



of San Diego

HOME

PLANNER RESOURCES

WHAT WORKING 'RETIREEES' SHOULD KNOW ABOUT TAXES

Countless surveys show a high percentage of pre-retirees planning to work at least part time during their retirement years, either out of desire or financial necessity. And many current retirees are doing just that. While paid employment during retirement can provide many financial as well as psychological benefits, retirees should be aware of the tax rules and ramifications of working during their Golden Years.

One of the most obvious ramifications is that you may find yourself in a higher-than-expected tax bracket. Retirees often assume that once they retire their expenses will be lower than they were in pre-retirement in part because they'll pay less in income taxes. This isn't always the case. Retirees who combine Social Security payments along with income from pension plans, annuities and other savings may find that their post-retirement income is not much less than their pre-retirement income. Adding post-retirement work income, even part time, could keep you in your old tax bracket or even bump you into a higher income tax bracket.

Additional employment income in retirement also may expose more of your Social Security benefits to federal income taxes. First, calculate what's called "provisional" income—that's your total investment income, retirement payouts, wages and half of your Social Security benefits. Currently, a couple, married filing jointly, with provisional income of no more than \$32,000, doesn't pay any taxes on their Social Security benefits. Couples with provisional income from \$32,001 to \$44,000 will expose up to 50 percent of their Social Security benefits to income taxes. Couples whose provisional income is over \$44,000 expose up to 85 percent of their Social Security benefits to federal tax. Put another way, you could lose up to 30 cents out of each dollar of Social Security benefits.

Of course, retirees also should take into account the impact working may have on their actual Social Security benefits. Retirees who have reached their full retirement age (which is gradually shifting from age 65 to age 67) can collect their full Social Security benefits regardless of how much money they make from employment. Retirees collecting early Social Security benefits (as early as age 62) will lose \$1 in benefits for every \$2 they earn in wages above \$11,520 in 2003 (adjusted annually).

All this suggests that if you're going to work during retirement, even part time, you might want to consider postponing the start of your Social Security benefits, either to when you reach full retirement age or even beyond that. There are pros and cons to this strategy, depending on your individual situation and life expectancy, so you'll want to run the numbers with your financial planner.

The plus side to all of this is that working during retirement could boost the overall benefits you'll

receive from Social Security. Social Security bases its calculations on your 35 highest years of earnings, and it automatically recalculates the benefit amount as additional earnings are credited to your earnings record. Even if you work only part time in retirement, you could earn more than you did in your earliest working years.

Another major tax issue to consider should you want or need to continue to work after you “retire” is what’s called required minimum distribution rules. If you’re still in your 50s or 60s, you don’t have to worry about them. But in general, once you reach April 1 of the year following the year you turn 70-1/2 years old, you must begin making minimum withdrawals from your retirement accounts, even if you’re still working.

One of the exceptions to this rule is the retirement plan of your current employer. If you have such a plan, you don’t have to make withdrawals from it until you leave that employer. Another exception is that you don’t have to make minimum withdrawals from Roth individual retirement accounts.

Otherwise, you must begin making withdrawals from your non-Roth IRAs, traditional defined-benefit pension plans, and qualified retirement plans such as a 401(k), simplified employee pension plan (SEP), or 403(b). Minimum distribution rules are complicated, but in general, the minimum amount you have to take out each year depends on the amounts in the accounts and your life expectancy.

The important point here is that you’re going to be required to receive this retirement income in addition to your employment earnings, so be prepared for its potential impact on your tax bracket and taxation of your otherwise tax-free Social Security benefits.

October 2003— This column is produced by the Chapter of the Financial Planning Association. We can be a continued resource for your personal finance coverage. If you use all or part of this column, please credit FPA or one of its Financial Planner Members.

The Financial Planning Association is the owner of trademark, service mark and collective membership mark rights in: FPA, FPA/Logo and FINANCIAL PLANNING ASSOCIATION. The marks may not be used without written permission from the Financial Planning Association.