RETIREMENT

HOW TO TAKE PENSION BENEFITS

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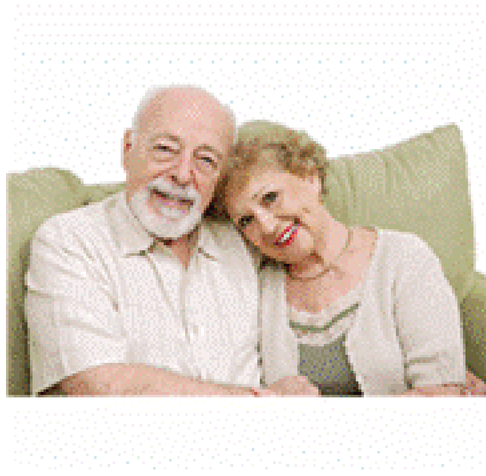


Many people, in an attempt to provide for a spouse, choose to receive the smallest amount of income while they are living, with the expectation that they will die first and there will be more financial security of a loved one. What happens if the spouse dies first? You are stuck with lower payments than you are entitled to and the company is the winner. On the other hand, if you are uninsurable and your spouse has no other protection then you have a valid reason for taking less than 100 percent of your pension. Thankfully that is not is a not as ordinary circumstance.

In a majority of cases it would be better to take the difference between high and low pay out options and buy a term life insurance policy with a portion of it to provide for the surviving spouse. In that way, even if your spouse dies first, you are still entitled to the highest pay-out and on his or her death and you can simply cancel the term policy on your own life.

Under ERISA (Employee Retirement Income Security Act) the normal annuity form is at least a joint and one-half survivor annuity unless the covered employee does something about it. I you want a single life annuity you must elect it under the rules set forth in your pension plan. Just consider the following example before deciding.

SINGLE LIFE ANNUITY

Xavier and Yvonne, both retired from their jobs and elected to take 100 percent of their benefits with no survivorship rights. Xavier was entitled to $500/month or $6,000/year and Yvonne was entitled to $400/month or $4,800/year. They drew pensions for ten years receiving a total of $108,000 during that time.

JOINT AND ONE-HALF SURVIVOR ANNUITY

Abigail and Bruce were co-workers of Xavier and Yvonne and retired at the same time but decided to take the 50% payment with survivor benefits. Abigail was entitled to $500/month or

$6,000/year and Bruce was entitled to $400/month or $4,800/year but they each received half or together $54,000 over a ten year period.

At the end of the tenth year Xavier and Abigail both died. Yvonne received $400 instead of sharing the $900/month as before, while Bruce continued to receive $450 as always. Bruce and Abigail both died at the end of another five years. Their respective benefits from the company had been.

	Yvonne	Bruce
1st 10 yrs.	$108,000	$54,000
next 5 years	$24,000	$27,000
	$132,000	$81,000

As you can see above, even though both couples are entitled to the same pension dollars, Xavier and Yvonne, who chose the pure annuity, came out ahead in this example.

LUMP SUM

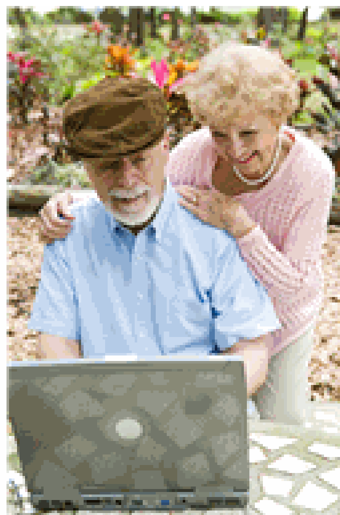
A lump-sum distribution must be made within one year and must consist of everything the employee is entitled to with no credit remaining in the plan. The portion attributable to the employee's pre-1974 (ERISA) service is taxable as long-term capital gain. The part due to services from 1974 on is taxed as ordinary income. It can be divided by ten and then have the applicable single-individual rate tax table applied (even if the employee is married with dependents.) The resulting figure is then multiplied by ten to find the tax. The Tax Reform Act of 1976 gave the participant a new election to treat both portions, pre-as well as post-1974, as ordinary income subject to the ten-year-averaging formula. This gets more complicated than I

have stated and is something to bring up with your accountant. Where contributions are made by an employee they are made with after-tax dollars and are not therefore taxed again upon distribution. If the distribution is made to a sole beneficiary, upon the employee's death there is a special employee death benefit you should be aware of. The first $5,000 of the otherwise taxable benefits are received by the beneficiary free of all taxation.

If the proceeds are to be kept out of the deceased employee's estate (free of federal estate taxes) the beneficiary must have the tax advantages normally accorded such a lump-sum distribution, namely capital gains treatment and ten-year-averaging. The choice of having the proceeds taxed as ordinary income but kept free of estate taxes or having the ten-year-averaging and capital gains advantages applied to the proceeds and subjecting them to possible estate taxation, can only be made by analyzing each individual case to determine which election would result in the greatest tax savings. Any death benefits attributed to the employer's contributions are not included in a deceased employee's estate. More will be said about estate taxation later.

If you change jobs and receive the pension benefits that you are entitle to (vested) from your old job, you can keep them and do what you like with them but they are taxed as ordinary income during the year received with no special treatment allowed. If you want to avoid such taxation, you can, within sixty days of receipt, reinvest the process in an IRA account without tax consequences. These partial roll overs are allowed with means you can keep and be taxed on a portion of the distribution and reinvest the rest within the sixty day limit.

ANNUITY



Annuity distribution is a term applied to all ways of receiving benefits other than in lump-sum. Inflation prior to 1983 wreaked havoc with the purchasing power of retired persons receiving payments from a fixed dollar annuity so new variations of the fixed annuity were developed. Some plans attempted to tie annuities to some sort of price index so the purchasing power of the

retiree would remain relatively constant. The variable annuity plans have the same goal and attempt to win their battle over the erosion of the pension dollar by investing pension contributions in a segregated portfolio for equity securities; the idea being that these is a correlation between the cost of living and the other equity investments. Of course, the possibility of greater growth is accompanied by greater risk and possible loss of capital.

Your premium dollars purchase units whose value fluctuates with the market. Therefore, you, as annuitant, assume the investment risk when purchasing a variable annuity. The company is guaranteeing that you will not outlive your income in terms of annuity units. Whether those units are worth enough to live on depends on the rate of inflation. On top of this, insurance companies charge sales fees, sometimes up to eight percent of each contribution, and management fees usually totaling one half to one percent annually of the fund's net asset value.

In non-contributory plans, since the employer has contributed untaxed dollars to the employee's account, on distribution all the annuity payments will be taxed at ordinary income rates. The rules are rather complicated where contributory plans are concerned. Basically, the person entitled to the annuity figures the ratio of his investment in the plan to the anticipated return from the plan and excludes a like proportion of every annuity payment from his gross income. This is refereed to as the exclusion ratio. Your accountant or other tax professional can give you more details.

There is a simpler alternative though. If employees in the first three years receive an amount which is the same or more than their investment in the plan, they can exclude those payments from their gross income. Then, beginning with the fourth year, they simply treat all the future payments as gross income.

PROS AND CONS OF ANNUITIES

Annuities are a gamble that you will outlive your resources. If you have acquired a significant amount to work with and are a prudent investor, it is a gamble that would be hard to win. For example, if you invested $100,000 at ten percent you could pay yourself $10,000 a year indefinitely. The withdrawal would equal the income earned and the capital would constantly remain intact. Admittedly, that’s in a fairy-tale would of no taxes. If you were to raise the disbursement to yourself without increasing the earning power of your principal at the same time, your reserves would eventually dry up. But even by increasing your spendable proceeds by $2,000 a year ($10,000 to $12,000) the principal would last for eighteen years. You get the idea. Of course if you change the interest earned or the capital invested either up or down the results would naturally be more or less.

WHEN DOES DISTRIBUTION TAKE PLACE

Distribution can occur at normal or the employee changes jobs, is disabled or dies or if the plan itself is discontinued. Additionally some distribution can occur during an employee's illness, to pay medical expenses before or after retirement and even during periods when the employee is laid-off .

Disability causing premature retirement is planned for in some pension plans. There are various options: The disabled, under one option, can retire at an actuarially reduced level; another allows for a kind of severance pay based on a percentage of an employee's past earnings; or pension credits can continue to accumulate with the passage of time as if the employee were still on the job and his full retirement benefits would begin at normal retirement age.

SUMMARY

As you may have guessed, I do not favor annuities, even the new improved kinds. However, I'm sure your insurance agent will make a good case for the other side. Therefore I recommend you discuss the subject with your agent before making any decisions. Remember, to ask yourself just

what personal interest the advisor may have in your decision; will he stand to gain if you decide one way or the other? In the long run, it's all up to you. As the sign in a New York City cafeteria says I urge you to treat yourself to "Courteous and efficient self-service."

Worksheet

How To Take Pension Benefits

Read each statement and put a true or false after it.

1. In my family several members have lived past the age of seventy?_____

2. I don't mind the sales and management fees which accompany some

annuities._____

3. My retirement plan is a contributory plan._____

4. I don't want responsibility when I retire._____

5. I expect to live beyond the normal life-span._____

6. I am uninsurable._____

7. I don't think I could invest my money to keep ahead of inflation._____

8. My spouse is not the beneficiary of any insurance on my life._____

9. I like to feel I am being taken care of._____

10. My spouse has no independent assets._____

11. I don't like to manage my own investments._____

If you answered with a TRUE in nine or more cases annuities are right for you.

If you answered with a FALSE in seven or more instances consider taking the proceeds in a lump-sum and investing for your own account.

If you came out somewhere in the middle ask some more questions, do some reading and give your circumstances a little more thought.

Recommended Reading

Money for your Retirement, by John Barnes
Can We Afford Early Retirement? by Frank Kleicler
*Your Retirement Inco*me, by James Jorgensen
Money & Retirement, by LeClair-Leimber-Chasman
The Star Spangled Retirement Dream, by James Gollin

Web site for AARP http://www.aarp.org/