

Information for Eligible Career Status Bonus (CSB) Members

Introduction:

Soldiers eligible for the Career Status Bonus (CBS)/REDUX Retired Pay Option, will have the choice of selecting the High-3 Retirement System or electing a \$30,000 CSB and remaining subject to retirement under REDUX (CSB/REDUX). **In other words**, soldiers with either chose to remain under REDUX and accept a bonus or accept the High 3 option.

Eligibility Requirements:

1. Be on active duty
2. Complete 15 years of active duty service
3. Have a DIEMS / DIEUS (Date of Initial Entry to Military / Uniformed Service) that is August 1, 1986 or later, and
4. Qualify under Service regulations for retention to 20 years of active duty service.

It's Your Decision:

The bonus election decision is a personal decision. It is recommend that you make it on the basis of your personal perspective -- how you see things! Be certain you take a good look at the risks that may be involved. At the same time, it is suggested that you consult several sources to get a variety of viewpoints and preferences. You may use the Employee Assistance Program for financial counseling. For an appointment, call 1(800) 222-0364.

OVERVIEW

- (a) If you are a CSB-eligible member:
 - (1) Assess your personal career expectations,
 - (2) Determine your probable use of any bonus money,
 - (3) Decide what kind of risk you're willing to tolerate,
 - (4) Work through at least a basic analysis of the options,
 - (5) Discuss the decision with two or more advisors that you trust.
- (b) Recommended CSB/REDUX decision analysis tools on line are located at <http://militarypay.dtic.mil> and <http://pay2000.dtic.mil>.) The web site allows "what-ifs" to let you see results using your own circumstances and expectations.
- (c) The following is a description of CBS/REDUX options basic outcomes for specific assumptions and highlights of important considerations.

THE \$30,000 CAREER STATUS BONUS (CSB)

The CSB and Taxes: If you elect the bonus, you will receive a \$30,000 one-time lump-sum payment, normally about the 15th year of active duty service. Taxes on the bonus may vary significantly depending on your personal Federal tax bracket, applicable state taxes, and opportunities to avoid tax. This can have a big effect on the future value of the bonus money. One important tax possibility is that the entire bonus may be tax exempt for an enlisted member if the election is made effective while serving in a combat zone or Qualified Hazardous Duty Area (QHDA). This one-time

tax exclusion does not exempt from taxation any future earnings on this money even if you continue to serve in a combat zone or QHDA.

Options and Implications: What you do with the money is important! There are three basic choices as we see it:

- (1) **Spend it outright** on a car, vacation, or similar item. You might have a great vacation or a really nice car, but the money will be gone and the value of what you bought will either be gone immediately, or at best will depreciate quickly. **You'll give up the potential for investment earnings and may have nothing available to meet future needs.** On the other hand, spending the money outright may allow you to avoid further debt or eliminate a significant amount of current debt. In this case, you could analyze such spending more as an investment than as an outright expense that has no future value. Be careful of your assumptions and projections in this kind of comparison.
- (2) **Put some of it in the Uniformed Services Thrift Savings Plan (UNISERV) and/or other tax sheltered investments** -- This option is currently pending and exact rules on eligibility have not been resolved for those who are able to elect CSB/REDUX before the UNISERV begins in January 2002. Members eligible to make a CSB/REDUX election may defer their decision until March 1, 2002, if otherwise due before that date, thus enabling such members to deposit some of the CSB in their UNISERV account. Check back with your military personnel and finance counselors to determine the options available to you before you make your final decision.

A UNISERV for military personnel is expected to be in place about January 1, 2002, with an expected \$10,500 annual contribution limit. This limit is periodically adjusted in \$500 increments. Qualified income deposited in the UNISERV is not taxable as income for the year in which paid. The deposit amount and subsequent earnings are only taxed when withdrawn. This lets your investment start with a larger base and grow faster than it would if you had to pay taxes on the earnings each year. You will have to be a UNISERV participant, already depositing a portion of your basic pay each month, in order to also deposit any of the CSB. If you are participating in the UNISERV with annual contributions of basic pay totaling \$1,500 you could deposit \$9,000 of the CSB into the UNISERV.

You will be able to put more of the CSB into the UNISERV if you qualify for a QHDA or combat zone tax exclusion when you make your election. In this case, any portion of the CSB not counted as taxable income can be deposited in the UNISERV up to a total annual contribution limit equal to the lesser of \$30,000 or 25 percent of total annual compensation

There are other investments with tax advantages that may be equal to those of the UNISERV, such as a Roth or traditional Individual Retirement Account (IRA). The advantages and restrictions vary with your personal situation, so you should see a trained advisor for details.

- (3) **Other Investments of After-Tax CSB Balance** -- Other choices for investing abound! You may want to put a down payment on a home, pay off some debt, improve your education, or invest in a business of your own. The risk associated with some of these investments may be considerable, but the potential return could also be substantial. Some, or all, of your investment earnings may be subject to income tax each year, which will tend to reduce your accumulated investment and rate of growth. Tax treatment of investment earnings may vary widely but must be considered to accurately assess their value. **All the more reason to seek advice from a capable and trusted source.**

Basic Considerations:

We want to emphasize that we can't show you the risk for any given option. You must decide the risk potential and how you will let that risk influence your decision. Generally, higher potential returns carry a higher risk. That said, there are three important lessons illustrated by these examples:

- (1) **The rate of return on an investment is crucial to the future value of that investment, with only a small difference (8% versus 10%) having a substantial impact.** You should base your decision on a rate of return that you feel is reasonable for you, or at least one where you can recognize and accept the risk. Rates of return less than 8 percent are normally achievable with a fairly modest risk. Rates greater than 8 percent have increasingly significant risk of earning less than expected, as well as the potential to lose a portion of the original investment (or even all of it in some cases).
- (2) **Putting less in tax-deferred investments (Option 2) can substantially reduce the future value of available assets.** Of course there are limits as to how much you are allowed to put in tax-deferred investments. However, the UNISERV and IRAs have a significant advantage that you should not overlook. This doesn't mean you can't do better. But if you don't take full advantage of these options, make sure you know and understand what you're missing.
- (3) **Spending the money outright (Option 3) can dramatically diminish your future assets because that money can't produce future earnings.** We spent the money on a vacation so there is no residual value to the money after the first year. Once the money is spent on something consumable, that is the end of it. This is a major factor in evaluating the bonus. Such spending uses the bonus and leaves you with less money for the future than you would have if you stuck with the High-3 retired pay.

These examples are just a sample of what you can do with the bonus payment. Obviously, the possibilities are unlimited and the risks can be significant. Of course, these investment options must be weighed against the prospective differences in retired pay that will result if you take the bonus and receive retired pay under the REDUX system versus the High-3 system.

REDUX RETIRED PAY VERSUS HIGH-3 RETIRED PAY

Differences in Retired Pay: If you elect the CSB, you must:

- (1) Agree to remain on active duty until you have 20 years of active duty service, and

- (2) Have your future retired pay computed under the provisions of the 1986 Military Retirement Reform Act (1986 MRRA, also called **REDUX**). For computation please refer to the CBS/REDUX comparative examples.

CONSIDERATION OF RISK AND OTHER FACTORS

The future won't turn out exactly as we assume in any analysis. You should think about the risk of things not turning out the way you expect. Only you can decide how much risk, and what kind of risk you're willing to tolerate. To do this, you should get a feeling for the effect of certain factors.

Inflation: Inflation will mainly affect the COLAs you get in retirement. However, the net difference between the High-3 and REDUX isn't too sensitive to the actual inflation because the difference is always 1%, or less if inflation is less than 1%. REDUX provides less retired pay in every case, but for a given career, the rate of inflation will have only a minor effect on the difference between REDUX and High-3. Inflation may affect the investment rate of return, but unless inflation is significantly higher than it has been any time recently, the bottom line is not likely to change due to a misestimate of inflation.

Age at Retirement and Length of Military Career: Generally, the longer you stay in service and the older you are at retirement, the more attractive you will find the CSB/REDUX option. This may have a big impact on your decision. Hopefully, you have a good feel for how long you want to stay in service and the probability that you will be allowed to stay that long. The percentage difference in High-3 versus REDUX retired pay gets smaller for each additional year of service. Not only is the multiplier reduction less, but there are fewer years until the reduction is removed at age 62. Invested wisely, the CSB grows with each passing year, and can be worth much more by the time you actually retire.

Increased Rates of Retired Pay Due to Pay Scale Increases and Higher Grade at Retirement: Working in the opposite direction of longer service are those factors that result in a higher initial level of retired pay for a given length of service. This would include the pay scale growing faster than inflation and any promotion or higher base due to greater longevity on the pay table. The greater your initial retired pay for a given length of service, the more dollars you will lose with the CSB/REDUX. These factors work in the opposite direction of age and length of service, so you need to look carefully at your expectations and see how all of the factors play out together.

Return on Investment: We mentioned this before, but it bears repeating. If you take the CSB, your allocation of the money and the rate of return on any investment will drive the future value of this option. If you can earn enough on your bonus investments, the CSB/REDUX would be attractive, but the higher your assumed rate of return, the greater the risk that you won't get that much. The assumed rate of return will affect a comparison of the bonus option with the extra retired pay under the High-3 system.

Failure to complete 20 years of active service: If you elect the bonus and fail to reach 20 years of service as agreed, you will be required to repay the percentage of the CSB that is equal to the percentage of service you failed to complete compared to what you agreed to serve. Repayment will be waived in the event of death, disability retirement, separation under a Service early out program,

or other cases based on equity and good conscience. Repayment may be withheld from any money to which you are otherwise entitled.

Your Choice: All-in-all, the choice is not simple. You will want to put enough effort into the decision to make yourself comfortable with your choice. Once your decision is made, work to make that choice deliver as much for you as possible. Be forward looking and don't try to second-guess yourself after the fact. Best wishes and good luck!

One Last Thought: We urge you to spend time making your decision. There is a lot of complicated information to digest. Particularly, we urge you to visit our web site at <http://militarypay.dtic.mil>. (Expected to come on line in February 2001. Until then, information for understanding and analyzing the CSB/REDUX choice will be available at <http://pay2000.dtic.mil>.) If you play with this for awhile and study the results, you will get a feel for what factors might most affect your decision and how.