

Bankruptcy Information

Petitions filed on or after October 17, 2005

This fact sheet explains how a bankruptcy petition filed on or after October 17, 2005, will affect a Thrift Savings Plan (TSP) account, loan, or in-service withdrawal. (For bankruptcy petitions filed *before* this date, refer to the fact sheet Bankruptcy Information — Petitions filed before October 17, 2005.)

How are funds in my TSP account affected by a bankruptcy?

The TSP is a tax-deferred retirement savings plan for Federal employees and members of the uniformed services. It is similar to retirement plans authorized under section 401(k) of the Internal Revenue Code. (See 5 U.S.C. §§ 8351, 8401-79.)

The funds in your account are held in trust for you by the TSP and are protected from the claims of creditors by a law which provides that the funds “may not be assigned or alienated and are not subject to execution, levy, attachment, garnishment, or other legal process.” (See 5 U.S.C. §§ 8437(e)(2).) This provision is enforceable in a bankruptcy action by virtue of 11 U.S.C. § 541(c)(2). Consequently, your TSP account cannot be made a part of your bankruptcy estate.

Is my TSP loan a debt?

No. The bankruptcy law states that a TSP loan is not a debt. (See 11 U.S.C. §§ 362(b)(19), 523(a)(18) (2005).)

Can my TSP loan be discharged in bankruptcy?

No. The bankruptcy law states that a TSP loan cannot be discharged (i.e., closed) in bankruptcy. (See 11 U.S.C. § 523(a)(18)(B) (2005).)

Must I stop my TSP loan payments when I file for bankruptcy?

Both a chapter 7 and a chapter 13 bankruptcy action will not affect your obligation to repay a TSP loan. Therefore, under either type of bankruptcy, you must continue making loan payments as provided in your Loan Agreement. This is because a TSP loan is not a debt and the TSP is not your creditor, so the bankruptcy court does not have jurisdiction over your TSP loan.

What will happen to my account if I stop my TSP loan payments?

When you borrow from your TSP account, you agree to repay the money to your account, with interest, by making regularly scheduled loan payments through payroll deductions. (See 5 U.S.C. § 8433(g); 5 C.F.R. part 1655.)

If you stop making loan payments for any reason other than approved nonpay status, the TSP will send you a notice explaining how to bring your loan payments up to date. If the bankruptcy court does not permit you to bring your loan payments up to date, the TSP must close your loan account and report the unpaid loan balance to the Internal Revenue Service (IRS) as a taxable distribution to you. Besides having to pay income taxes on the amount of the distribution, you may be subject to a 10 percent IRS early withdrawal penalty.

Once a TSP loan account is closed, it cannot be reopened and the outstanding balance cannot be returned to the TSP. In addition, you cannot apply for another TSP loan for 12 months from the date a taxable distribution is declared.

Note for members of the uniformed services: TSP accounts for members of the uniformed services may include contributions from pay subject to the combat zone tax exclusion. If the TSP declares a loan to be a taxable distribution, any portion of the outstanding loan balance that is attributable to tax-exempt contributions will not be subject to Federal income tax or the 10 percent early withdrawal penalty.

Can I temporarily suspend loan payments during my bankruptcy action?

No. The IRS requires the TSP to close a loan account and issue a taxable distribution if payments do not continue under the terms of the Loan Agreement.

Can the bankruptcy court change the terms of my TSP Loan Agreement?

No. The bankruptcy law states that the bankruptcy court cannot change the terms of your TSP loan. (See 11 U.S.C. § 1322(f) (2005).)

However, if your loan is in good standing, you can ask the TSP if you are eligible to reamortize your loan and change your payment amount or shorten or lengthen your loan term within the loan's maximum term limit.

Can I obtain a financial hardship in-service withdrawal during my bankruptcy action?

The answer to this question depends on whether you file for bankruptcy under chapter 7 or chapter 13 of the Bankruptcy Code.

A chapter 7 bankruptcy action does not affect your ability to obtain a financial hardship in-service withdrawal.

However, if you are a debtor in a chapter 13 bankruptcy, you are only eligible for a financial hardship in-service withdrawal if you have unpaid medical expenses, a casualty loss, or unpaid legal fees incurred for a separation or a divorce. (See Form TSP-76 or TSP-U-76, Financial Hardship In-Service Withdrawal Request.) You are not eligible for a financial hardship in-service withdrawal based on negative net monthly cash flow. Such a withdrawal is only available if you can demonstrate that your net monthly income is insufficient to pay ordinary monthly household expenses, and, in a chapter 13 bankruptcy action, the bankruptcy court will ensure that you have sufficient funds to pay living expenses.