



Information on
Computing the Tax Free Portion of a Phased Retirement Annuity
and
Subsequent Composite Retirement Annuity

The following information on how to determine the tax free (*excludable from income for tax purposes*) portion of your monthly annuity is based on updates to Publication 721, “*Tax Guide to U.S. Civil Service Retirement Benefits*,” published on February 27, 2017. Publication 721 references *IRS Notice 2016-39. Notice 2016-39* and *2016-26 Internal Revenue Bulletin 1068*, published June 27, 2016, address the tax treatment of phased retirements. The IRS Notice applies to the taxation of phased retirement annuities payable under CSRS and FERS. Please note that OPM cannot provide you with tax advice or information to determine how you should compute or pay your Federal income taxes. For up-to-date information on computing your taxes, you should contact your tax advisor or your local IRS office.

Section 1: Tax Free Portion on Monthly Annuity under Phased Retirement

In most non-disability retirements, a portion of each annuity payment is taxable and a portion is a tax-free (*excludable from income*) return of your Retirement Contributions (*including any payments on deposits and redeposits*) to the retirement fund. To compute the portion that is excludible from income for tax purposes on a phased retirement annuity, use a formula to obtain your tax-free monthly percentage. This formula consists of your Retirement Contributions, the present value factor for your age at entry into phased retirement, and the amount of the **full** monthly gross life rate that would have been payable had you fully retired and elected a life annuity in lieu of a survivor benefit.

The tax-free percentage is derived by dividing your Retirement Contributions by the initial amount of your full gross monthly life rate annuity multiplied by the CSRS or FERS present value factor for your age as of the effective date of phased retirement.

Total Lump Sum Credit

Full gross life monthly annuity x (CSRS or FERS) Present Value Factor = tax-free percentage
The tax-free percentage is then applied to your Gross Monthly Phased Annuity to find the monthly tax-free portion.
Gross Monthly Phased Annuity x tax-free % = Monthly Tax Free Amount

Your Retirement Contributions can be found in **Part I** on your Annuity Statement. The amount of your initial full gross monthly life rate annuity can be found in **Part IV** on your Annuity Statement. The amount of your monthly phased annuity can be found in **Part II** on your Annuity Statement. Present Value Factor charts can be found at the OPM retirement website: <https://www.opm.gov/retirement-services/phased-retirement/>. (“**Present Value Factors**” Tab)

Example
Total Retirement Contributions Amount: \$95,000
CSRS Present Value Factor based on Age 58 at Phased Retirement Annuity Commencing Date of June 1, 2015: 236.5
Full Gross Monthly Life Rate Amount: \$3609.00
Phased Gross Monthly Amount: \$1752.00

Finding the Tax-Free Percentage: The tax-free percentage equals the Total Retirement Contributions (\$95,000) divided by the full monthly life rate times the present value factor for age 58 at retirement (\$3,609 times 236.5)

\$95,000	\$95,000	= 11.1% (.111)
\$3609 x 236.5	\$853,528.50	

Finding the Tax-Free Portion of the Phased Retirement Monthly Annuity:

The tax-free percentage is then applied to the gross monthly phased annuity amount: $\$1,752 \times .111 = 194.47$

The initial tax-free portion of the phased retirement monthly payment is \$194.47.

The tax-free percentage will always remain the same even though the Gross Monthly Phased Amount may change. The percentage must be applied any time the gross monthly benefit changes (*such as for Cost of Living Adjustments, known as COLAs*).

For instance, in this example, let's say that on December 1 of the year following the phased retirement, the phased monthly amount of \$1752 was increased to \$1795 by a 2.5% COLA. The tax-free percentage of 11.1% will be applied to \$1795 to yield a tax-free amount of \$199.25 ($\$1795 \times .111$).

Section 2: Final Retirement Status “Composite Annuity” Tax Free Portion

Computing the tax-free portion on your composite retirement annuity involves the Simplified Formula adjusted for the total tax-free amount allowed for the phased retirement. The components for the Simplified Method consist of:

- your total Retirement Contributions (*including payments on any deposits and/or redeposits*) for the entire service period;
- the correct tax table from Publication 721 showing an age factor for you as an annuitant with or without a survivor benefit;
- your new gross monthly composite annuity rate;
- the total tax-free amount you received during phased retirement.

To compute the tax-free portion for a composite annuity, we take the total Retirement Contributions for the composite annuity and subtract out the sum of all monthly tax-free amounts accrued during the phased retirement (*i.e., Total Tax Free Portion of Phased Retirement Annuity*). This amount is then divided by the age factor from the appropriate tax chart for the Simplified Method in IRS Publication 721. The result is the tax-free amount on the monthly composite annuity.

Example	
Annuitant's Age:	58 years
Spouse's Age:	57 years
Combined Age of 115 on Simplified Method Table 2 of Publication 721:	360
Retirement Contributions At Phased Retirement:	\$67,950.22
Additional Retirement Contributions During Phased Retirement:	\$9,060.52
Total Retirement Contributions:	\$77,010.74
Total Tax Free Portion of Phased Retirement Annuity:	\$6,405.33
Retirement Contributions Credit for Simplified Method: ($\$77,010.74$ minus $\$6,405.33$)	\$70,605.41
Simplified Method Number (<i>from tax chart with survivor</i>):	360
Tax Free Portion of each Composite Payment (<i>for 360 payments</i>): ($\$70,605.41 \div 360$)	\$196.13
Note: The Retirement Contributions Credit for Simplified Method can be found in your Retirement Booklet.	

Section 3: Subsequent Retirement with a Phased Retirement Component

Whenever there is a phased retirement component and a subsequent retirement, regardless of the type of final retirement, the tax-free monthly amount of the final retirement must be determined as explained in Section 2 of this notice.

More Tax Information

For more tax information, please visit the IRS site at: <https://www.irs.gov/pub/irs-irbs/irb16-26.pdf>