Retirement 101

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What is Retirement?

You have finally reached your long-awaited retirement. If you have saved and planned properly, this will be a time of financial independence for you. There are some other considerations that you should keep in mind when you retire. If you choose to work after retirement, you should be aware of the effect it will have on your Social Security benefits. You should also keep abreast of the required minimum distribution rules and their effect on your retirement investments.

Retirement earnings and Social Security

Reduction of Social Security benefits based on earnings

If you need extra income during retirement or if you find that a retiree's life is boring, you may want to consider working. However, be aware of the effect that working during retirement has on your Social Security benefits. The Social Security Administration gives you the opportunity to work and receive retirement benefits so long as your earnings do not exceed the annual earnings limit, a limit that applies only if you are under "full retirement age," which varies between 66 and 67 depending on your year of birth. After you reach your full retirement age, you can earn as much as you want without affecting your Social Security retirement benefit. In 2020, you can earn up to $18,240 if you have not yet reached full retirement age. If you earn more, $1 in benefits will be withheld for every $2 you earn over that amount. However, a special limit applies during the year in which you reach normal retirement age (up to, but not including, the month you reach normal retirement age). In 2020, this limit is $48,600. If you earn more, $1 in benefits will be withheld for every $3 you earn over that amount.

Evaluate pros and cons of exceeding earnings limit

It might seem like a good idea to always keep your earnings below the Social Security Administration's limits. However, there may be times when you might want to consider taking a job where your earnings exceed those limits. While you are subject to withholding for your higher earnings, your overall income may be greater because of those same higher earnings. Furthermore, because you pay Social Security taxes when you work, Social Security reconfigures your benefits to take into account the extra earnings.

Example(s): Phillip, age 63, receives $1,000 in monthly Social Security benefits for a total of $12,000 per year. In 2020, Phillip takes a job that pays $30,240 per year, $12,000 over the annual earnings limit of $18,240. Social Security withholds $1 for every $2 that Phillip earns over the limit or $6,000. Phillip still receives $6,000 from Social Security ($12,000 - $6,000 = $6,000). He has a total income of $36,240 ($30,240 in earnings + $6,000 in Social Security). Although he has lower monthly Social Security benefits, Phillip's overall income is greater than it would be without the job because of his higher earnings.

Tip: *If you earn other income during the year, then you might have to pay income tax on part of your Social Security benefits if your total income exceeds a certain base amount.*

Other facts regarding Social Security

- There is a special rule regarding the annual earnings limit during your first year of retirement. If you retire midyear, you may find that you have already earned more than the annual earnings limit. The rule allows you to receive full Social Security benefits for any whole month that you are retired despite the fact that you exceed the annual earnings limit.
- You will be subject to penalties if you fail to report retirement earnings.
- If you receive Social Security benefits as a family member, your earnings will affect only your own benefits.

Required minimum distributions (the age 70½ or 72 rule)

If you are retired, you might still be enjoying the tax-deferred status of your investments held in retirement plans. However, if you have a traditional IRA, you are required to begin taking required minimum distributions for the year in which you reach age 70½ (age 72 if you reach age 70½ after 2019). If you fail to take the minimum distribution, you are subject to a 50% penalty on the amount that should have been distributed. Required minimum distributions generally must be made from employer-sponsored retirement plans after age 70½ (age 72 if you reach age 70½ after 2019). However, if you retire from your employer after age 70½ (age 72 if you reach age 70½ after 2019), you may be able to delay taking required minimum distributions from that employer's plan until after you've retired.

Note: *Required minimum distributions for defined contribution plans (other than Section 457 plans for nongovernmental tax-exempt organizations) and IRAs have generally been suspended for 2020.*

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