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The Seven Ages for Important Decisions on Retirement

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Important decisions in planning retirement income and expenses can be made at seven ages, and the decisions made at those ages can have a substantial effect on the quality of retirement.

Needless to say, perhaps, the age to start saving for retirement is as soon as you have an income. One of the best and earliest techniques for retirement saving occurs when young people have summer jobs. They are likely to have no significant tax liability from those jobs, so it is an ideal occasion to open a Roth IRA. There is no income tax deduction for contributions to a Roth IRA, so a year when an individual has little or no taxable income is an ideal time to make such contributions. The other side of the Roth IRA bargain is that, provided you wait a while to take distributions, the amounts withdrawn are free of federal income tax, and there is no date by which distributions from the Roth IRA must be made to the person who set it up. This is in contrast to the rule for traditional IRAs and qualified plans, requiring that distributions begin shortly after age 70-and-a-half and continue each year thereafter. The ability to postpone distributions from Roth IRAs for an indefinite period is a valuable attribute. In general, as soon as there is a vehicle available for retirement saving, make use of it.

Age 50: Catch-Up

The first age for retirement decisions is 50. At age 50, it is possible to make catch-up contributions to IRAs and qualified plans. The premise of permitting such contributions is that contributions might not have been made in earlier years, but the ability to make catch-up contributions is not dependent upon having failed to make contributions earlier. This provision, Internal Revenue Code Section 402(g)(1)(c), was added to the law in 2001, and offers an opportunity to make additional contributions at an age when an individual might begin to think more carefully about accumulating assets for retirement. The catch-up contribution provision will occur in the IRA documents received from the provider (bank, mutual fund company, insurance company), but for those who are participating in qualified plans, the plan must provide for catch-up contributions, and most plans do. This is a good point to emphasize that participants in qualified plans should have an understanding of how they work, and what options are available in them. Review of the plan's summary plan description, which most people ignore, is a worthwhile effort in planning retirement saving.

Retirement saving also occurs outside of retirement plans. It is possible to save money and invest it in conventional ways, outside of the IRA and qualified plan venues. Careful planners will know that a comfortable retirement probably requires even more than the maximum that can be accumulated through the tax saving techniques. But this much seems clear: If you are not deferring the maximum under IRAs and qualified plans, you are probably not saving anything outside of them. Some people use the premise, or excuse, that they need not save as much because of the growth in value of their homes. Apart from the debunking of that theory in the recent fall in housing values, the technique of living in retirement from the sale of a residence and downsizing to a smaller one was never valid. Those who downsized, as it happened, usually paid as much for a smaller home, in purchase price and upgrades. While it might be helpful to think about accumulating assets in other ways, saving as much as possible in IRAs and qualified plans should be the first step, and age 50 offers an opportunity to increase the rate of accumulation.

Age 59-and-a-half: Penalty Ends

A second age point in the retirement process arrives at age 59-and-a-half. This is the age established in the Internal Revenue Code (Section 72(t)) when distributions may be made from IRAs and qualified plans without a penalty. Prior to that age, withdrawals may be subject to a 10 percent penalty, in addition to income tax imposed on a distribution. There are some exceptions to the penalty, such as for death or disability, but generally 59-and-a-half is a tollgate, after which withdrawals can be made more easily. This will always be possible in an IRA, but a qualified plan must affirmatively permit such withdrawals.

The ability to withdraw from retirement accounts at age 59-and-a-half can be a problem. Most people have not retired by age 59-and-a-half, but if amounts can be withdrawn without penalty (other than paying income taxes), there will be a temptation to take distributions for nonretirement reasons. These might be worthwhile, such as paying college expenses for children, but there is a downside to reducing funds available for retirement at this point in life: Not only will you lose the amount withdrawn, but also the future appreciation. Consequently, age 59-and-a-half can be a dangerous point in planning for retirement. It is advisable to resist the temptation to withdraw funds at that point. If funds are needed for an important reason, it might be a better course to borrow them from a qualified plan (you cannot borrow from an IRA), because that imposes a discipline to pay back the funds into the plan, together with the interest on the loan that will be added to your account balance.

Age 62: To Collect or Not

At age 62, it is possible to retire and begin collecting Social Security benefits. That age is not considered full retirement age, so a person who begins receiving benefits at 62 will receive a reduced amount. Why would some make this choice? One reason is that the individual might believe that the system is shaky, and wish to get something out of it. Another reason might be that one spouse will retire and the other continue to work, and the retiring spouse might believe that he or she could invest the payments received and earn a better rate of return than is implicit in the larger amount that would be received at full retirement (66 for many people). There is no single correct answer. If you continue working at age 62 and earn more than a modest amount, you will receive little or no benefits. But retirement at age 62 offers an option to begin receiving Social Security benefits that can be considered as part of a plan for retirement. As long as the individual knows what is given up by taking benefits at that early date, the decision to take early retirement can be an appropriate one.

Age 65: Medicare

Individuals may sign up for Medicare at age 65. Medicare, it is generally agreed, is a very complicated program, and a full discussion of the options when signing up would be a very long article by itself. Deciding whether to sign up for the various parts of Medicare or retain private insurance is a complicated decision that probably requires expert assistance. The website www.medicare.gov is helpful, but even that information isn't enough to know that one has made the right choices. Of all of the areas of decision-making that must be faced by those approaching retirement, Medicare and health insurance issues are surely the least understood.

Age 66: Social Security Retirement

For many people, age 66 is the time when full retirement benefits can be received from Social Security. (For younger people, the age stretches out to 67; look for further increases in the future.) The amount of retirement benefits can be estimated online, from the website www.ssa.gov, which will show the amounts received at various retirement ages. At age 66, benefits can be received even if an individual is still working, no matter what level of income is being received.

So why not start receiving benefits at that age? A delay in the receipt of benefits beyond age 66 will increase the amount received on eventual retirement. From age 66 to 70, the increase is substantial. After 70, the increases are much less. Again, whether to take benefits at age 66 or wait until a later age is a personal one: Does the individual want to apply at age 66 and begin taking benefits, or can he or she live on other income and assets and afford to wait until 70? What is the individual's life expectancy? A comparison of the benefits payable at the various retirement ages, available on the website cited above, will help with the decision, although it might be advisable to have a financial adviser help with the process.

Age 70: Retirement

There is little incentive to delay receiving Social Security benefits beyond age 70. If an individual has postponed his or her receipt, age 70 is the time to begin receiving benefits. Benefits continue for life, and if the individual is survived by a spouse, there are additional benefits payable. There is not much to decide at this point.

Age 70-and-a-half: IRA and Plan Benefits Must Begin

Pursuant to Internal Revenue Code Sections 401(a)(9) and 408(a)(6), required minimum distributions must begin by April 1 of the year following the year in which an individual reaches age 70-and-a-half. (Similar rules apply to Section 403(b) tax-sheltered annuities, but they are limited to educational and nonprofit organizations.) That first sentence is subject to so many conditions and exceptions, and opportunities for planning, that one author has written a book of more than 500 pages explaining the code sections.

Here is one important point: If an individual continues to work beyond age 70-and-a-half and does not own as much as 5 percent of the employer, the payment of benefits can be postponed until actual retirement. This could be of interest to lawyers in law firms where they do not own 5 percent of the firm. By continuing to work, benefits in qualified plans may remain in that plan, and continue to grow on a tax-deferred basis. This option is not available for IRA accounts, and this might affect an individual's decision to transfer assets from the law firm's qualified plan to an IRA. And, it might affect the law firm's decision as to how benefits may be distributed. An individual might be encouraged to leave funds in the law firm's plan if distribution options extended beyond a lump sum distribution to annual or quarterly payments. In that way, participants in the plan could take some distributions without being required to take the full minimum required distribution. But this presents another question: What does it mean to continue working? There appear to be no minimum requirements for hours or presence in the office.

The stages of retirement are times when decisions may or must be made regarding the accumulation of retirement income and its distribution. By understanding the options and the applicable law, and having assistance as needed, the retirement process can be used to the most satisfying advantage.

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