

Early Retirement

Some Rules of the Road

Have you ever reviewed your pay stub and entertained thoughts of taking an early retirement? Suppose you are age 55 and could take home a pension income that amounted to 60% of your pay if you retire now. If you earn a high income, it may seem that you'll be able to retire in reasonable comfort. However, before calling it quits, weigh all of the facts *carefully* to be sure an early retirement makes financial sense for you.

Here are eight rules you should consider if you're thinking about taking an early retirement:

Rule #1: *Weigh the differences between the benefits of retiring now and in the future.* Retiring at age 55 with, hypothetically, 60% of your income may seem like a good deal at first. But, if you wait until age 65 to retire, you will have gathered another ten years of full earnings under your belt, along with any increases for promotions, merit raises, and inflation. This will provide you with more money to save for retirement and, ultimately, may boost your Social Security and pension benefits. Also, if you consider the difference in the percentages you will receive now and in ten years—for example, 60% if you leave now, versus 80% if you retire in ten years—leaving now may not sound so good after all.

Rule #2: *Remember to factor inflation into your decision.* If you still think you can manage on, say, 60% of your income, remember that inflation will erode your pension. Consider this: If you retire today and receive a pension income of \$1,600 per month for life, in 20 years at a 4% rate of inflation, you will have only the equivalent of \$707 in today's dollars.

Rule #3: *Prepare for longevity.* The longer you live, the greater will be the effects of inflation, and more resources will be required to support your needs. As life spans lengthen, an early retirement plan should include a budget to cushion the financial burden incurred by potentially more years spent in retirement.

Rule #4: *Evaluate other retirement income resources.* If you already have a sizable retirement nest egg, or if you expect to collect a pension from a previous employer, the size of the pension you could receive from *your current* employer may not be critical. If so, perhaps you can leave work behind, since you will have other funds on which you can rely.

However, don't make the mistake of expecting Social Security to provide most of your retirement income. The Social Security Administration (SSA) projects that benefits will replace only 40% of the average worker's pre-retirement income (SSA, 2005). Also, the future of Social Security is uncertain, and cutbacks in other government programs, such as **Medicaid** and **Medicare**, may require you to provide even more of your own funds.

Rule #5: *Part-time work may make early retirement feasible.* If you decide to leave your present company, are you banking on securing employment elsewhere to supplement your pension? The prospect of ongoing income may make it possible to

consider an early retirement option, even if it doesn't pay a high percentage of your earnings. However, keep in mind that it may be difficult to find another equally high-paying position. Be certain of the earnings and longevity you can expect from your next job before depending on it for income until you permanently retire.

Rule #6: *Be aware of the effects early retirement may have on Social Security benefits.* If you are under age 65 and continue working after you begin collecting Social Security benefits, you may have to "give back" a portion of your benefits. In other words, your Social Security benefits may be reduced once your earnings exceed a certain income cap. If you continue working after you begin collecting Social Security, a portion of your Social Security benefits might be taxed. The calculation to determine how much of your benefits will be included in your gross taxable income is somewhat complicated. For more information, contact the Social Security Administration.

Rule #7: *Taking an early retirement on your own may not make sense if the specter of corporate downsizing looms.* Is there a chance your company will lay you off if you do not elect to leave on your own? Many companies now lay off high earners as part of their cost-cutting measures. If your company is experiencing financial difficulties and downsizing appears imminent, you may get a better deal by waiting a little while for a "forced" early retirement with a company severance package.

Rule #8: *Understand the potential tax consequences of early retirement.* If you opt for early retirement, you may incur a 10% federal income tax penalty for early withdrawals from a qualified plan, which you do not roll over. However, if you are terminating employment you only have to be 55 to avoid the penalties, not 59½, so if you make a rollover into an IRA at age 55, keep in mind that withdrawals later taken from that **Individual Retirement Account (IRA)** before age 59½ may also be subject to a penalty.

Early retirement may be a long-held dream and a financial possibility. But, before calling it quits, analyze your situation carefully. You will have to live with the effects of your decision for the rest of your life. Take the time now to make sure it will still be a smart decision in the long run.