

How Federal Annuities are Taxed



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Background:

When a retired Federal employee receives annuity payments, a portion of that annuity is based on after tax retirement contributions made to either the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS). The other portion comprises of government contributions that will be taxed as well as any accrued earnings on both the employee and government contributions. The taxable portion will be based on standard Internal Revenue Service (IRS) rules, the amount of contributions, your age at the time you retire and the IRS life expectancy factors.

If your annuity started after November 18, 1996, you will use the Simplified Method to figure the tax-free part of your CSRS or FERS annuity. The Simplified Method for computing the tax-free portion is the total retirement contribution divided by a factor for your age at retirement. The factor estimates the number of payments you will receive in your lifetime. For employees who elect a survivor benefit, the formula is slightly different. Rather than using your age at retirement, you combine your age and the age of your survivor to determine the estimated number of payments. **Example: Simplified Method**

Total Pension Received		\$35,000
Total Retirement Contributions	\$50,000	
Life Expectancy factor in months (Publication 721)	360	
Tax free amount per month (divide contributions by life expectancy factor in months)	138.89	
Tax free amount per year		\$1,666.68
Taxable portion of pension (total pension minus annual tax free amount)		\$33,333.32

Impact:

The Office of Personnel Management (OPM) will provide you with your total retirement contributions upon application for retirement. Once you have your total retirement contributions, you can calculate your tax-free portion using the charts on the following page. OPM will also automatically calculate the tax-free portion of your annuity and provide that amount on your annual tax statement, Form 1099R. You must report this tax-free portion when you file your tax return.

Federal Tax:

The Internal Revenue Service Publication 721, *Tax Guide to U.S. Civil Service Retirement Benefits*, explains how the Federal income tax rules apply to civil service retirement benefits received by Federal employees or their survivors. This booklet is available on the Internet (www.irs.gov), or you may call 1-800-TAX-FORM to get the publication mailed to you free of charge.

The payment schedule varies depending on your particular circumstances. Use one of the tables below based on your individual scenario:

Annuity without a Survivor Benefit (based on your age only)

<u>Age at Retirement</u>	<u>Number of Payments</u>
55 & under	360
56 to 60	310
61 to 65	260
66 to 70	210
71 and over	160

Annuity with Survivor Benefit (based on your age plus age of your survivor)

<u>Combined Age of Annuitants</u>	<u>Number of Payments</u>
Not more than 110	410
111 to 120	360
121 to 130	310
131 to 140	260
141 and over	210

Formula:
$$\frac{\text{Total Retirement Contributions}}{\text{Number of Payments}} = \text{Monthly Tax Free Amount}$$

At the time OPM processes the first automatic tax withholding from your annuity, they will send you a notice with an election form (W-4P) which you will use to indicate your tax withholding decision. **This form is issued in instances where the W-4P was not submitted with the original retirement application, the standard procedure when filing a retirement application.**

You may:

- a. Disregard the W-4P, thereby continuing the tax withholding which OPM automatically began. Taxes are automatically withheld from an annuity check at the “married + 3” withholding rate, unless the retiree instructs OPM to make a different tax withholding rate.
- b. Complete the W-4P election form, indicating your decision to begin monthly tax withholdings, to increase or decrease the amount of an existing monthly tax withholding, or to cancel tax withholdings completely. Once the form is completed, send the form to OPM.

- **If you want to start or change a rate of withholding** - Request a W-4P election form from OPM. Complete the form and return it to OPM or use the services online at <https://www.servicessonline.opm.gov/> or call the automated self-service telephone system at 1-888-767-6738.
- **To later cancel your tax withholding** - Send a completed W-4P or a signed letter (including your Civil Service Annuity (CSA) number and signature) to OPM or use the services online at <https://www.servicessonline.opm.gov/> or call the automated self-service telephone system at 1-888-767-6738.
- **It is not mandatory for you to have taxes withheld from your monthly annuity** - However, you must file an estimated return to the IRS if less than 90 percent of the Federal income tax due during a year is withheld from your income. You will be liable for the full amount of the taxes when they become due and may incur an additional interest penalty if sufficient taxes were neither withheld from your income, nor paid to the IRS in advance as estimated payments.

State Income Tax:

In many instances your annuity is also subject to State tax, unless you live in a State that has no personal income tax law or a State that exempts Federal annuities from State tax. Retirees are encouraged to contact their State taxing authority to determine if their Federal annuity is subject to State Income tax.

Some States that tax Federal annuities participate in a program that allows OPM to withhold the tax directly from your annuity. If you live in one of the States shown below, you should contact OPM to have your State tax withheld from your annuity.

Arizona	Arkansas	California
Colorado	Connecticut	Delaware
District of Columbia	Georgia	Idaho
Indiana	Iowa	Louisiana
Maine	Maryland	Michigan
Minnesota	Mississippi	Missouri
Montana	Nebraska	New Jersey
New Mexico	North Carolina	Ohio
Oklahoma	Oregon	Rhode Island
South Carolina	Utah	Vermont
Virginia	West Virginia	Wisconsin

You must specify the monthly amount of State tax that you want withheld. Deduction amounts must be in whole dollars. The minimum monthly amount OPM is able to withhold is \$5.

Your State tax deductions will be reflected on the notice of annuity adjustment mailed when payments change and will be included in your annual statement (Form 1099R) used for income tax filing purposes. However, state tax deductions will not be taken from interim partial annuity payments. These are payments made to retirees before final adjudication of their retirement application. As an annuitant receiving full payments, you may start, change, or stop State tax deductions by using the services online at: <https://www.servicesonline.opm.gov/> or call the automated self-service telephone system at 1-888-767-6738. When calling, you will need your CSA number and your Social Security number.

Caution: This handout provides information as it relates to Federal Annuity tax liabilities. Remember when you are planning and calculating retirement income additional tax deductions may be required for your, Thrift Savings Plan and Social Security if applicable.