

# How To Get Your Tax-Exempt TSP Money In To A Roth IRA

The Federal Thrift Savings Plan (TSP) is the “401K” for military and other federally employed physicians. It is a great retirement plan, with minimal expenses (2-3 basis points total), and 5 great index funds, plus a bunch of Lifecycle funds similar to Vanguard’s Target Retirement funds. Their G Fund is a unique investment that provides intermediate term treasury yields while taking money market risks. The TSP even recently implemented a Roth option.

## Tax Exempt TSP Money

When deployed to a war zone as a military doctor, you are given the option to contribute money to the TSP above and beyond the \$17,500 annual limit. This money is (mostly) earned tax-free because you’re in a war zone. When it comes out of the TSP in retirement, it also comes out tax-free, but the earnings from it do not. It turns out that this acts like a non-deductible IRA, which is really inferior to a taxable account unless you’re going to hold on to it for many decades. But there is a way to get that tax-exempt money OUT of the TSP, and into a Roth IRA. All of the research I have done on this indicates it to be completely legal, but you’re not going to get any help from the TSP, the IRS, or a Roth IRA provider like Vanguard on this. Here are the required steps.

## Separating Tax-Exempt TSP Money

First, make sure it actually makes sense to contribute tax-exempt money into the TSP. If you have better uses for the money, such as regular traditional or Roth TSP contributions, contributions to Roth IRAs, contributions to your spouse’s 401K, high interest debt, or even the [Savings Deposit Program](#) (SDP) you probably are better off using the money for that

rather than sticking it into the TSP.

Second, get deployed. You ideally want to max out your TSP contributions for the year PRIOR to deploying or AFTER returning, so that the tax-exempt money is going in to the TSP in addition to the regular contributions. January to January deployments make this hard. Go to finance and make sure they're doing the right thing with your money. It'll likely require multiple trips if you're like most of us.

Third, get out of the military. You can't pull TSP money out until after you separate from the military.

Fourth, [transfer almost all your TSP money](#) out to a traditional IRA. If some of it is Roth, then I suppose that portion would go to a Roth IRA. The Roth TSP wasn't available when I did this. I left \$200 in the TSP. Keep in mind you can only do a partial TSP withdrawal like this ONCE.

Fifth, [transfer an amount equal to your tax-deferred money](#) (your total minus your tax-exempt money) BACK into the TSP. The TSP DOES NOT permit the transfer of "post-tax money" (such as those tax-exempt deployment contributions) so the only money that goes into the TSP is the tax-deferred money, leaving you a traditional IRA with the basis equal to the value.

Sixth, You then convert this IRA to a Roth. There should be no tax bill for this.

When all is said and done, you've essentially taken the tax-exempt TSP money out of the TSP and put it into a Roth IRA, while leaving the rest of the money inside a great retirement plan. Now instead of earnings on that money being fully taxable, it is now completely tax-free forever. My tax-exempt contributions were about \$25K. Over the next 40 years at 8%, that might save me as much as \$171K in taxes.

**Beware The Step Transaction Doctrine**

You should be aware there is some risk that the IRS could consider this illegal due to the [step transaction doctrine](#). This is the same issue [some people have](#) with the [backdoor Roth IRA](#). Basically, if a series of steps, although all legal by themselves, are simply a means of performing an illegal action, then they're all illegal. Frankly, I don't think anyone at the IRS cares about stuff like this (they're too busy chasing down Tea Party groups and partying), and even if they did, I could afford it. I'm also not sure how they'd figure out I did all this from what gets reported on my taxes from the whole process. It looks very clean on your tax forms. I haven't heard of the IRS having any kind of a problem with this, but I confess I'm the only person I know who has ever done it. Certainly many people have used similar methods to [isolate the basis in their 401Ks](#).

### **Issues with the Roth TSP**

Now that the [TSP has a Roth option](#), most military docs should be using it. Not only does it allow you to shelter more money (\$17,500 after-tax is more than \$17,500 pre-tax), but the marginal tax rate for military docs is often comically low, especially in a year with a deployment. I believe the tax-exempt money is always considered to be put into the tax-deferred portion of the TSP, so even if all your other contributions were Roth, you'd still have fully taxable earnings in the tax-deferred portion. It would still be worthwhile isolating your basis using this method. The TSP is still considering allowing [in-service conversions](#), but hasn't reached a decision yet.

Those separating from the military with tax-exempt money in the TSP should consider isolating the basis to convert that tax-exempt money to Roth money.

What do you think? Have you isolated basis before? Do you have tax-exempt TSP money? Comment below!