NATIONAL ENDOWMENT FOR FINANCIAL EDUCATION

COLLECTING YOUR RETIREMENT FUNDS

How to Decode the Rules that Determine Your Financial Future

ENGLEWOOD, COLORADO—Choosing the age at which you will stop working and begin collecting retirement funds is among the most personal and important of decisions. Whether your plan is to quit work at age 50, or never completely leave the workforce, government regulations will have something to say about when, and how much, you can collect from Social Security and other retirement accounts. As if that isn't enough to think about, some of these guidelines have changed in recent years. So, while keeping up with the most current set of rules is tiring, it's also essential.

"Deciding when to leave the workforce and start collecting retirement money requires a thoughtful review of legal and regulatory issues, accurate calculations of income that are based on your work history and personal judgments about your future needs and estimated longevity," says Ted Beck, president and CEO of the Colorado-based National Endowment for Financial Education® (NEFE®). Beck adds, "It's critically important for people to have a plan for retirement based on both their past standard of living and the financial lifestyle they hope to enjoy in the future." NEFE is an independent, nonprofit foundation committed to educating Americans about personal finance and empowering them to make positive and sound decisions to reach their financial goals.

Medicare and Social Security Play by Different Rules

One number that hasn't changed is the age at which people become eligible for the health care benefits of Medicare—65. It's important to remember that if you're not going to take retirement at that age, you will need to apply for Medicare three months before your 65th birthday.

Contrary to what many people believe, Medicare and Social Security become available at different times in one's life. You can begin receiving Social Security benefits when you reach age 62, or wait until you're 70 years old. If you choose the earlier date, your monthly check will be permanently reduced, whereas if you wait to start getting benefits, you'll receive a larger check each month. Most private pension plans have specific dates and methods for distribution of benefits, as well. For traditional Individual Retirement Accounts (IRAs), you can begin to withdraw funds without penalty as early as age 59-1/2, but you also must start to collect no later than age 70-1/2.

Higher Age for Receiving Full Retirement Benefits

The traditional standard of retirement at age 65 hasn't really been true for many years. According to the U.S. Bureau of Labor Statistics, from 1948 to 2004 the number of people in the workforce over age 65 decreased from 27 percent to 14 percent.

To reflect this, in 2000 the Social Security Administration started implementing a higher age requirement for collecting what now are considered full retirement benefits. However, the increase in eligibility is gradual, so that for those born in 1937 and earlier the age 65 requirement remains, while for those born in 1938 and later collection begins at 65 years and two months, with incremental increases up to age 67 for those born in 1960 and later. There has been some talk of increasing the retirement age again, but so far no action has been taken by Congress.

The decision about when to start taking Social Security benefits is often based on speculation about how long you think you're going to live and what your current economic circumstances are. The bottom line is that the longer you wait to begin receiving benefits, the larger the checks you'll receive, albeit for a shorter period of time.

If you can manage without Social Security for a few years after you become eligible to collect benefits, you can receive up to an 8 percent credit (for those born in 1943 or later) for each year up to age 70. Known as delayed retirement credit, this extra money each month can make a big difference in your comfort level and standard of living.

If you begin taking Social Security at the earliest possible opportunity, your monthly check will be reduced by 20-30 percent, depending on your age. For those who need this regular income, it may be less a matter of preference than necessity, and certainly the experts agree it's better to take the early payment than to go into debt. For others, the option to leave an unfulfilling job at the earliest opportunity may be the best decision. No matter when you decide to accept Social Security, it's important to note that the amount of Social Security benefit is calculated on a year-and-month scale rather than a year-by-year basis. For example, a person collecting Social Security at 63 years and two months of age would receive less than an individual retiring at 63 years and three months of age.

Continuing to Work After Benefits Have Been Collected

For those at retirement age who want to continue with paid work after they begin receiving Social Security payments, there's some good news. In April 2000, part of the retirement earnings test was repealed so that most working seniors at full retirement (ages 65 to 67, depending on date of birth), will not face a reduction in Social Security benefits based on their earnings. This means that once you reach retirement age, there is no limit to how much money you can earn while still receiving full retirement benefits. (It's also important that you understand the definition of "earnings," which typically means wage income;

interest and dividends do not count as earnings for this purpose.) There still is an earnings limit, however, for those who begin collecting Social Security *before* their full retirement age, and it changes each year. For example, in 2006, those currently receiving early Social Security benefits with earnings greater than $12,480 a year will have $1 in benefits withheld for every $2 in earnings above the limit. Similarly, if you reach full retirement age *during* 2006, you can earn up to $33,240 annually in the period before the month in which you reach retirement age before partial benefits are withheld.

If you plan to work after you start to receive your Social Security checks, it's important to remember that employees who return to the workforce after they have begun collecting retirement funds are subject to withholding for Social Security and Medicare taxes on their retirement wages, just like all other employees. Additionally, some people who receive Social Security benefits have to pay income taxes on them. According to the Social Security Administration's (SSA) official Web site, this applies only to those with other income above certain amounts on top of Social Security.

In addition to the age at which you begin taking benefits, your payments are based on your earning history. For planning purposes, it's important to know what your benefits will be, information that is readily available. Several years ago, the SSA began mailing statements to all workers age 25 and older who were not receiving benefits to let them know when they would be eligible to start collecting. Detailed information about retirement ages and collection is available at www.ssa.gov.

Required IRA Withdrawals

Another important regulation for those who postpone taking benefits until years after they reach full retirement age delineates that at age 70 and six months, you generally must begin to take payments from your retirement savings plans where taxes have been deferred, even if you're still working. This withdrawal, known as the required minimum distribution, includes several popular Individual Retirement Accounts (IRAs), including traditional IRA accounts, Simplified Employee Pension (SEP) accounts and certain employer-sponsored plans. There is a significant penalty for failing to take these payments.

For many people, retirement plans offered through their place of work will be an important source of their income, and there are regulations governed by federal law regarding rights and responsibilities for both participants and sponsors of these plans.

Most of these rules are spelled out by a law called the Employee Retirement Income Security Act of 1974 (ERISA), which sets minimum standards for retirement plans in private industry. A booklet explaining important features of the law is available from the U.S. Department of Labor's Employee Benefits Security Administration Web site at www.dol.gov/ebsa. In addition to information on eligibility, accruing benefits, becoming vested and taking retirement benefits, the booklet answers frequently asked questions about how employment or termination interruption affects benefits and the impact of mergers and other business changes on your plan.

Retirement is a dream come true for many, but lack of planning can lead to a permanent reduction in one's ability to collect deserved money. Make an effort to understand the rules and regulations associated with the collection of retirement funds. "Talk about your plans with your family and—if you have one—a financial planner, collect the information you need from the federal government and your retirement plan administrators, do a little dreaming about the kind of future you want and then set about building the base for a secure financial future," Beck says.

More information about retirement planning also is available at www.smartaboutmoney.org.