COOPERATIVE EXTENSION SERVICE
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FACT SHEET: Retirement Planning—The Decision To Retire and Retirement Income

Fact Sheet 422

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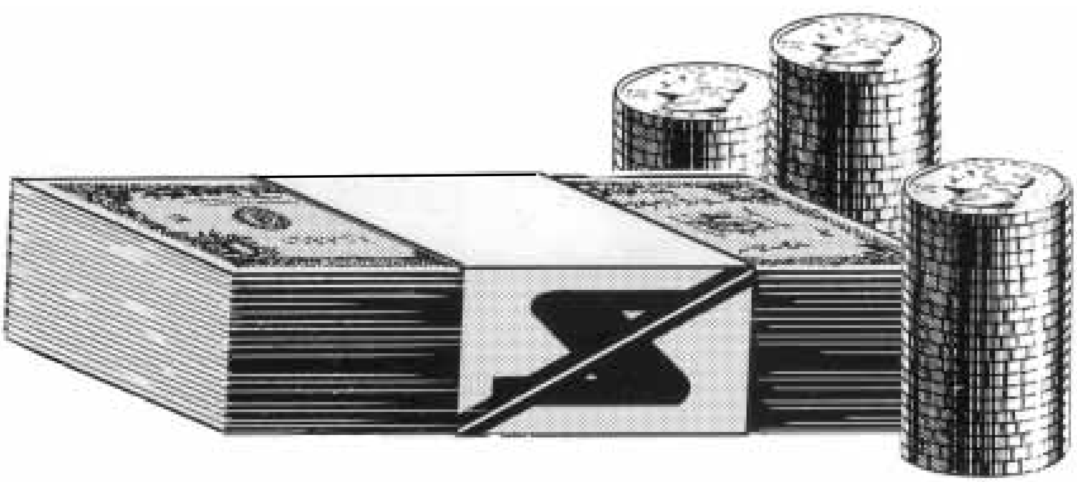
Deciding To Retire

If you plan to retire within the next few years, it is time to complete your retirement plan. Most retirement planning experts suggest that you plan a set of new activities when you retire from your current job. You can use the years immediately before retirement to develop skills you can use after retirement. Experts also advise forming friendships with people other than your fellow workers. New friendships may keep you from feeling lost and lonely after your retirement. The primary goal of this publication is to help you plan your retirement income. However, without a plan for retirement activities, you may feel that your life is dull and dreary even though you have enough income.

After planning retirement activities, determine your goals and assess the finances you will need to reach these goals. Reaching your goals requires a financial plan. To complete a financial plan for your retirement years, you first must choose your retirement date. Next, figure out the number of years you will require retirement income (your life expectancy). Then, develop a spending plan. Finally, figure out the amount of retirement income you will receive.

When Should I Retire?

Base your decision to retire the following factors: (1) your health and potential health insurance benefits, (2) your life expectancy, (3) your eligibility for full Social Security and pension benefits, (4) the size of your savings, and (5) the way you and your family feel about retirement. When you rate these items, be aware that many of them relate to one another. For example, perhaps your savings and company pension are low, and you expect to live beyond the normal life expectancy. Then, the traditional retirement age of 65 may not be right. On the other hand, suppose your parents' and grandparents' lives were relatively short and your health is questionable. In this case an early retirement may be a right choice. By planning now, you will be able to predict more accurately whether your expected income benefits will match your expected expenses. This knowledge will help you decide your retirement date.



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Why Is My Life Expectancy Important?

Your life expectancy is the average number of years you can expect to live after a given age. Table 1 lists selected life expectancies for blacks and whites between the ages of 55 and 70 (at the time of publication, life expectancy statistics for other ethnic groups were not available). For example, at age 65 a white female can expect to live 19 more years, or until age 84. A black female can expect to live 17 more years or, until age 82. If individuals in your family have lived long lives and you are healthy, you may want to plan for a longer lifespan. To help you decide how fast you can spend your savings, write down the number of years you expect to live in retirement. Then, select the appropriate number from the Table 1. You may want to add a few years to your life expectancy. The figures in the table are averages.

The fewest number of years I expect retirement to last is ________.

The most number of years I expect retirement to last is ________.

How Much Will I Need To Live On?

One way to set up your retirement budget is to keep a record of your living expenses. Then, subtract those expenses that are work related. You may want to set up a separate fund for major expenses such as replacement of furnishings, appliances, or your car. The Cooperative Extension Service's Bulletin 337 *Retirement Planning—Managing Retirement Expenditures* discusses how to calculate living expenses after retirement. In it, you will find worksheets for determining work-related expenses, major irregular expenses, and for estimating retirement expenses.

Table 1. Number of years of life expectancy by age and gender (1989)

	White		Black	
Age	Male	Female	Male	Female
55	21.4	26.8	18.7	23.9
60	17.7	22.7	15.8	20.3
62	16.4	21.1	14.7	18.9
63	15.7	20.3	14.2	18.3
64	15.0	19.5	13.7	17.6
65	14.4	18.8	13.2	17.0
70	11.5	15.1	10.8	13.9

Source: *1992 Statistical Abstract of the United States.*

Sources of Retirement Income

Retirement incomes typically come from three major sources—Social Security, pensions and salary reduction plans, and savings and investments. Those who plan to work part-time can consider those earnings as a fourth source.

Social Security

For most Americans, Social Security is a primary source of retirement income. Social Security replaces about 24 percent of the maximum wage base ($61,200 in preretirement income in 1995) for those who earn the maximum each year. For those who earn one-half (about $11,000 annually) of the average U.S. income, Social Security replaces 59 percent of preretirement income. Social Security can tell you how much your benefit is likely to be. Fact Sheet 622 Retirement Planning: Understanding Social Security is accompanied by the "Request for Earnings and Benefits Estimate Statement" that you can send to Social Security for a statement of your benefits. You can also call the Social Security Administration at 1-800-772-1213 to request a copy of this form.When you complete this form, remember to include your Social Security number and sign it. The reply you receive from the Social Security Administration will include the following:

- the number of quarters (there are four quarters per year) you have worked on record;
- your total Social Security recorded earnings since 1937;
- the total of FICA taxes you have paid through the years;
- your annual earnings each year since 1957;
- an estimate of your benefits should you become disabled;
- a projection of your retirement benefits if you start to receive them at age 62, 65 ,or 70; and
- an estimate of survivor's benefits.

You should think carefully about retiring before age 65, the age at which you become eligible for Medicare. You may have to pay a hefty health insurance premium if your employer does not continue your health insurance until you are eligible for Medicare.

Benefit eligibility. A full benefit is formally called the *primary insurance amount* (PIA). You can retire at age 65 with your PIA. Also, you can retire as early as age 62, with 80 percent of your PIA (Table 2). Social Security pays spouses 50 percent of the working spouse's benefits at age 65 and 37.5 percent of the benefit at age 62 provided that the spouse's earned benefit is not larger. Some spouses enter or reenter the labor market later in life and work until retirement. The spouse should determine if his or her earned benefit is larger than a dependent-spouse's benefit. A spouse's 50-percent benefit also is available if the spouse is caring for a child under the age of 16 or a child who became disabled before age 22. Surviving spouses receive 100 percent of the worker's benefit at age 65 and 71.5 percent of the benefit at age 60. If the surviving spouse becomes disabled, he or she will be eligible for 71.5 percent of the benefit at age 50.

An unmarried ex-spouse may receive benefits based on the former spouse's account. An ex-spouse receives the same amounts at the same ages as married spouses. To qualify, the marriage must have lasted for at least 10 years. Also, the ex-spouse (the worker) must be eligible to receive benefits. Additionally, at least 2 years after your divorce, benefits may begin at age 62 if your ex-spouse is eligible for benefits. You are eligible even though your former spouse has not yet retired. After age 60, you will not lose your benefits if you remarry.

When a worker takes a reduced benefit, the reduced benefit is permanent. Additionally, when the working spouse dies, the survivor receives the same reduced benefit that was being paid to the worker (but not less than 82.5 percent of the PIA). If you are the spouse of a retired worker, you can take a reduced benefit at age 62 on your own account. If your spouse dies, you then can receive the benefit your spouse received if it is larger.

Benefits for work after age 65. Workers who continue working after age 65 without claiming Social Security benefits receive increased benefits. Those who turn 65 in 1994 or 1995 receive 4.5 percent more for each additional year worked. Those reaching age 65 in 1996 or later, will see the size of their benefits increase gradually. The annual increase will rise to 8 percent for those reaching age 65 in 2008. Retirees who start to receive Social Security benefits and continue working for pay may receive reduced Social Security checks. Social Security reduces checks for the months the worker earns more than the maximum allowable amount. Your age determines the maximum allowable amount. The maximum changes each year. In 1995, is $8,160 annually for individuals under 65 and $11,280 annually for individuals older than 65. If you earn more than these amounts, you lose $1 in Social Security benefits for every $2 earned if you are under 65. Additionally, you lose $1 in Social Security benefits for every $3 earned if you are over age 65. After age 70, you may earn any amount, and Social Security will not reduce your benefit.

Table 2. Social Security benefit eligibility percentages according to retirement age

Age	Worker PIA* percentage	Spouse PIA* percentage	Survivor PIA* percentage
65	100.0	50.0	100.0
64	93.3	45.8	94.3
63	86.6	41.6	88.6
62	80.0	37.5	82.9
61	—	—	77.2
60	—	—	71.5
Disabled 50	—	—	71.5

* Primary insurance amount is the amount the worker is eligible to receive at age 65. All percentages are based on the PIA.

Public pension offset. If you work in the public sector, you may become eligible for a public pension rather than Social Security. If you receive a public pension, your spousal or survivor Social Security benefits may be reduced. Pension eligibility results in a $2 reduction in Social Security benefits for every $3 received from the pension. Depending on your age, there are some exclusions from this rule. Be sure to consult your Social Security office if you think this regulation might apply to you.

Additionally, workers who receive a public pension based on employment not covered by Social Security may receive reduced Social Security checks. Social Security does not reduce checks for public-pension workers who have the required amount of earnings under Social Security-covered jobs for most of their adult lives.

Applying for benefits. To receive benefits from Social Security, you must apply. You should apply 2 to 3 months before you retire. If you wait until after you retire, you may have to wait twice as long before your checks start. To apply, you must furnish your Social Security number. Also, you must submit an official record of your birth or a religious record issued before you were 5 years old. Only original or certified copies are acceptable. Social Security will return them to you. If you do not have originals, submit the best record you have. If you do not have the proper documents, consult Social Security.

Social Security records are not always current. Therefore, you should submit your last two W-2 forms. If you are self-employed, submit copies of your last tax return and cancelled check. You may also need your marriage certificate. Also, a former spouse needs records of the duration of the marriage. If you are eligible to receive children's benefits, you will need their birth certificates and Social Security numbers to apply.

Pensions and Salary Reduction Accounts

Pensions. The average company pension in 1991 was $7,490 per year after 20 years of service at a

$35,000 income at age 65. If you work for a large corporation, the Federal Government, the State of Maryland, or the military, your pension may be larger. To be eligible for full benefits, you must be fully vested. This means you have worked for the company from 5 to 7 years, depending on the vesting method described in your plan. Vesting entitles you to the employer's contribution to your pension. However, for defined benefit pensions, the actual size of your pension depends on your wage level. Also, it depends on the number of years you worked, the benefit formula, and the existence of Social Security integration. When your employer integrates your pension with Social Security, your Social Security benefit reduces a portion of your pension benefit. The size of your defined contribution pension and profit-sharing benefit depends on the size of the fund and its earnings over your working years. Your plan will determine your earliest retirement age.

As you plan your retirement income, ask your employer if your pension will increase with inflation. If so, ask about the method used to figure the increase. Corporate pensions frequently have little or no inflation protection. Government pensions typically provide inflation protection, but the actual amount depends on the plan.

Single annuity or joint and survivor annuity benefits. Your retirement benefit from a defined contribution or defined benefit plan will be in the form of either a single or a joint and survivor annuity. A single annuity provides benefits until the worker's death, whereas a joint and survivor annuity also provides survivor benefits. To fund these additional survivor benefits, the employer reduces the pension payment. The amount of the reduction sometimes depends on the age difference of the two recipients.

The law requires that married couples take a joint and survivor annuity unless the worker's spouse signs away his or her rights. Consider rejecting it only when the surviving spouse will have income that is at least 75 percent of the current joint retirement income. If you and your spouse have adequate pensions, a joint and survivor annuity is less likely to be necessary. However, the only way to be sure is to have a fully planned retirement budget before you make this important decision.

Section 401(k), 403(b), and other salary reduction plan benefits. You may be able to receive your benefits from a salary-reduction plan in one of several ways. These include an annuity, a lump sum, or a combination of the two. Many plans allow you to choose the way you will receive your benefit. If you work for a company, you may have a 401(k) plan. You will probably have all of the available choices. If you work for a nonprofit organization such as a school or hospital, you may have a 403 (b) plan or tax-sheltered annuity. In 403(b) plans, you can elect how you will receive the part of the plan resulting from your voluntary contributions. These plans usually distribute nonvoluntary contributions as an annuity. If you work for a state or local government, you may have a 457 plan. These plans typically offer all of the choices. If you work for the Federal government, you may participate in Thrift Plan of both Federal retirement plans. Federal employees may take their contributions as a lump sum or a partial lump sum with the remainder as an annuity.

As you begin to sum your retirement income, separate income received as an annuity from amounts that will you receive as a lump sum. Add lump sum amounts to assets (to be liquidated) on Worksheet 1, 4B, which lists your potential sources of retirement income.

Tax effects on withdrawals from tax-deferred accounts. Carefully consider your options when withdrawing funds from your tax-deferred accounts at retirement. The decision you make will affect the amount of taxes you must pay on the amount withdrawn. Here are five tax rules that could affect your choice.

First, all withdrawals from pensions and tax-deferred plans are subject to taxes at ordinary rates. The exception is the amount set aside from pre-tax income.

Second, any amounts withdrawn as a lump sum are subject to a 10 percent early-withdrawal penalty if you are not yet age 591/2. You can avoid this penalty when leaving a job by taking the balance as an annuity based on one of three methods. Consult your tax advisor for these rules.

Third, regardless of age, the law requires that your employer or custodian of your tax-deferred plan withhold 20 percent of all lump-sum withdrawals for Federal income taxes. This may not be the tax you actually pay. It could be more or less. You figure the exact amount when you prepare your yearly income tax return.

Fourth, you can defer withdrawals from tax-deferred accounts until age 70½. At age 70½, withdrawals must begin based on the life-expectancy of you or joint life expectancy with your spouse.

Finally, 5-year averaging on lump sum withdrawals may reduce your taxes. Through 5-year averaging, you may be able to reduce the aforementioned taxes. You can use 5-year averaging when taking a lump sum from corporate plans, self-employed plans, and the Federal Thrift plan. However, you can only use it once after you are $59^1/_2$, and you must have been a member of the plan for at least 5 years. To use 5-year averaging, divide the lump sum by five. Then, look up the tax rate on the single taxpayer schedule and multiply the result by five. Pay this tax with your regular yearly taxes. If you turned age 50 before January 1, 1986, you can also use 10-year averaging. However, you must look up the single taxpayer tax rate in effect in 1986. Figure your taxes both ways to determine which save the most taxes.

Reducing taxes on withdrawals. There are several strategies that you can use to continue deferring taxes. First, you can ask your employer to transfer funds directly from your employer to an IRA, a "conduit" IRA, or a new employer's plan. An IRA allows you to roll over the amount of the lump sum in the plan that you will have to include in taxable income if not rolled over. When you roll over this sum, it remains tax-deferred. The exception is withdrawals made by public employees from Section 457 plans that cannot be rolled over. A "conduit" IRA is an IRA used to hold the funds temporarily until you can transfer them to your new employer's plan. It may be necessary to keep the custodian of the rolled-over funds from mixing them with a regular IRA. To prevent mixing, be sure you have only the conduit IRA at the chosen financial institution. You no longer have 60 days to make the transfer yourself without being taxed. When requesting a direct transfer from your employer, you must inform your employer of the name and address of your rollover IRA. Your employer must make the check out directly to the IRA, not jointly with your name. Some employers deliver the check directly to the employee who then must forward it to the IRA or new pension plan. If you have to transfer the check yourself, it is critical that you do so within 60 days of receiving the check. The IRS will not allow you to roll over the funds if you miss this deadline. A rollover IRA allows you to withdraw money as you need it, now or in the future.

Second, keep the funds in your former employer's account. Your employer may want you to take the money now. However, your employer cannot force you to withdraw the funds if your account is worth more than $3,500 and you are under age 62 or under the plan's retirement age.

Third, take the money as company stock. Company stock is not subject to the 20 percent tax.

Finally, rather than taking a lump sum or rolling the sum over, take the sum as annuity or as series of at least 10 annual payments. If you have fewer than 10 annual payments, your employer must withhold twenty percent from each payment.

Savings and Investments

Your savings and investments include those assets listed above including IRAs, SEPs, Keoghs, and tax-deferred funds you choose to take as a lump sum. At retirement you have three choices for use of assets under your control. You can let these assets grow if your other retirement income is enough. You can add the earnings on these assets to your other retirement income. Finally, you can start to spend the principal as well as the interest.

Table 3. Number of years to deplete principal and interest

	Percentage of savings withdrawn													
Amount of return	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
1%	69	40	28	22	18	15	13	11	10	9	8	7	6	5
2%		55	35	25	20	16	14	12	11	10	8	8	7	6
3%			46	30	23	18	15	13	12	10	10	9	9	8
4%				41	28	21	17	14	13	11	10	9	9	8
5%					36	25	20	16	14	12	11	10	10	9
6%						34	24	18	15	13	12	10	9	9
7%							31	22	17	15	13	11	10	9
8%								29	21	16	14	12	11	10
9%									27	20	16	13	12	10
10%										26	19	15	13	11
11%				**Forever**							24	18	14	12
12%												23	17	14
13%													22	16
14%														21

WORKSHEET 1

Estimated Annual Income After Retirement

(See instructions on page 8.)

Yearly income

1. Social Security

Man's at age ________ .... ________

Woman's at age ________ .... ________

1. Total $ ________

2. Pensions and Employer Benefits

Company .... ________

State or Federal government .... ________

Veteran's .... ________

Union or other .... ________

Profit sharing .... ________

Deferred pay .... ________

Other .... ________

2. Total $ ________

3. Earnings

Salary, wages .... ________

Commissions, royalties, fee .... ________

Partnership income .... ________

3. Total $ ________

4. Assets

A. Savings and Investments (that earn income)

IRA (interest or dividends) .... ________

Keogh (interest or dividends) .... ________

Savings account (interest) .... ________

Money market (interest) .... ________

Treasury securities (interest) .... ________

Mutual funds (dividends, capital gains) .... ________

Stocks (dividends) .... ________

Bonds (dividends) .... ________

Real estate .... ________

Farm/business rent or installment payments .... ________

Home equity conversion .... ________

Annuities .... ________

Other .... ________

4A. Total $ ________

Worksheet 1 (continued)

B. Assets (to be liquidated to provide income from principal and earnings)

	Column A Net value	Column B Income
Lump sums (pensions, tax-deferred plans)	________	________
IRA	________	________
Keogh	________	________
Savings accounts	________	________
Money market	________	________
Treasury securities	________	________
Real estate	________	________
Mutual funds	________	________
Stocks	________	________
Bonds	________	________
Antiques, collectibles	________	________
Farm/business	________	________
Anticipated gifts or inheritance	________	________

4B. Total $ ________

Estimated Total Gross Income .... $ ________
(Total amounts in shaded boxes)

5. Possible deductions from income

Federal income tax .... $________

State/city tax .... ________

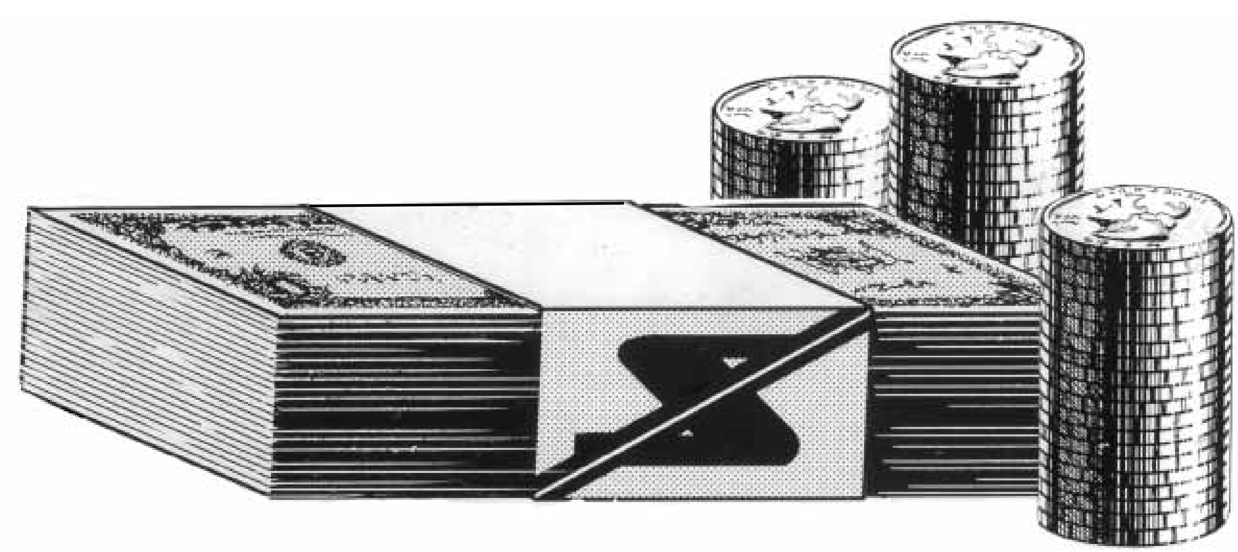
Social security tax .... ________

Total .... $ ________

(Subtract total tax deductions from total gross income to estimate your total net income.)

Total estimated net income .... $ ________

Adapted from "Planning for Retirement Income," a CEH Topic, J. Hogarth, Cornell University, 1984.



At some point in retirement you may need to liquidate most of your assets to maintain your lifestyle.

Are you concerned that you will outlive your savings if you start to live on your principal? You can determine how many years your savings will last. However, you need to choose a specific interest rate and the percentage of your total savings that you will withdraw each year when consulting Table 3. For example, suppose your savings and investments earn an annual return of 8 percent and you withdraw 10 percent per year. Then, your savings will last 21 years. If you only withdraw 8 percent of your savings each year, you will never deplete your fund. The reason is that you will be living on the interest only. If you plan to withdraw interest to cover living expenses, remember that Federal and State income taxes will reduce the amount you have to spend.

Earnings

If you plan to begin a new career or part-time work when you retire, you will have another source of income. Remember to reduce your earnings by the amount of your working expenses. Also, if your earnings exceed Social Security's earning limits, you will lose $1 in Social Security benefits for every $2 in earnings. Check with Social Security for the amount you can earn each year. This penalty applies until age 70. You can find a more detailed discussion of earning opportunities in Fact Sheet 424 *Retirement Planning—Managing Your Finances During Retirement.*

How Much Retirement Income Will I Receive?

You will be able to answer this question after you have completed Worksheet 1 (pages 6 and 7), "Estimating Annual Income After Retirement." Estimate possible income in the four sections described below.

Social Security (number 1). Refer to Fact Sheet 622 *Retirement Planning: Understanding Social Security* or call 1-800-772-1213 to request Form 7004 "Social Security Earnings and Benefit Statement Estimate." Fill out the form and mail it in the preaddressed envelope. You will receive your benefits estimate in 4 to 6 weeks.

Pension (company, government, veteran's, union), profit sharing, and deferred pay (number 2). Your employer's benefits office can provide this information if you do not have it. Remember to check with your previous employers' benefit offices if you have vested pension rights for working other jobs.

Earnings (number 3). Estimate the income you plan to earn in a postretirement part-time job.

Assets. (numbers 4A, savings and investments, and 4B, assets to be liquidated). These groups (4A and 4B) contain many of the same items. Enter amount in the 4A, Savings and Investments, when you plan to withdraw the earnings only. (Enter only the amount you will use as income.) Ignore the item if you plan to reinvest the earnings. Estimate income from last year's records.

Record in 4B, Assets to be Liquidated, those assets that will provide income from both the principal and interest in the next 12 months. Remember, when you liquidate an asset, there may be expenses for selling and taxes due. Therefore, record the net value in Column A. Total those assets you plan to liquidate. The amount of assets you liquidate may be larger than your current income needs. If so, enter the amount you plan to spend in the next 12 months in column B, and reinvest the difference.

To complete the worksheet, total the shaded boxes to show an estimate of your gross income. Subtract estimate taxes to produce Net Income.

How Do I Match My Income and Expenses?

Transfer your Total Estimated Net Income to the worksheet in Bulletin 337 **Retirement Planning—Managing Expenditures.** Now you can compare your projected income with your projected expenses. Remember to plan for inflation. Social Security adjusts for inflation if the yearly inflation rate exceeds 3 percent. Most company pensions adjust partially or remain fixed. Be sure to manage your savings to assure a return that increases at the inflation rate to offset price increases.

Note: Rules are correct as of August 1995.

References and Further Reading

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