

Benchmark

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How Working Affects Retirement Benefits

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Many baby boomers say they want to work into their mid-60s and beyond, for both financial and social reasons. But going back to work after you sign up for Social Security can affect your benefits if you earn too much money. Here's a look at the effect of working after age 62:

Working without claiming your benefit can increase your monthly check. You can claim Social Security benefits at age 62, but continuing to work without signing up for Social Security until you reach full retirement age or further delaying up until age 70 will increase your retirement benefits, assuming you now make more than you did in your 20s. Every year you keep working, your benefit gets recomputed. If you can replace some low-earning years when you were young with some higher-earning ones in your 60s, that could enhance your benefit.

While employed, you can also continue to tuck money into 401(k)'s, IRAs, and other retirement savings. What Social Security does is calculate the average of your 35 best earnings years. If this year's earnings are not higher compared to the lowest of those years, then that is not going to add to your benefit.

Watch out for income limits. But even if they keep working at 62 and older, many people don't want to wait to collect Social Security. You can work a little bit and still continue to get your Social Security benefits. In 2008, those who collect benefits before reaching the year of their full retirement age can earn up to \$13,560 without penalty. Above that level of earnings, they will lose 50 cents of every benefit dollar. Working may decrease your retirement benefits until you reach your full retirement age. For boomers born in 1946 and turning 62 this year, it's age 66.

In the year in which you turn your full retirement age, work becomes a better deal. From January of that year until your birthday you can earn a higher amount (up to \$36,120 in 2008) with no penalty, above which your Social Security check is reduced by about 33 cents of every dollar earned. And once your birthday passes that year, you can earn any amount by working without your benefits being reduced at all.

Wages, bonuses, commissions, and vacation pay all count toward the income limits, but pensions, annuities, investment income, interest, and government or military retirement benefits do not. This calculator can tell you how your specific earnings will affect your benefits.

Benefits aren't withheld forever. Workers who received reduced benefits or whose benefits were suspended because they earned more than the income limits after signing up for Social Security will have their benefits recalculated to a higher amount when they reach full retirement age. This can completely or partially reverse the smaller Social Security check you would otherwise permanently receive.

For example, a worker whose full retirement age is 66 but who claims Social Security at 62 might receive a yearly benefit of \$8,760. But if the employee worked for just one more year and earned \$30,000 before retiring completely at age 63 (which means the Social Security check would be withheld for earning above the limit), his benefit would be boosted at age 66 to \$9,344 per year. If they still feel capable and are still healthy, that extra year of work can have a long-lasting effect on their future benefits. When [the benefits] are recomputed, they may be erasing a bad year that they had 10 years ago or 30 years ago.

You may have to pay taxes on your benefits. Even after all your years of paying into the system, you still can't escape Uncle Sam. About a third of people who get Social Security have to pay income taxes on their benefits. If the sum of your adjusted gross income, nontaxable interest, and half of your Social Security benefits is between \$25,000 and \$34,000 for individuals (\$32,000 and \$44,000 for couples), you have to pay tax on up to 50 percent of your benefits. Above \$34,000 (\$44,000 for couples), you could pay on up to 85 percent, the highest portion of Social Security that is taxable.

You may be able to reduce taxes by spending down your IRA instead of claiming Social Security early. For example, a retired married couple both age 72 who receive \$24,000 annually in Social Security benefits and \$45,000 of IRA income would have an adjusted gross income of \$62,050. If a similar couple were to delay taking Social Security and spend down their IRA assets during the "bridge period" between when they retire and when they sign up for Social Security, they would receive \$39,000 worth of Social Security but a lower IRA income of \$30,000. Although they would take in \$69,000, just like the first couple, their adjusted gross income would be far lower, only \$40,675. The first couple would pay \$3,206 more in federal taxes.

Many retirees will pay slightly higher taxes during the bridge period, but experience thousands of dollars in annual savings from the point that higher Social Security income begins. By decoupling when to take the majority of IRA income from the time one takes the majority of their Social Security income, much greater tax efficiency can be achieved.