CORNERSTONE

PARTICIPANT PERSPECTIVES

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DECIDING WHEN TO START TAKING A PENSION

When to start taking your pension payments will depend upon a number of different factors. Here are some key points to consider before implementing a plan.

Most businesses today do not offer a pension plan. But pensions are still a common benefit for teachers, federal employees, and others who work in the public sector. Many grandfathered private sector plans also still exist. In fact, millions of public and private sector American workers participate in a pension plan.

For those fortunate enough to have a workplace pension, one of the critical decisions you'll need to make is when to begin collecting benefits. Although payments typically begin at age 65, many plans allow you to start collecting your retirement benefits as early as age 55. But if you opt to receive benefits before you reach full retirement age, the size of your monthly payout will be less than it would have been if you'd waited. When is the optimal time to start, in order to maximize your total payments?

Unfortunately, there is no simple answer. What works best for you will depend upon different factors. Here are some points to consider before deciding.

LONGEVITY

The longer your lifespan, the better off you are delaying your pension payments. Although nobody can pinpoint exactly how long they will live, they may be able to guesstimate. Today's newborns have an average life expectancy of 76.4 years. A man who reaches age 65 has a life expectancy of about 17 years; a woman, about 20.[1] Those in good health, with a family history of longevity, stand a good chance of exceeding these figures. What's more, medical advances have helped increase these averages over time. As a result, many people today can look forward to retirements of 30 years or longer.

SPECIFIC TERMS OF THE PENSION PLAN

The terms of a pension vary widely from plan to plan. A typical pension plan's payout depends on years of service; your timing may depend on when you hit a threshold year. Other factors affect payout, such as whether overtime and bonuses count toward your payout or if benefits are capped at a certain percentage of salary. Many plans also offer cost-of-living adjustments (COLAs). Make sure to check the terms of your specific plan.

IS THE PENSION SAFE?

Although there are federal and state laws that seek to ensure that a given pension plan meets all its payment obligations, there is no guarantee that that will be the case. Pension plan defaults have been rare, but no pension plan is bulletproof. If a local government entity or private corporation falls on hard times, it could affect pension payouts. It's no secret that many large public plans are underfunded. Some estimates put the collective shortfall in the trillions. Whether such underfunding will eventually reduce benefits in a particular plan is anyone's guess. But the upshot for prospective pensioners is that it may not be wise to pin all your retirement hopes on one pension plan.

PERSONAL CIRCUMSTANCES

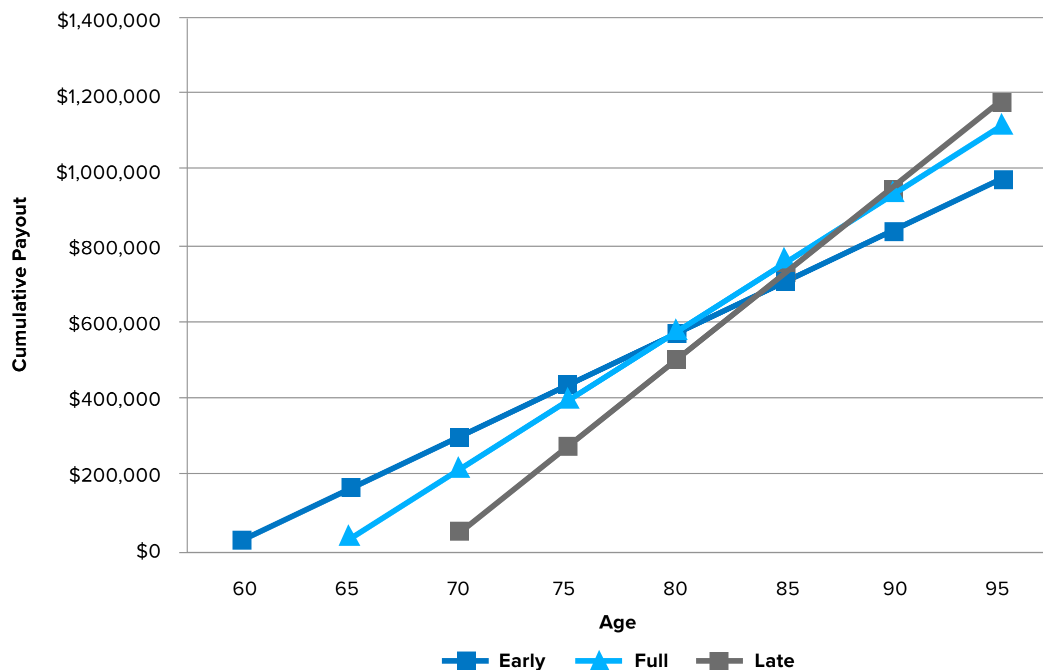
Everyone has individual needs and financial situations. You may have other sources of retirement income—Social Security, an individual retirement account (IRA), a 401(k) plan, or additional retirement savings. You may also plan to cash in on a home or other real estate to help fund your retirement. Or, you may have a spouse with their own pension plan. Whatever your circumstances, be sure to factor them into your decision.

COMPARE CUMULATIVE PAYOUTS[2]

The following chart shows the cumulative payments of a hypothetical pension plan, for early (age 60), full (age 65), and late (age 70) start times. It assumes a pension of $3,000 per month or $36,000 per year at full retirement age; that payments are fixed, with no COLA increases; and that the pension decreases 5% for each year of early retirement and increases 5% for each year of late retirement (until age 70).

Note where the lines cross each other. An early start will result in the highest cumulative benefit until you hit age 80. After that point, "full" timing begins to net a higher cumulative payout. And if you opt to wait until age 70, your cumulative benefit won't outpace a full benefit until you reach age 90.

Keep in mind that this example is for illustrative purposes and may differ from your actual experience. Talk with a financial professional who can help you determine when to start taking your pension payouts.



[1] Source: Centers for Disease Control and Prevention, Mortality in the United States, 2021, NCHS Data Brief No. 456, December 2022.

[2] Illustration is hypothetical. Your plan will differ.

TAX PLANNING FOR DIVORCE

Several tax planning points may be important to consider in a divorce situation.

If you are in the process of getting a divorce, taxes are probably not highest on your list of concerns. Still, there are some tax-related issues to consider.

PROPERTY SETTLEMENTS

Dividing property in connection with a divorce generally has no immediate consequences for either spouse. However, if the spouse who receives property in the divorce settlement later sells it, there may be a gain to report for tax purposes. So, potential taxes should be a consideration in deciding which spouse will receive a property.

Note that a spouse who receives property in a divorce figures any gain on a subsequent sale of the property using the transferring spouse's basis (e.g., cost), not the property's value when it was received.

For example: Michelle receives 10 acres of unimproved land in her divorce settlement. Her ex-husband bought the land for $25,000. It's now worth $100,000. If Michelle sells the land for $100,000, she will have to report a taxable gain of $75,000 (the difference between the $100,000 selling price and the $25,000 cost basis).

PERSONAL RESIDENCE

If a divorcing couple sells their home while they are still married, they are entitled to exclude up to $500,000 of gain from their taxable income if otherwise eligible for the exclusion. If the ownership of the home is simply transferred to one spouse as part of the divorce settlement, there is no taxable gain or loss at the time of transfer. However, should that spouse later sell the house while they are unmarried, only a $250,000 exclusion would be available.

RETIREMENT BENEFITS

A divorce settlement often determines how retirement plan benefits will be divided. However, an employer may distribute retirement plan benefits to a former spouse only after receiving a court-issued document that meets the requirements for a qualified domestic relations order (QDRO). The benefits are taxable to the former spouse who receives them pursuant to a QDRO.

DEPENDENCY EXEMPTIONS

The Tax Cuts and Jobs Act of 2017 suspended the deduction for dependency exemptions for 2018 through 2025. However, after 2025, the deduction will apply (unless additional changes are made). While the spouse who has legal custody of a child is generally entitled to claim the dependency exemption, this tax advantage is negotiable and subject to change from year to year. The custodial spouse can waive his or her right to the exemption, allowing the noncustodial spouse to claim it.

OTHER TAX BENEFITS

Having a child qualify as a dependent may impact other tax benefits. For example, there is a potential child tax credit of up to $2,000 annually for each qualifying dependent child under age 17.

ALIMONY VS. CHILD SUPPORT

Under the Tax Cuts and Jobs Act of 2017, a tax deduction is no longer available for alimony payments made under post-2018 divorce or separation agreements and recipients are not required to include the payments in income. Previously, payments that qualify as alimony under tax law were deductible by the paying spouse and considered taxable income to the recipient spouse.

These are just some of the tax planning issues that could be important when negotiating a divorce situation. Be sure to consult your tax and legal professionals to discuss how these general rules pertain to your personal situation.

HOW TO SET UP A COLLEGE SAVINGS PLAN FOR A GRANDCHILD

A Section 529 plan offers one tax-advantaged way to help fund the cost of college. Here's what you need to know about setting up a plan for a grandchild.

A four-year college education is expensive. Research from the College Board* says the average published yearly cost of tuition and fees for 2023-2024 at a four-year private college was $41,540, while it was $11,260 for in-state students at a four-year public school. Room and board are another charge. And if history is any guide, college is unlikely to get any less expensive over time.

If you have grandchildren and would like to help them get a good start in life, what better gift could you give than the opportunity to graduate from college with few, if any, student loans? One tax-advantaged way to help fund the cost of college is through a Section 529 plan. Here's what you need to know about setting up this type of plan for a grandchild.

WHAT THEY ARE, HOW THEY WORK

Most Section 529 plans are state sponsored. They come in two varieties: prepaid tuition plans and college savings plans. You can set up a separate Section 529 plan for as many beneficiaries as you wish and fund each plan by investing a lump sum or by making regular contributions. You can contribute to a Section 529 plan regardless of your annual income or age. Moreover, if you don't like some of the features of your state's plan, you can participate in another state's plan.

The money in a Section 529 plan grows on a tax-deferred basis, and distributions for qualified educational expenses are free of federal income tax. (Many states offer Section 529 plan tax benefits for their residents as well.) To avoid federal gift taxes on your plan contributions, you can limit them to the gift-tax annual exclusion amount ($19,000 per beneficiary in 2025; $38,000 if you and your spouse contribute) or elect to treat a larger contribution as though the gift was spread out over five years. By contributing, you are generally also removing the gift amount from your estate for federal estate tax purposes.

Another big advantage to opening a Section 529 plan on a grandchild's behalf is that grandparent-owned Section 529 assets are not factored into the Free Application for Federal Student Aid (FAFSA), which helps determine a student's eligibility for grants, work-study programs, and loans. However, just be aware that up to 50% of any distribution made from a nonparent-owned Section 529 plan may be counted as income on a student's future financial aid applications. (It may be possible to avoid this situation by delaying distributions from nonparent-owned accounts until the final two years of a grandchild's college career.)

It can be smart to open the account while your grandchild is still very young. By investing sooner —thanks to the power of compounding—a significant sum potentially may be available to pay college expenses by the time your grandchild enters college.

In addition to Section 529 plans, there may be other options you can explore if you want to help pay for a grandchild's education. It can make sense to work with a financial professional to determine what approach is best for your circumstances.

Source/Disclaimer:

**Trends in College Pricing 2023*, The College Board.

Investing in Section 529 plans involves risk, including loss of principal. Before you invest in a Section 529 plan, request the plan's official statement and read it carefully. The official statement contains more complete information, including investment objectives, charges, expenses, and the risks of investing in a Section 529 plan, which you should carefully consider before investing. You should also consider whether your home state or your beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's Section 529 plan. Section 529 plans are not guaranteed by any state or federal agency. By investing in a Section 529 plan outside of the state in which you pay taxes, you may lose the tax benefits offered by that state's plan. Withdrawals used for qualified expenses are federally tax free. Tax treatment at the state level may vary.

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