IRAs

Service members who have funds available to save for retirement will ask which investment package is best for them. Before answering their questions, counselors should analyze members' financial circumstances. If the member has limited funds to invest for retirement, the member should fully fund a Roth IRA before contributing to a TSP account. While a Roth account will yield the same future value as a TSP account,[174] a Roth account has overwhelming tax benefits. At retirement when the investor receives distributions, he has no tax liability provided he meets certain requirements.[175] Not only is there no tax liability; but the investor is not required to take mandatory distributions from a Roth IRA.[176] Roth account holders can allow their investments to continue to grow for as long as they wish. This feature is valuable to investors desiring to preserve a larger tax-deferred sum for their heirs.

Granted, Roth IRA contributions cannot reduce current income levels for income tax purposes, and contributors pay tax up-front.[177] A young service member may not have the resources to contribute the maximum amount[178] to a Roth IRA and pay the federal tax liability on that amount. If the member does not have the resources to do both, the member should invest as much as he can afford into a Roth IRA after paying taxes. Roth accounts should be used to the maximum extent possible.

One possible factor for investing in the TSP before investing in a Roth IRA is the loan feature of the TSP. While Roth account holders can remove part of their funds for limited circumstances,[179] they cannot return the funds to their accounts. They cannot in effect "borrow" money from themselves, as can TSP participants. Counselors should discuss the loan and withdrawal aspects of Roth and TSP accounts with service members.[180] Members should consider the loan aspect when deciding whether to contribute to a Roth or a TSP account. Attorneys however, should remember that TSP members can only borrow up to the value of their contributions and earnings.[181] Further, attorneys should impress upon members that funds set aside for retirement should be reserved for retirement.

Investing in the Thrift Savings Plan After Investing in Roth IRAs

If a service member has resources available after funding a Roth account, the member should invest in the TSP to the maximum extent possible. The member will enjoy the several benefits of a TSP account. As discussed above, those benefits include an easy method of investing, tax deferment, diversification, low investment costs, a loan option, and portability.

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172. A financial counselor should inquire about a member's future need for cash. Consider a member who has a strong possibility that he will need funds and has no source of funds other than his retirement investments. That member should not place his assets in investment vehicles that restrict or penalize withdrawals.

173. This article does not include any discussions of basic principals of financial planning. If clients are not knowledgeable regarding these basic principals, attorneys may recommend: THOMAS STANLEY & WILLIAM DANKO, THE MILLIONAIRE NEXT DOOR (1998); ANDREW TOBIAS, THE ONLY INVESTMENT GUIDE YOU'LL EVER NEED (1999).

174. *See* ARMY LAW., Sept. 2000, at tbl. 1 (TSP Comparison), *at* http://www.jagcnet.army.mil/TJAGSA (Publications, 2000, September, Miscellaneous Administrative Information).

175. I.R.C. § 408A(d)(1) (1999).

176. *Id.* § 408A(c)(5).

177. *Id.* § 408A(c)(1).

178. The maximum amount an individual can contribute is the lesser of $2000 or the individual's compensation for the year. *Id.* § 219. *See supra* notes 133-135.

179. *Id.* §§ 72(t), 408A(d).

180. *See supra* notes 125-37 and accompanying text.

181. 5 C.F.R. § 1655.11 (2000).

Choosing to invest in a TSP is a sound choice for service members.

Redux Considerations[182]

Service members who entered service after 1 August 1986 may select between two military retirement plans. They can choose to retire under Redux or the program called the "High-Three."[183] Members trying to decide between programs will need to determine which program will provide them with the greatest value. In making that determination, a significant factor is a member's plans for investing his Redux career-status bonus. The TSP can play an important role in those investment plans.[184] Attorneys should prepare to discuss how the TSP factors into the choice of retirement programs. The companion article entitled *Choosing Between the High-Three and the Redux Retirement Programs: Thrift Savings Plan Participation a Valuable Option* provides information on how investment choices regarding career-status bonuses affect the relative values of the two retirement programs.

Generally, if service members can afford to invest significant portions of their career-status bonuses, the Redux retirement program will yield greater future values.[185] The author bases this generality upon various assumptions which may not apply to some clients. A counselor will have to consider other factors besides a member's ability to invest his career-status bonus. Counselors should thoroughly review this article and the companion article, and carefully consider clients' total circumstances before providing advice.[186]

Conclusion

Some readers may become game show millionaires and live happily ever after. The majority of people, however, will have to concern themselves with saving for retirement. The Thrift Savings Plan would serve as a valuable tool for active duty service members saving for retirement because it is a sound investment program. Attorneys should prepare to advise members on how to reap the full benefits of the program. Attorneys need a complete understanding of the relationship between the TSP, the Roth IRA, and taxable investment accounts.

Basic advice includes encouraging the maximum use of Roth accounts. After fully funding Roth accounts, members should take advantage of the TSP. Additionally, for Redux service members, attorneys need an understanding of the role TSP plays in the choice of retirement programs. Attorneys must consider many factors carefully before advising Redux members.

The TSP will benefit military members and thus the military as a whole. Taking care of service members is good business and will enhance retention and recruiting. Legislators served their country well when drafting the program. Service members should urge their legislators to implement the program as soon as possible.

182. *See supra* note 4.

183. The High-Three program is available to members who entered service after 8 September 1980, but before 1 August 1986. *See supra* note 4.

184. The TSP can play an important role in choosing between retirement programs because members can invest significant portions of their bonuses tax-deferred into TSP accounts. *See supra* notes 71-81 and accompanying text.

185. *See supra* note 4.

186. In analyzing a client's situation, counselors should remember the helpful online calculator provided by the DOD. When using DOD's calculator however, attorneys need to be fully cognizant of the assumptions built into the program. *See supra* note 4.