TAX YEAR
2023

Pension Income Planning

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Pension Income Planning

An employee nearing retirement may face a dilemma when it comes to choosing his or her pension. Pension options from a defined benefit retirement plan generally include a lifetime payment with no survivor benefit, a joint and 50% survivor payment, or a joint and 100% survivor payment. The joint and survivor benefits are reduced amounts from the lifetime payment option.

Predicament

If the employee selects the lifetime payment and then dies before the surviving spouse, no monthly pension will be left for the spouse. If the employee selects one of the survivor options, and the spouse dies before the employee dies, the employee will be locked into the lower payout for the rest of his or her life.

The amount of potential loss of income can be devastating to the retired employee or spouse. Emotionally, an employee may be inclined to choose one of the pension options that give an ongoing benefit to his or her surviving spouse. However, this may not be the best financial decision.

Example: *Henry, age 65, will be retiring soon. He and his wife, Louise, also age 65, are reviewing his pension options.*

Option	*Monthly Pension*	*Survivor's Monthly Pension*
Life	$2,000	$ 0
50% survivor benefit	$1,600	$ 800
100% survivor benefit	$1,200	$1,200

If Henry chooses the life option and subsequently dies, Louise will be left without any portion of his pension. With the 50% survivor benefit, Henry would have $400 less per month than the life option, and Louise would receive a pension of half of Henry's if Henry were to die. With the 100% survivor benefit, Henry would receive $1,200 per month and if he were to die, Louise would receive $1,200 per month.

Insuring the Pension

An employee who is in good health could consider purchasing a life insurance policy that will provide a death benefit to the spouse in the event the employee dies and leaves the spouse without a continuing pension payout. The spouse can then use the death benefit from the insurance policy to create an ongoing income for the rest of his or her life by purchasing an immediate annuity. This income could replace all or some of the amount of income the pension could have provided. This would allow the employee to select the lifetime payout option for the pension.

Retired employee's death. If the retired employee dies after choosing the lifetime payout and a life insurance policy, the lifetime payout from the pension will cease. The life insurance will then be paid to the beneficiary income-tax free. The spouse could use the death benefit from the life insurance to purchase an immediate annuity that would generate guaranteed lifetime income.

Spouse's death. If the employee's spouse were to die before the retired employee, the retired employee would have several options. First, the lifetime payout would continue on for the retired employee (at the full amount as no survivor benefits were chosen). The life insurance could be continued for other beneficiaries, such as children, or the policy could be modified to provide a reduced paid-up insurance amount, or the policy could be terminated completely and any cash value returned to the retired employee.