Lump Sum Pension Payment

A pension plan may have an option that allows you to take your entire pension benefit as a lump sum instead of receiving monthly payments. How do you make the best financial decision? When considering a lump sum, ask yourself the following questions: How is your health? Do you hve a family history of longevity? Are you good with money/investing? This life "checklist" will help you take into account your future financial needs.

Common Mistakes in Pension Calcuation

The first step in deciding between a lump sum or monthly payment is to review the information on your pension statement and make sure it is correct. Errors on your statement can cost you money! The Employee Benefits Security Administration provided the following list of common errors in pension plan calculations:

- Basic information such as birthdate, and/or Social Security number was incorrect.
- You failed to update your personnel office with changes (marriage, divorce, death of spouse) that may affect your benefits.
- The calculation was not based on all of your years of service with the company, or all work within different divisions.
- The pension plan administrator used an incorrect benefit formula, such as a wrong interest rate, or made basic mistakes in teh mathematical calculation.
- Your company merged with another company, or went out of business, and there is confusion over which pension benefits you qualify for.
- Your employer failed to make the required contributions on your behalf.

Disadvantages to Lump Sum Payments

- If you or your husband takes a lump-sum payment, you may lose your retiree health insurance – sometimes right away, sometimes after your husband dies.
- If you and your husband decide to take a lump-sum benefit and invest it yourselves, you will not have widow’s benefits if he dies before you (and vice-versa).

Advantages of Monthly Payments

Advantages of opting for a monthly payment and not taking a lump sum include:

- You will receive a guaranteed monthly annuity for your lifetime.
- You will not be responsible for managing the investment of your lump sum payment.
- You will not be tempted to spend part or all of the lump sum instead of rolling it over.

When You Don’t Have a Choice

In certain circumstances, a pension plan can require you (without your consent) to take your pension in a lump sum when the present value of the pension you have earned is less than $5,000.

- The pension plan must follow federal tax law regulations that state the interest rates the plan must use to calculate the present value of the pension.
- However, if the present value is greater than $5,000, you and your spouse must both consent to take the benefits in a lump sum.

Rolling Over Can Avoid Tax Penalties

If you receive a lump sum pension payment, you will have to pay taxes on the payment unless you roll it over into an individual retirement account (IRA) or other eligible plan. (For example, if you are changing jobs and your new company’s pension plan accepts transfers.)

- You can roll all or part of the lump sum payment into an IRA and defer paying taxes on that amount. Your pension plan can either transfer the payment directly to the IRA or send you a check, which you then put into an IRA or other eligible plan.
- If the plan directly transfers the lump sum payment, it will not withhold taxes.
- However, if the plan sends you the payment, it is required by law to withhold 20% for income taxes, even if you will not owe that amount on your income taxes. (You must then come up with the dollar amount of the 20% withholding and roll that over, or you will be liable for taxes on that amount.)

Tax Penalty for Receiving Payment Before Age 59 ½

In addition, if you receive a payment before you are 59 ½ years old and you do not roll it over, you may have to pay an additional 10% tax on the payment. There are several exceptions, and you should check with the Internal Revenue Service to see if you qualify. Generally, the exceptions include receiving payment:

- because you have left an employer and you are over age 55;
- for disability retirement;
- in equal monthly payments over your lifetime (early retirement); or
- for certain medical expenses.

Tips for Protecting Your Pension

To safeguard your pension until retirement, the following tips from the Employee Benefits Security Administration will help keep you on track:

- Know your pension plan. Obtain and review your Summary Plan Description (SPD), the rulebook for your pension.
- Review your individual benefit statement and individual account information. Know what your accrued and vested benefits are.
- Maintain a pension file. Keep records of where you've worked, dates you've worked there, your salary and any plan documents or benefit statements you've received.
- Notify your plan administrator of any changes that may affect your benefit payments (i.e., marriage, divorce, death of a spouse.)
- Know how the merger or acquistion of your company will affect your pension benefit.

Have questions about your retirement plan? Not sure where to turn for help? *PensionHelp America can connect you with counseling projects, government agencies, and legal service providers that offer free information and assistance. PensionHelp America is a resource of the* ***Pension Rights Center****, a nonprofit consumer organization dedicated to protecting and promoting the retirement security of workers, retirees, and their families. Find them at www.pensionshelp.org.*

The **Women's Institute for a Secure Retirement (WISER)** is dedicated to education and advocacy to improve the long-term financial quality of life for women.

Article Source
Women's Institute For A Secure Retirement
Source URL
https://www.wiserwomen.org
Last Reviewed
Thursday, January 7, 2021