

Retirement plan payout options: A spectrum of choices

As you approach retirement, an extremely important decision awaits you. How do you take a payout from your retirement fund or funds?

One end of the spectrum offers a lump sum distribution, which you either take in hand or roll over into an IRA. At the other end of the spectrum lies the annuity. Annuities provide the security of a contract purchased from an outside provider that statistics say you can't outlive. And in between are a variety of other options that may be available to you.

Some distinctions and background

Not all types of plans are "true" retirement plans as defined by the IRS, even if they have the same effect or goal that you seek. For example, such arrangements as defined contribution money purchase pension plans and 403(b) retirement plans (plans that cover employees of public schools, tax-exempt organizations, etc.) are the real thing. However, 401(k) and profit sharing plans technically are not.

Why the distinction? For one thing spousal consent is needed for true retirement plans before distribution can be authorized by a trustee or the named fiduciary. On the other hand, 401(k) and profit sharing plans, require no spousal consent for distributions. (Spousal consent to name or change a beneficiary is, however, required for all types of tax-qualified retirement plans.)

Many plans may be written to purchase an annuity on a default (automatic) basis. Similarly, many 401(k) and other types of plans may make this option available as part of the agreement signed by the employer and the employee.

Finally, it's important to remember that some distributions are required by law. For instance, individuals are required to start at least a minimum distribution by the April 1, following the year that they turn age 70 1/2, unless they are still working. If still working (and not 5% owners), they may defer initial distribution until the April 1 following the year that they retire.

Lump sum distributions

You may choose to take your accumulations in a single sum for a given tax year and pay tax in that year. In most instances, you will pay tax at your ordinary income tax rate on your lump sum.

Or, you can escape immediate taxation of your lump sum distribution by arranging for a direct rollover of funds from the retirement plan to an IRA or to an employer's plan that will take the funds. (This approach avoids a mandatory 20% withholding tax on your payout if you receive it in hand.)

The annuity choice

Let's say that your retirement plan does offer you the annuity option (either through the plan itself or by purchase through a third party). The annuity chosen may be fixed, meaning that you receive a payment of a predetermined amount of money periodically with a guaranteed benefit. A variable annuity provides for a fixed number of "accumulation units" that fluctuate according to the investments chosen. These are converted to "annuity units" at payout time to calculate the benefits paid.

From a tax standpoint, distributions from a retirement annuity plan generally include amounts that are tax free and represent the recovery of your cost (investment in the contract). Generally, the balance of the payment will be taxed. To find out more about the taxation of annuity payments, consult *IRS Publication 575*, available at www.irs.gov.

Single or multiple annuity accounts may be established with one or more providers.

Choices within choices

Accumulations can be distributed as a single sum (that lump sum again), in level premium payments or in flexible premium payments, regardless of whether a fixed or variable annuity is chosen. Among the most common settlement options:

- *Straight life*: This option calls for payment of a specific amount for the annuitant's life only. Any money left unused reverts to the provider. No beneficiary is named.

- *Life with period certain*: This approach pays the annuitant for life, but if he or she dies during a period certain (e.g., 10 years, 20 years), a beneficiary will continue receiving periodic payments either as installment refunds or in a lump sum payout.

- *Joint and survivor*: Here the annuity is paid over the life of two individuals (usually spouses). When the first spouse dies, the annuity payments continue to be paid to the survivor

at a predetermined amount that may be a full survivorship payment, or a one-half survivorship benefit or a one-third/two-thirds survivorship benefit.

Other retirement plan payout methods

Plans may offer other kinds of distribution options. For instance, *installment payments* may be allowed. Here, benefits are distributed from the plan in monthly, quarterly, semiannual or annual intervals.

- *Fixed-dollar payments* are recurring payments of a specified sum at regular intervals until the plan participant's plan share is exhausted. The length of the payout period will depend upon the investment performance of the plan, but the amount will not change.

- *Fixed-term payments* are made at regular intervals over a predetermined number of years. The amount will change based on the balance available at the beginning of each year, but the term will not. The amount to be distributed is based simply on the beginning balance divided by the number of years in the payout period.

- Some plans contain *default provisions* that are effective when the participant fails to make a choice. For example, some plans will provide for payout as a joint and survivor annuity if the participant does not make a choice (or make it in time) or if there is a discrepancy that was unable to be resolved. In some cases the default provision may call for a lump sum payment.

Seek guidance

Before you make a choice about the form that you want your retirement benefits to take, you will want to talk to your advisors. In addition to tax and retirement planning issues, you will want to examine any estate planning implications of your choice. Taking the time to understand all your options and opportunities before you act will keep all your doors open.