Work or Retire?

Making A Good Decision with Your UAW-GM Pension
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Welcome to your Financial Education Module on ‘Work or Retire’. The purpose of this program, both this e-book, the accompanying DVD presentation, interactive forms and the web-links, are to provide you and your family with the tools you need to make a good retirement decision. **Decisions about your retirement are one of the most important financial moves you’ll make in your life.** The issues are complex, yet the simple fact is, you need to know what’s involved. The American auto industry is in a big time of change, and as this world whirls around you, it’s important to protect yourself.

Retiring from UAW-GM involves looking at three different parts of your retirement, or three ‘legs’ of the retirement stool: your pension, Social Security, and PSP. Each of these three legs has its own set of rules and decisions. When you take them together, you can figure out for yourself when and whether you can afford to retire. You may even find that you can have more money in retirement than working at UAW-GM, after you take taxes and other expenses into account. We’ll take you through some ways to look at your retirement decision and see if the dollars make sense.

A word about retiring: This program is about MONEY. There are a lot of other things that go into a retirement decision, like how you want to spend your time, or how good your health is, or how old your kids are, or a variety of considerations that aren’t directly financial. In this program, we’re taking an approach used by Ben Franklin, which is comparing the money of **working** at UAW-GM, to the money of **NOT working** at
UAW-GM. The program doesn’t look at your personal life, whether you love your job, whether you hate midnights, or anything other than the raw numbers. Another point: numbers vary by individual. All of the examples and techniques in the program are illustrations of how to analyze the situation, not some scheme to get you to retire. You need to plug in your own numbers, sit down with your significant other or financial advisor (who may be the same person), and look at your personal situation: As they say with different model cars and your driving habits; your mileage may vary.

Now, let’s get started.
Disclaimer

- The rates used are examples.
- Based upon benefit class code, the base rate for pension calculations will be between $53.55 to $54.30 for each year of service.

Before you get going on this analysis, it's important to note that the materials used in this presentation are based on a variety of assumptions and factors. Here they are:

- The rates used for Pension illustrations are based on the UAW-GM contract in effect as of October 1, 2011.
- The Supplements and pension rates are for retirements between October 1, 2011 and September 1, 2015.
- The Contract has a variety of Basic rates, and the examples use a basic rate in the middle of the rates.
- The Contract provides for an increase in the pension basic rates and the supplements.
- Tax rules are using the 2014 Tax rates as projected as of 2014 year end.
- Social Security rules are as of 2014 year end.
- We are not covering special early or disability retirements in our example, which may be different.

The materials in this program are intended to provide education about analyzing a retirement situation. Nothing in this program should be considered as giving tax, financial or retirement advice. You should make your own comparison and consult your own tax or financial advisor. In the event there is a conflict with this program and the UAW-GM Contract or benefit programs, the official contract shall be the deciding language.
Disclaimer continued

- For ease in illustration we are using whole years of credited service and retirements at a fixed age. Realize that you receive credit for months as well.
- Tax rates are based on Michigan residents filing a joint return for 2008.
- Check with your UAW-GM Leadership, UAW-GM Benefit Representative, UAW-GM Legal Services Plan, your attorney, financial advisor or the Social Security Administration for updated/current information.

In addition, all examples in this program are using whole years of credited service. You may have partial years of credited service, which will change your examples. For state tax comparisons, rather than have the complexity of 50 state tax rules applied, we have used Michigan tax laws. When you make your comparison, use your own state tax rules. Note from author: It is important for you to know how your state or the state you will move to, if you retire, treats pension payments.

Check with your UAW-GM Leadership, UAW-GM Benefit Representative, your attorney, financial advisor or the Social Security Administration for updated/current information.
First, let’s do a brief overview. Why worry about retirement dates? Because the date you retire can mean thousands of dollars more in your pocket. In addition, if you make the right kind of comparison of the bottom line, after tax and after expenses, you may find that you’ll make more not working for UAW-GM, at least on comparisons of straight time.

So the first thing we want to do is give a primer on the UAW-GM pension, so you can get an idea of the playing field.

Next, we’ll want to cover your supplements. There are three types of supplements: an interim supplement, which is based on 85 points or 60 years of age and at least 10 years of credited service, and the early retirement supplement known as the “30 and out” supplement, which is for those of you with more than thirty years. The third type is temporary supplement for mutual (MSR) retirements and Total and Permanent (T&P) retirements. There’s a big difference between the three.

Then, we’ll get into how to make a bottom line comparison. We’ll take a comparison on an after-tax basis and see how you can look at this for yourself. To help you see what works for you, we’ll use several examples, one of 29 or 30 years, one with over thirty years and with straight time and overtime, and a Social Security example. Then, we’ll throw in a PSP withdrawal to have a look at what we can do with your PSP without hurting your future finances.
We'll go over some basics about Social Security, which acts as a leg of our retirement stool, and lets us get a retirement income source independent of your employer and indexed to inflation.

Finally, we'll provide some of the details of what to do with your PSP, not the investing, but taxes and cash flow issues, like how much you can take without hurting the principal, and what you can take without hurting your tax return.
Why Worry About Retirement Dates?

- The right date can mean more dollars in your hand!
- HUGE differences between different service dates
- The importance of ‘bottom line’

We can give you over nine hundred reasons a month to worry about retirement dates. Most of the time, we spend our time listening to the coffee break experts about when and how to retire. “Thirty and out” is the battle cry, and to a degree, this is a point where the pension is very attractive. The difference between 29 years and 30, for example, is profound. The difference between 30 and 31 is less exciting.
Here's a good example of just how important it is to pay attention when you retire. Let's look at Mike, who's 56, and has 29 years of service. He can retire (with 85 points), and he will get a supplement, called an interim supplement. This supplement is much lower than the 30 and out supplement in the Contract. Mike may be better off waiting until he hits 30 years to retire. Let's have a look using a method Ben Franklin used to use. It's called a T-account and it compares items line-by-line to see which is better.
If you look at the graphic above, if Mike retires at age 56 with 29 years of credited service, he’ll get a basic pension of about $1,566, or about $54 times 29 years. Remember, in all of our examples in this program, we’re using an average pension rate, so check your own numbers. The basic pension is reduced if you retire before age 62, so there’s a reduction of $571.59 (36.5%), because Mike is 56.

Next, if Mike has 29 years of credited service, he will get a supplement based on his 29 years, called an interim supplement. In his case, this will be $771.40. Mike doesn’t get the larger, 30 and out supplement, because he has 29 years. Mike’s pension until age 62 and one month is $1,765.81, which is his basic, minus the early retirement age reduction, plus the supplement.

What if Mike waits a year? The break room experts will tell him to hang on, because he’ll get a lot more if he waits. And in this case, the break room experts are right: The pension calculation is way different, all in Mike’s favor. For our example, let’s just look at two workers, one who’s 56 with 29 years of service, and someone age 57 with 30 years of service, both retiring in May of 2010. The 30-year example is quite different. The Basic is slightly higher for thirty years versus 29 years, so the basic is $1,620 instead of $1,566 (because you have one more year). The reduction is slightly lower (30.6%), $495.72 instead of $571.59, because you are one year older (and closer to 62).
The big difference is in the supplement. The supplement for 30 years or more is the difference between $3,170 (for retirements between 10/1/13 and 09/1/14) and the reduced pension. So in this example, the basic pension is $1,620, reduced by $495.72 for retiring before 62, down to $1,124.28. The 30 and out supplement of $2,045.72 is what it takes to get the total pension to $3,170.

Pretty big difference in this example: $3,170 if you work 30 years, or $1,765.81 if you work 29 years.
### 30 years or 31?
#### Two People Retiring the Same Year

<table>
<thead>
<tr>
<th></th>
<th>30 Years Age 56</th>
<th>31 Years Age 57</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Pension</td>
<td>1,620</td>
<td>1,674</td>
</tr>
<tr>
<td>Reduction for &lt;62</td>
<td>-591.30</td>
<td>-512.24</td>
</tr>
<tr>
<td>30 and Out Supplement</td>
<td>2,131.30</td>
<td>2,008.24</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>3,160</strong></td>
<td><strong>3,170</strong></td>
</tr>
</tbody>
</table>

So, if 30 worked so well, why not stay longer, like 31, or 35, or 40 years? The simple fact is that the 30 and out supplement takes your pension to the amount of $3,170 (for retirements between 10/01/13 and 09/1/14). If you have more than 30 years of service, the **supplement** is going to be reduced. You will still retire with 30 and out retirement. The additional years are beneficial after the supplement drops off.

Look at the figures above. Two people, one with 30 years of service age 56. The other is 57 with 31 years: one year older and one more year of service. The 30 years person gets $3,170, computed as follows:

- Basic pension of $1,620, which is 30 years times $54 (remember to use your own basic benefit rate), minus
- Reduction for early retirement of $591.30 for retiring at age 57, plus
- 30 and out supplement of $2,131.30, to total $3,170

Now take the 31 year example:

- Basic pension of $1,674, which is 31 years times $54 (remember to use your own benefit class code), minus
- Reduction for early retirement of $512.24 for retiring at age 58, plus
- 30 and out supplement of $2,008.24, to total $3,170
The 31 year person had a bigger basic pension ($1,674 minus $512.24, or $1,161.76), but had a smaller supplement. The 30 and out supplement will decrease as the basic pension gets larger.

It’s worth noting that the 31 year person will get a bigger basic pension when the supplement drops off ($1,674 plus Social Security for the 31 year person, versus $1,620 plus Social Security for the 30 year person). The supplements only are added to the pension if you retire before age 62 years and one month.
Pension Primer

1. Basic Pension a function of years of credited service
2. Reduce by a factor
3. If under age 62, add in a supplement, either:
   a. Interim, based on under 30 years (over age 55)
   b. Or the ‘30 and out’
   c. You may be eligible for temporary benefits in special circumstances.

OK, we see that when you retire can make a difference, let's review that pension formula:

1. Your basic pension is your years of credited service times a pension factor, which is generally your Benefit Class Code, A, B, C or D. It's a simple calculation, years times amount. We’ve been using $54 per year of credited service, but under the contract, the amounts vary between $53.55 per year of credited service to $54.30 per year of credited service.

2. The basic pension is age reduced for retiring before age 62 and one month. This is based on age reductions negotiated in the Contract.

3. If you are under age 62 and one month, or (see box) if you were born before September 15, 1949, you get a supplement that is either:
   • Based on the number of years you have up to 30 years.
   • The '30 and out' supplement if you have 30 or more years of credited service.
   • A temporary supplement in special circumstances, like a plant closing or special offer, Total and Permanent Disability (T&P) or Mutually Satisfactory Retirement (MSR).
When do I get the 80% of my Full Social Security amount?

<table>
<thead>
<tr>
<th>Date of Birth</th>
<th>Age Eligible for 80% of Social Security</th>
<th>Full Retirement Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938 or before</td>
<td>62</td>
<td>65</td>
</tr>
<tr>
<td>1938</td>
<td>62 + 2 mo</td>
<td>65 + 2 mo</td>
</tr>
<tr>
<td>1939</td>
<td>62 + 4 mo</td>
<td>65 + 4 mo</td>
</tr>
<tr>
<td>1940</td>
<td>62 + 6 mo</td>
<td>65 + 6 mo</td>
</tr>
<tr>
<td>1941</td>
<td>62 + 8 mo</td>
<td>65 + 8 mo</td>
</tr>
<tr>
<td>1942</td>
<td>62 + 10 mo</td>
<td>65 + 10 mo</td>
</tr>
<tr>
<td>1943 to 1954</td>
<td>63</td>
<td>66</td>
</tr>
<tr>
<td>1955</td>
<td>63 + 2 mo</td>
<td>66 + 2 mo</td>
</tr>
<tr>
<td>1956</td>
<td>63 + 4 mo</td>
<td>66 + 4 mo</td>
</tr>
<tr>
<td>1957</td>
<td>63 + 6 mo</td>
<td>66 + 6 mo</td>
</tr>
<tr>
<td>1958</td>
<td>63 + 8 mo</td>
<td>66 + 8 mo</td>
</tr>
<tr>
<td>1959</td>
<td>63 + 10 mo</td>
<td>66 + 10 mo</td>
</tr>
<tr>
<td>1960 +</td>
<td>64</td>
<td>67</td>
</tr>
</tbody>
</table>
Now, some more examples:

- Claudio is 49, and has 30 years of service;
- He’s thinking of retiring to another job, maybe somewhere other than where he works now.
- He currently gets about 13 hours of OT a week.

Claudio is 49, almost 50. He has one child, who is age 11. He’s thinking of retiring, maybe working somewhere else. He currently gets about 13 hours of overtime, but that’s not certain.
Two Comparisons: ST and OT

- Straight Time comparison is easy to do, since Claudio gets a base of $28.12 an hour.
- Overtime is tougher, since Claudio is clearly working some hours for free to get to the overtime hours.

To make this illustration, we're going to compare the 'bottom line', or the after-tax, after-PSP, and after-expense comparison of pension check and paycheck. Now remember, these are examples: your situation may vary. To make these comparison, we'll start with straight time, which for Claudio is about $28.12 an hour. We'll also do an example using 13 hours of overtime.
Comparing Work or Retire

- First, define retire as, ‘not working here’
- Next, compare the bottom line, after all work-related expenses
- It all comes down to time and money

A good definition is important here. Retire shouldn’t mean ‘don’t work’: It should mean ‘don’t work here’. Because of the advances in the UAW-GM contract, workers can have a very valuable retirement after thirty years. In fact, because of the Contract, your employer, may pay more to not work here as to work here, at least on a straight time basis!

To make the comparison, you have to look at what you have in your pocket. Your paycheck is nice, but there are a lot of things that come out of it, like federal taxes, state taxes, Social Security, Medicare taxes, union dues, PSP contributions, a variety of things. The bottom of the check doesn’t look like the top of the check. The same thing applies to the pension check: there are expenses that come out of the check, and these have to be taken into account: Remember the old rule: It’s not how much you make, its how much you keep.

This whole comparison is time and money: you might look at it like this: UAW-GM will pay you x to work here and y to NOT work here.
So here’s the top line: 40 hours a week times 4.33 weeks a month is 173.2 hours a month. Straight time pays about $4,870 a month to work here. With thirty years, you get a combination of pension plus supplement to equal $3,170 for retiring between October of ’10 to present. Top line to top line, it looks like you make about $1,700 a month more to work here.
Federal Taxes aren't bad for Claudio, because he gets a child credit for his eleven year old. His federal taxes are low either way, presuming he's the sole wage earner. Take out about $240 of federal income taxes for the paycheck, and about $56 of federal income taxes for the pension check. Now remember, this part is going to be very different for you. If your spouse works, or if you have other income, or if you have a lot of dependents or deductions, your taxes will be different. Get your tax return and maybe the person who helps you do your taxes to look at what your taxes would be if you work or if you don't.
Claudio has to pay state taxes as well. Claudio would pay $150 of state taxes on his paycheck. A lot of states have no tax or limited tax on pensions. Check your state rules for your comparison to see how much if any of your pension will be taxable. A good web site with state tax comparisons is [http://www.ncsl.org](http://www.ncsl.org).

### State Taxes, if applicable

<table>
<thead>
<tr>
<th>(Pre-62)</th>
<th>Work</th>
<th>Don’t Work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross</td>
<td>4,870</td>
<td>3,170</td>
</tr>
<tr>
<td>Fed</td>
<td>240</td>
<td>56</td>
</tr>
<tr>
<td>State</td>
<td>150</td>
<td>0</td>
</tr>
</tbody>
</table>
Next comes Social Security and Medicare taxes, imposed on wages. Claudio has to pay 6.2% for the base Social Security taxes, and 1.45% for Medicare taxes. Note there are no Medicare or Social Security taxes on pensions. This means there’s $302 and $71 coming out of Claudio’s paycheck that isn’t coming out of the pension check. (In 2011 the 6.2% is on income up to $106,800 only.)
Now let’s look at your PSP (Personal Savings Plan). Your PSP is a wonderful financial planning tool. In your PSP, you can put away money from your paycheck, not pay federal taxes (and in most cases state taxes), until you take the money out. Your PSP is a tax-deferral program. Now, your PSP is not like taxes or other deductions from your paycheck: you get the money back later. But it does affect your bottom line. If you put money in your PSP, your paycheck will be reduced by the after-tax amount. For example, for Claudio, for every $100 he puts in his PSP, his paycheck will go down by about $80. When you save in your PSP, you not only save the contribution, you save taxes as well. For 2012 (calendar year), you can contribute up to $17,500 in the year to your PSP on a pre-tax or Roth basis, for a total of up to $51,000 for all types of contributions added together. If you’re going to be 50 or older in 2012, you can add another $5,500 on a pre-tax or Roth basis, for a total of up to $56,500, for all types of contributions added together. PSP is a retirement savings: when you’re working it comes out of your paycheck. When you retire, you don’t contribute. In fact you may actually start taking money OUT, which we'll cover in a few moments.

It's important for you to see that we’re not calling your PSP an expense (like the taxes, which are gone), but rather a savings. If you are able and wisely invest your money, your PSP can create a substantial nest-egg to complement your retirement.
In fact we'll see later in this program just how effective your PSP can be as a retirement tool. For our example, Claudio is saving 10% toward his retirement in his PSP, he's putting $487 a month in (which is still less than the maximum). While he works, this is tax deferred, so he deducts it from his taxable paycheck. When he retires, he won't be contributing to his PSP, so it doesn't come out of his pension check.
Now let's look at JRE. What's JRE? Job-related expenses. These are the costs of having a job, from union dues to work clothes, to driving extra miles to work, to the extra costs of having a job. The Department of Labor tells us the average cost to hold down a middle-income job is about 6%. For Claudio, it's probably costing him about $292 a month to have his job. No job, no job-related costs. We would like Claudio to stay in the UAW, so we're going to take out union dues. Retire dues are $2.00 per month for a husband and wife, so we have included that deduction from the pension check. We haven't factored in the cost of golf balls, exercise class, or whatever else Claudio is going to spend his money on in retirement. That's what the bottom line is for.
So what is the bottom line? In Claudio’s case, his bottom line is $3,328 of after-payroll taxes, after-PSP savings, after job-related-expense calculation. If he retires? $3,102. If you figure his pay on straight time, he’s actually working 173.2 hours, which means he’s netting $1.30 an hour (remember he is stashing money in his PSP, which isn’t gone).

Claudio is making over $28 per hour but only taking home about $19 an hour after the dust settles (and he saves some money in his PSP). He can make about $3,102 to NOT work at UAW-GM. So that’s like getting paid $17 per hour to not work. If you take into account his commute time, getting up early, getting home, and so on, retiring might look good. But you decide.
Now let’s give Claudio an extra 13 hours of overtime per week, worth $42.18 an hour. Not bad! So now, the overtime in Claudio’s checks add up to an extra $2,374 a month. But the $2,374 only means about $1,400 to the bottom line. Let’s see, Claudio is working 53 hours a week, so 230 hours a month, not counting the commute, the extra lunch in the cafeteria, etc. He’s making $7.08 an hour. $4,728 to work 53 hours a week, or $3,102 to not work here.

And, what Claudio has to consider is that overtime isn’t certain. Yes, he can work the extra hours now, but who knows what happens. What’s important is that Claudio knows where he is financially.
What Happens at 62?

- Any Interim, Temporary, or Thirty and Out Supplements drop off (depending on the year you were born)
- Social Security kicks in at certain ages (depending on the year you were born)
- Pension reverts to unreduced amount (except 60/10 retirement)

We’ve brought this up before, but note that the supplements drop off when you reach age 62 years and one month. If you were born after 1938, then Full Social Security begins at a date later than age 65 (see the chart on page 20). When you do reach age 62 years and one month, the pension early retirement reduction factors drop off if you have 30 years or more of service or your age and years of service at retirement total 85 or more, so the net result is that the retiree may get just about the same total amount before and after Social Security. Of course, Social Security benefits are not fully taxed, so there is a modest increase. In addition, the pension doesn’t account for any spousal Social Security benefit. An additional issue is the earnings limitation on Social Security benefits collected between the ages of 62 and Full Retirement Age (FRA).
Let’s take the example of Ted. Ted is like a lot of people in the plants. He’s been around a long time, he likes his job, and he’s good at it. He knows that retiring might make sense, but he can’t quite make the jump. At least until now. This year, he had elevated PSA levels and the scare left him thinking about what he wanted to do with the rest of his life.

Ted is a skilled trades person and can get all the hours he wants. He has 36 years with the company. His friends are retiring and playing golf, meeting for coffee and playing with their grandchildren. In addition, Ted has just received his Social Security estimate and finds that he will receive about $1,540 of Social Security benefits if he retires now.

Let’s put Ted to the T-Account and see what happens.
On a straight-time basis, Ted makes about $5,686 a month. He's married, and filed a joint return. Out of his paycheck, he pays $477 in federal income taxes and $197 in state income taxes. He pays $353 into Social Security, and about $82 of Medicare taxes. Ted contributes $569 to his PSP, and pays about $341 in getting to and from work, union dues, and so on. His bottom line on straight time is $3,667 a month.

If he retires, he gets a pension based on his 36 years of service. He'll get $1,944 of pension, plus $1,540 of Social Security. There is federal tax on the pension. For Social Security, the Social Security benefit may be taxed if you make over a certain amount. In general, Social Security is not taxed at lower income levels (under $32,000 if married, under $25,000 if single) and partially taxed, up to 85% of the benefit, at higher income levels. The calculation is a bit complex and we’ll cover it later in the program.

Take out $48 in federal income taxes. There may be no state taxes on pension or Social Security. You should check your state rules for your situation. No Social Security or Medicare taxes, no PSP contribution, and no job-related expenses. Bottom line for Ted is $3,434 to not work, or $3,667 to work. So he nets a little over $200 a month or about $1.34 per hour.
Let’s add 20 hours of overtime a week. This adds about $4,265 to Ted’s monthly income. His ‘top line’ goes way up to $9,951, so Ted’s making over $100,000 a year. Who wants to retire from that?

Ted clears about $6,067 from his $9,951 a month. Notice his taxes are higher, both because of higher income and higher brackets. The bottom line looks a lot more promising, with Ted making about $2,633 a month more. But how much is he really making? Ted is working 60 hours a week to get the additional $2,633 a month. That boils down to $10.17 an hour, and we still haven’t looked at how his PSP could help in retirement.
What about PSP? As we said earlier, a PSP is a great wealth accumulation tool called a 401(k) program. 401(k)’s have the feature of allowing you to take pre-tax money (money before you pay state or federal taxes) and invest it in a tax-deferred account. You pay taxes on the money when you withdraw the funds. So PSP allows you to accumulate money, including the tax savings, on a tax-deferred growth. By all reckoning, it is a great accumulation tool. If we take the money we were putting into a PSP and take it out to supplement your retirement, the calculation changes even more dramatically.

Normally, when a financial planner talks about 401(k) withdrawals, we want to preserve the principal for as long as possible. Your PSP is a nest-egg, and in this uncertain world of tax changes, medical changes, market changes, oil prices and world news, keeping a nest egg is more important than ever. You may want to consider leaving your PSP balance alone for some period of time, and allowing it to accumulate and grow until you need it. However, if we want to see what we could get from your PSP and not hurt it, we can make a comparison using some form of withdrawal. Withdrawals can be a variety of ways, but for financial planning purposes, we consider some regular form of withdrawal, like a fixed percentage of the account (say 3 or 4%), or perhaps the income or interest on the account.
When you actually start taking a withdrawal, it’s advisable to build in some form of inflation protection. This can be as simple as taking a percentage of the account, like 3%, or by building in some sort of inflation protection. Again, erring on the side of caution will at least preserve your nest egg.

Of course all of this has to be done within the confines of the tax rules on PSP withdrawals. In taxes, what the big print gives, the fine print takes away. A PSP has some complex tax rules about withdrawals and you can make expensive mistakes by taking too much out too early, or even worse, taking money out too late. It’s important to know the rules. Consult with your tax advisor or preparer if you are not sure. IRS publication 590 explains all of the rules. [http://www.irs.gov/publications/p590/index.html](http://www.irs.gov/publications/p590/index.html)
There are a variety of ways to look at 401(k) withdrawals. There are three phases of your financial life: the early phase is where you accumulate money. Here, the most important phase is saving. The more you put in, the faster your account grows. The second operative phase is after you’ve built a significant balance and your investment return exceeds your contributions. This phase is called preservation. Here your important skill is investing, since your investment return is the most important factor to growth. The third phase is distribution, where you take money out of your 401(k). Here the most important thing is risk reduction. Reducing risk in the distribution phase is essential, since a volatile investment can be fatal to a 401(k).

“Putting In or Taking Out?”

With your PSP, there are a few basic approaches: You can use your PSP as a retirement supplement to add to your retirement, you can use your PSP as a sort of ‘bridge’ to a later date, or you can use your PSP as a ‘nest-egg’ or retirement savings pool.

If you use your PSP as a retirement supplement, you need to treat it like your pension: it needs to last your lifetime. In addition, you should consider adding in some inflation protection as well. There are a couple of ways to determine the length of your withdrawals; you can make the money last longer than your lifetime, or you can try to use it up over your lifetime.

## PSP Withdrawals

- **Approaches:**
  - Use 401(k) as a retirement supplement:
    - Inflation - adjusted permanent stream
    - Permanent stream allows perpetual flow; leave some to heirs
    - ‘Die Broke’ - use it all up
    - Die broke is appealing, but difficult to execute
  - Use 401(k) as a bridge for early retirement
  - Use 401(k) as a nest-egg
PSP Permanent Retirement Stream

- Need in current dollars/(return-inflation)
- Example: Need (Want) $12,000/year (above your pension)
  - Inflation @ 3%/Return @ 8%
  - Real Rate of Return = 5%
  - $12,000/.05 = $240,000
  - $240,000 401(k) nest egg, growing at 8% will provide a $12,000 annual stream with a 3% inflation adjustment, forever.

To take a permanent stream, subject to tax rules, of course, you can simply either take the amount you want and divide it by the real rate of return, or take what your 401(k) balance currently is and multiply it times the real rate of return.

Here’s what we mean: Let’s suppose you believe your long-term rate of return will be about 8%. You also feel that inflation will cause your retirement needs to increase at 3% a year. Your inflation-adjusted return is about 5%, or 8% minus 3%. [NOTE FROM AUTHOR: This calculation is over-simplified and not completely correct. The actual real rate of return in this example is 4.85% (1.08/1.03), but for purposes of simplicity, we will say ‘about 5%’ and know the rules if we need to.]

Now take a retirement need or want, like $12,000 a year on top of your pension. $12,000 divided by 0.05 is $240,000. So you can take $12,000 out of your 401(k), make about $19,200 of investment return (assuming 8%). Next year, you start with about $247,200, which will allow an inflation adjusted distribution of $12,360. And make investment earnings of $19,776, which will leave behind some additional $7,416 of principal.

The withdrawal gets bigger, and the balance gets bigger.
This shows how the money builds up for your spouse, your kids or whoever. You get a bigger PSP balance, and a bigger withdrawal, as long as you take less out than you make. It is important to know that the income tax rules have to be followed, and in some cases, particularly if you live to a ripe old age, the distribution will increase to more than the inflation adjusted amount.

It’s also pretty important to make good assumptions on your calculation. Yale University uses this method to make sure that their endowments always have enough money. What Yale does is re-adjust the income and inflation numbers from time to time to make sure the endowment is keeping up with inflation. Yale then takes out only the investment return less inflation.

This approach has a distinct problem. Yale University will probably need a continuous stream of money for as long as it exists (which will probably be hundreds of years). So taking out less than it makes on its endowment (like your PSP) is a great idea. It’s pretty certain that the cost of running a university will be more in 2037 than now. What’s the cost of taking care of a retiree who’s 59 now in the year 2037? Will you spend as much when you’re 80 or 90 as when you first retire? And how much do you need after your retirement is over, when you die? Do you need to leave money for a spouse, or for children (do you want to?). You could scrupulously protect your PSP balance, invest it wisely, take the smallest possible distributions, and leave a bundle at your death, only to have your kids pay a giant amount of taxes and have your son-in-laws buy Harleys with what’s left.
Which brings us to a second approach, which is to use up the assets over your lifetime (or if you have a spouse, both your lifetimes), and have all of the money used up upon your death. This doesn’t mean you have to spend all of the money on yourself. You might, for example, use some of the funds to pay for a grandchild’s education, or better yet, you could participate in the grandchild’s education, like taking them on a trip or buying them a computer. It also doesn’t mean you don’t have to participate in charity, it only means you do your charitable works during your life instead of as a legacy.

There is a popular book entitled “Die Broke” by Stephen Pollan and Mark Levine, published in 1998 that goes through a variety of methodologies of using up your money during your lifetime, including ways to ensure you have enough money to last you for your lifetimes (including some that are reasonably guaranteed to provide an income stream). In our previous example, using the $12,000 a year withdrawal with a 3% inflation kicker, you would need $206,000 instead of $240,000, and you would run out of money in 37 years. Note there are ways to make sure you run out of money when you run out of life. Insurance companies offer a product called an immediate annuity, which guarantees a stream of money for a specific period of time (like your life).
If you have a look at this graphic, you see that the ‘capital’ line goes away at some point. This is the point where you are supposed to die (and be broke). Recognize the problem with the die broke approach: you can mess up and be dead broke instead of dead and broke.

If you intend to use your PSP as a retirement supplement for your lifetime, you should consider carefully the method you use to create your distribution. Consider your investment return, the projection of inflation, and how long you want the money to last. This is an important decision, so you may want an independent financial professional to help you in your decision.

Another approach some people do with their PSP is to use it as a retirement ‘bridge’ to supplement their income until some later date, like when their spouse retires. Say one spouse works for UAW-GM, and her husband works for another company, and he won’t get a pension and collect Social Security until he becomes 63. They want to retire now. They could use her PSP (within the tax rules, of course) to ‘bridge the gap’ until he can collect his pension and retirement. Be sure to make accurate calculations when you plan to use a 401(k) as a bridge.
Another way to use your PSP is as a retirement nest-egg. Here you merely leave the PSP alone and grow it until you need it, or until the mandatory distributions start (basically at age 70½). This is a good strategy for tax management early on (since you don’t pay tax on PSP until you make a withdrawal), and allows you a nest-egg for unknown future costs (like medical expense or long term care).

For purposes of this short course, we’re treating a PSP as a retirement supplement. It’s beyond the scope of this program to cover investing. If you want more information in investing, there are a considerable number of resources.
Let’s go back to our friend Claudio. He’s saved $200,000 in his PSP. He’s under the age of 55, so we’re going to have to open up our tax book and find an exception to the rule that says you have to be over 55 to take money out of his PSP without paying a substantial penalty.

Luckily, you can take money out of your 401(k) at any age if you follow something called the SEPP (Substantially Equal Periodic Payments, or the §72(t)) rule. The SEPP exemption would allow Claudio to take money out of the plan through an IRA rollover, as long as he took a consistent periodic amount (like $833 a month) for at least five years and didn’t change that amount until after age 59½. Let’s have a look at Claudio under that arrangement. By the way, the SEPP doesn’t mean you have to run out of money. If Claudio took $10,000 a year out of his 401(k) rollover and made 8%, he’d have about $287,000 in ten years, at which time he could take out any amount he wanted.

If you want to see the tax rules on the 72(t) exemption, see IRS publication 590 [http://www.irs.gov/publications/p590/index.html](http://www.irs.gov/publications/p590/index.html)

If we add a PSP withdrawal to Claudio’s previous example, where’s he taking money out of his PSP instead of putting it in the difference is even more dramatic.
If we take the example of straight time work or retire, the numbers are pretty impressive. If Claudio works straight time, he grosses about $4,870 in pay. His federal taxes are about $240, his state taxes are $150 (assuming about a 4.35% state tax rate), Social Security taxes are $302, Medicare taxes are $71. Remember Claudio was putting about $5,844 a year into his PSP. In addition, it costs Claudio about $292 a month to work (union dues and so on). He nets about $3,328. Your numbers will be different, but remember this is an example.

If Claudio retires with 30 years or more, he gets a pension of $3,160 (for retirement between 10/01/09 and 09/01/10). If we take a withdrawal from his PSP balance, using the IRA rollover we discussed previously, and Claudio has a $200,000 PSP balance, he can withdraw (without penalties) about $833 a month. This is taxable, so his deduction’s would be $181 for Federal income taxes and Union dues for a retired couple are $2. He has no state taxes (recognize this changes from state to state), no Social Security or Medicare taxes. No contributions to his PSP, since he’s withdrawing from it instead of putting into it. And (darn!) no going to and from work and a buck or two of union dues as a retiree instead of the regular union dues and cost of working.

Bottom line of retiring? Pension, including supplement, plus 401(k) withdrawal, minus taxes, equals about $3,810 a month net to not work, versus $3,328 to work. Comes out to about $2.78 an hour that Claudio PAYS to work.
Look at the overtime example: thirteen hours a week of overtime, plus 40 hours of regular pay, minus taxes, PSP and expenses, comes out to about $4,728, compared to $3,810 to not work. Net difference for 53 hours a week (not counting travel to and from work) is about $918 a month. Is this exciting? Claudio’s making $4.00 per hour working here.
Assume Ted, the 63 year old we met earlier, also has $200,000 in his 401(k) (even though he probably has more). Let’s also assume he takes 5% out of his account a year, letting him increase his balance and his withdrawal. At a real rate of return of 5%, Ted can take out $833 a month, increasing his after-tax cash flow to $4,123. Now, on a straight time comparison, Ted is down about $2.63 per hour.
Ted’s Big Adventure (OT)

<table>
<thead>
<tr>
<th></th>
<th>Work</th>
<th>Don’t Work</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross</td>
<td>9,951</td>
<td>1,944</td>
</tr>
<tr>
<td>Fed</td>
<td>1,257</td>
<td>-192</td>
</tr>
<tr>
<td>State</td>
<td>364</td>
<td>-0-</td>
</tr>
<tr>
<td>FICA</td>
<td>527</td>
<td>+1,540</td>
</tr>
<tr>
<td>Medicare</td>
<td>144</td>
<td>-0-</td>
</tr>
<tr>
<td>PSP</td>
<td>995</td>
<td>+833</td>
</tr>
<tr>
<td>JRE (6%)</td>
<td>597</td>
<td>-2</td>
</tr>
<tr>
<td>NET</td>
<td>6,067</td>
<td>4,123</td>
</tr>
</tbody>
</table>

NET $7.48 an hour.

Remember our skilled trades guy, Ted? He could get 20 hours of overtime. And remember he was eligible to collect Social Security. With 20 hours of overtime a week, Ted fares better. Now he’s making, for his 60 hours a week, an extra $1,944 a month. This boils down to $7.48 per hour.

Your bottom line is simple: you need to do this for yourself. As with any example, they look good but they’re not YOUR numbers. Below is a worksheet. Get a paycheck stub and calculate you working bottom line. Add in what you think the extra costs of working is, or use the Department of Labor estimate of 6% of pay. Get a pension projection and either use a tax table or have a tax person figure out your pension bottom line. Here’s a link to your PSP and benefits site: [http://401k.com](http://401k.com)
In this section, we’ll cover some of the rules about 401(k), IRAs and Social Security. These rules can be complex, but don’t let them get in the way of your retirement. Knowing the rules is very important to making your retirement plan work.
Let’s start with the rules on how PSP distributions are taxed. Remember that when you contribute to PSP, your contributions are not taxed (except for Social Security and Medicare taxes). You also don’t pay current taxes on any income earned on your investments in your PSP. You get the benefit of saving money and saving taxes at the same time. When you take money OUT of your PSP, the roles reverse and you pay taxes on the money coming out. As you make withdrawals from your PSP, those sums are included in your income.

If you choose the Roth option you will pay taxes when the deposits are added to the PSP. Your Federal and State taxes while working will be more than those we have illustrated. The good news is; the account grows tax free and you will not pay taxes when the money is withdrawn using a qualifying Roth Distribution. You may also roll your Roth 401(k) to a Roth IRA after retirement and not have to take Required Minimum Distributions at age 70½.

When you retire, you have a variety of options open to you. Depending on your age when you take money out, you might just leave your money in your PSP and take out funds as you wish (like a regular payment of some of the interest). You may want to take a larger amount out of your PSP, or move the whole thing to another plan, like an IRA and manage it that way.

So the first option with PSP is simple: you can leave it in the PSP, or move it out.
A Qualifying Roth Distribution is after age 59½ and having the account more than 5 years. As with all 401(k) & IRA Distributions make sure you know the rules and tax consequences before you take a distribution.

If you move it out of the PSP, you may cause taxes, and maybe some big taxes. Taking a distribution to yourself (just taking the money out) will be taxable, and possibly subject to an additional tax of 10%. There is a second option for persons born before 1936, where the money can be taxed as if you received it over ten years (called, not surprisingly, 10-year forward averaging). The third option involved transferring the PSP balance to another qualified (qualified means not currently taxed) like an IRA (Individual Retirement Account) plan or another qualified plan. Another qualified plan might be another employer’s plan, like if you retired from UAW-GM and went to work at a golf course where they have a 401(k) plan. Another employer might even be you, if you set up your own business, like real estate or kayak building or whatever. When you have your own business, you can make a plan for yourself like PSP (with even bigger contributions) and keep deferring income and saving taxes.
The first thing to know about your PSP is that once you retire, you can leave the money there and make withdrawals. If you retire in the year you become age 55 or older, any withdrawals from your PSP are taxed at whatever your tax rate is (which includes all your other taxable income, like your pension, spouse’s income, interest and so on). You can take any amount of money you want out of your PSP after you retire, up to the whole balance. However, taking the whole balance as a distribution treated as ordinary income is usually the most expensive tax treatment. An extremely unfortunate example would be a PSP participant, who upon retiring requests the Plan to send him a check for the full amount of his account which he then deposits in his checking account.

The problem is the progressive tax rates. Federal taxes start at a 10% bracket and move up progressively through a 15% bracket, 25% and so on. Adding a large distribution to your ordinary income in this way may very well take you from the 10% and 15% federal income tax brackets up to a much higher level of taxation. In addition, unless you will be at least age 55 in the calendar year you are separating from company service, you could be subject to a 10% penalty tax for distributions before age 55.

SO, the warning here is to think about the size of the distribution and your age and tax bracket before you take a withdrawal. You can possibly pay as much as 45% on a portion of a distribution!
We have more about the exceptions to the penalty tax for early withdrawals, but first let’s look at an example of how ordinary tax treatment of your plan distribution could invite the tax man to your retirement party.

**Unintended Consequences**

Sue is single, 53 and has worked at UAW-GM for 32 years. She packed away as much as she could in her PSP. As a result, she’s built up a nice nest egg of about $240,000 in her account. Her plant is closing, so she got an offer of $45,000. Sue took the offer, started getting her pension, and then took another job. Her friends were telling her to take her money out of the plan for investing, so she took the entire balance as a distribution. Her picture looks like this: we assumed $12,000 of itemized deductions with the lump sum, standard deduction without.

<table>
<thead>
<tr>
<th>Income from UAW-GM: $24,000</th>
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</thead>
<tbody>
<tr>
<td>Buyout: $45,000</td>
</tr>
<tr>
<td>Pension: $18,000</td>
</tr>
<tr>
<td>New Job: $15,000</td>
</tr>
<tr>
<td>PSP Distribution $240,000</td>
</tr>
</tbody>
</table>

**The Damage:** $95,063 Taxes + $24,000 Penalty = $119,063

**What she could have done:**
If she would have left the money in her PSP, or rolled it over to an IRA, or even to her new employer’s plan, she would have saved $98,037 in taxes. She gave up over 40% of her savings.

**Moral of the story:**
Your PSP is a tremendous wealth accumulation tool, but remember the tax man when the money comes out!
A Lump Sum Distribution is the payment to you, within one calendar year, of your entire balance in a qualified retirement plan, such as your PSP. You must have separated from service with the Company in order to be eligible to receive a lump sum distribution. If you receive a lump-sum distribution, you may be able to make a one-time election to figure the tax on the payment by using ten-year averaging. This special treatment can result in a lower tax rate on the whole sum, because it treats the payment as if it were paid over ten years. In addition, the tax on the distribution is computed separately from your other taxable income so that you are not pushed into a higher tax bracket.
Lump Sum Distributions

- A Qualified Plan Participant is Eligible for Ten-Year Averaging if:
  1. Born Before January 1, 1936, and
  2. Was a Plan Participant for at Least 5 Years

- Tax is Computed on the Distribution:
  1. As if Received Over 10 Years

But what the big print gives, the fine print takes away. Here’s the catch: to be eligible for Ten-Year Averaging, you must have been age 50 before January 1, 1986. In other words, you must have been born before January 1, 1936. You also must have been a plan participant for at least 5 years. Under 10-Year Averaging, the tax is computed as if you received equal distributions over 10 years, using 1986 tax rates for a single taxpayer.

Enough of the tax lesson, you should consult your tax advisor for details.
Direct Transfer

- You May Transfer Your Plan Balance Directly to
  - Another Employer’s Qualified Plan, or
  - A Self-Directed IRA
  - A Roth IRA

- The Plan Administrator Transfers Your Funds to the Qualified Plan or IRA Trustee
  - You do Not Take Possession of the Funds
  - Check is Payable to Trustee, for Your Benefit

- As Long as Receiving Plan Accepts Transfers
  - You May Make Unlimited Transfers

Another approach with your PSP is to make a direct transfer to another plan or an IRA. The beauty of a transfer is there is no tax on moving between plans. Some key points to note about transfers is that the money has to go from your PSP to the IRA (or other plan) directly. You shouldn’t take the money in your own name and move it into the plan. When you do a transfer, your PSP writes the check to the trustee of your IRA. You receive the check (or the shares of employer stock), made out to the trustee of your new plan, and you deposit it with that custodian. As long as the receiving plan accepts transfer, you can make unlimited transfers.

You can use transfers as a way to consolidate accounts as well. Suppose you worked somewhere else and had a 401(k) or pension plan that had a lump sum and you rolled or transferred that to an IRA. You can use the rollover IRA to consolidate your previous plan and your PSP.

You may do a direct transfer to a Roth IRA. The problem here is that the balance will be taxed in that year, excluding your Roth PSP balance and your PSP after-tax contributions, since you already paid tax on those contributions. Make sure you consult with your tax advisor regarding this option!
Rollover

- You Take Possession of Your Distribution, then Roll it Over to Another Qualified Plan or IRA
  - The Check is Made Payable to You

- You Receive the Requested Distribution, Less 20% Withholding Tax.
  - Withholding Tax Refunded If You Rollover the Entire Taxable Amount within 60 Days
  - 20% Withholding Tax Doesn’t Apply to IRA Distributions

- May Do Only One Rollover in a 12 Month Period

A rollover is different from a transfer, even though most people, including a whole bunch of people in the financial services business, call any plan-to-plan transfer a rollover. Technically, a rollover is when you take full possession of the distribution (the check is made out to you, not the trustee of your IRA), and then within 60 days, you contribute the money to an IRA.

When you take a distribution in your own name, the PSP administrator must withhold 20% federal tax. If you’re following the numbers, you have 60 days to roll the entire balance over to an IRA. However, the IRS has 20% of your distribution in withholding. You can see this can present a problem if you don’t want to pay taxes (and maybe penalties) on the distribution. When you take the check in your name, you’d have to come up with the withholdings to make the entire distribution tax-free. Let’s look at the following example.
This example shows a $200,000 401(k) distribution.

If you decide to “Rollover” your plan distribution, your employer is obligated to deduct 20% for withholding tax. This happens if the check is made out in your name, so you can cash it. You can see that the check made payable to you is reduced by 20% withholding tax to $160,000. The balance of the amount you were expecting, $40,000, is forwarded to the IRS.

When you then roll the $160,000 distribution into another employer’s qualified plan or self-directed IRA (within 60 days), you must also include the $40,000 withheld for taxes to avoid paying taxes on it. The problem, of course, is: where do you get the extra $40,000 to include in your rollover? If you find the money and include it in your rollover, you’ll be able to claim a refund on your tax return, but the problem is: you need the money now! That’s why it is better to make a “Direct Transfer”. Let’s say in this example, you didn’t have an extra $40,000 laying around to make the rollover, but you do put the $160,000 in an IRA. You’d pay taxes, and maybe a penalty of 10% on the $40,000. Depending on your other income, this might cost you as much as $18,000 of tax, just to have $40,000 in withholdings.
With a “Direct Transfer”, the check is made out to the new plan custodian, “for the benefit of” or ‘fbo’- you. This means you are not able to cash the check and no withholding tax is required. The check is occasionally sent directly to the new custodian. However, if it is sent to you, you simply forward it to the new custodian. Since the check is made out for your benefit, the new custodian can only deposit the funds in your IRA account.

Now, let’s summarize the taxation of distributions and give you some more details on how to avoid penalty taxes.
Taxation of Distribution Summary

- **Ordinary Income Tax Rate**
- **Before Age 59 ½**
  - 10% Penalty Tax
- **Age 59 ½ -70**
  - You Rule!
- **Age 70 ½**
  - Minimum Distribution Requirement
  - 50% Penalty Tax

To have a look at the rules, you pay tax on your PSP money when it comes into your hands. PSP distributions (or distributions from an IRA that had PSP funds transferred to it) are taxed at your regular income tax rates. Depending on your age when you take a distribution, you may have to pay additional taxes. Qualifying Roth distributions are not taxed.

The first rule is if you take money out before age 59½. If you take PSP distributions before age 59½, you may be subject to an additional 10% tax (the IRS doesn’t call this a ‘penalty’, although they used to, so we’re calling it a penalty). The biggest exception to the penalty is easy to remember: you don’t pay any penalty tax if you separate from service (retire or quit) in the year you are 55 or older and take a distribution from your PSP. There’s more exceptions, including the very important one that lets you take your PSP money at any age, which we’ll get into later.

Between 59½ and 70½, you can basically take any amount of distribution you want or need. Here, you use your PSP money like you want. Remember that you will pay tax on the distribution, so watching your tax bracket (and probably watching your balance so you don’t run out) becomes very important.

With Roth 401(k) distributions you are never taxed on the amounts you contributed. Amounts in excess of your contributions will be subject to tax and penalty if they are not qualifying Roth distributions.
At 70½, things become a little more complicated. In general, by 70½ (technically, by April 1 of the year after you turn 70½: don’t ask why), you must begin taking a required minimum distribution (RMD). If you fail to take the RMD, there is a 50% penalty associated with the required withdrawal. 50% is usually a pretty good deterrent, but most custodians (the people who hold IRAs) will make the distribution for you whether you want it or not.

Roth 401(k)s may be transferred or rolled into Roth IRAs. Roth IRAs do not require distributions at age 70½.

So the rules are basically: before 59½, you can take money, but have to follow the rules to avoid penalties; between 59½ and 70½, you can take money however you want, and after 70½, you must take some money or face penalties. Also, oh yes, you pay tax on whatever you take out. We said your PSP was rewarding, which it is; we didn’t say the tax rules involved were easy to understand.
Premature Distributions

- 10% Penalty Tax on Distributions Before Age 55
- Exceptions to the 10% Penalty Tax:
  - Death
  - Disability
  - Medical Care Expenses in Excess of 7.5% of AGI
  - Health Insurance Premiums Paid by the Unemployed
  - Qualified Higher Education Expenses
  - Qualified First Time Homebuyers, up to $10,000
  - Substantially Equal Periodic Payments
  - Tax-Free Rollover/Transfer to Another Plan/IRA
  - QDRO
  - IRS Seizure

We covered the pre-59½ penalty: Here is a list of exceptions to the 10% penalty tax for early withdrawal.

- We don’t recommend either of the first two exceptions, but it is reassuring to know that if you die your spouse or other beneficiary can remove funds from your PSP or IRA without paying the 10% penalty. It’s also good to know that if you become disabled, you’d be able to tap into your 401(k) and IRA funds before age 55 with out paying the 10% penalty tax. You would, of course, still have to pay ordinary income tax.
- If you have Unreimbursed Medical Care expenses in excess of 7½% of your Adjusted Gross Income you may withdraw funds from your IRA to pay these expenses, without paying the 10% penalty tax. If you take advantage of this exception, you’d want to keep good records to be able to prove what portion of your medical bills we’re in excess of the 7½% threshold, in case of an audit.
- You may also withdraw money from your IRA to pay health insurance premiums if you are unemployed, without the 10% penalty.
- Similarly, you can withdraw up to $10,000 from your IRA, without penalty, as a first-time homebuyer. As with all these exceptions, you’d still have to pay ordinary income tax on the amount you withdrew.
• Taking “substantially equal periodic payments” is a useful and sophisticated technique that allows you to avoid the 10% penalty on withdrawals taken at any age. We’ll cover this and the 55 year old rule on your 401(k) in just a few minutes.

• As mentioned earlier, there is no 10% penalty on tax-free Rollovers or Direct Transfers to another plan or IRA, when done properly. However, once the money is in the IRA Rollover, the normal IRA rules apply.

• QDRO, stands for the Qualified Domestic Relations Order that a judge may issue as part of a property settlement in a divorce. If a judge issues a QDRO requiring you to transfer a portion of your 401(k) to your soon-to-be ex-spouse, you are not required to pay the 10% penalty tax on that distribution. Pretty nice of them, eh?

• Along the same line, you are not required to pay the 10% penalty tax for early withdrawal on any amount the IRS seizes from your 401(k) or IRA for non-payment of taxes.

• Now, let’s take a closer look at a couple of special exceptions to the 10% penalty.

The same exceptions are not true with Roth 401(k)s. Make sure to consult with your tax advisor about how these exceptions apply to you.
Special Exceptions to the 10% Penalty Tax Before Age 59 ½

1. Terminating Your Employment in the Calendar Year You will be at Least Age 55
   - Applies to Funds in Your 401(k), 403(b)

2. Substantially Equal Periodic Payments, Annuitization or 72(t) Distribution
   - Applies to Funds in an IRA
   - May be Funds Transferred or Rolled Over from a Defined Contribution Retirement Plan to an IRA

The two most important exceptions to the 10% early distribution penalty are for taking funds from your PSP at 55 or older, and taking a regular set of distributions from your IRA.

The termination of employment exclusion #1, says that you don’t pay the 10% penalty for any distribution made from your PSP to you after the year you turn 55 or older, provided you have left employment. That means that Tom, who is 54, but will be 55 in December, and retires from UAW-GM in July, would be able to take funds directly from his PSP without the extra tax. Sue is 53, and she wants to use her PSP as a retirement supplement. This exception won’t work for her, since she’s not attaining 55 in the year she takes the distribution. Ralph is 56, and hasn’t retired. He can’t use the exception either. You have both be attaining 55 (or older) and leave employment to use this exception.

If you’re younger than 55 and want to have a distribution from your PSP money, or if you want the flexibility of an IRA as a retirement tool, you can use the second exception, called the Substantially Equal Periodic Payments exception, or the §72(t) exemption. Exception #2 lets you get some money out at any age, provided that the funds come from an IRA (so you have to do some sort of transfer to an IRA), are a regular series of payments, and the payment streams are not modified.

Let’s look at both exceptions in detail.
1. Terminating Employment in Calendar Year You will be at Least Age 55

- No 10% Penalty
- Applies Only to Funds in PSP, other 401(k)s, 403(b)s
- Potential Pitfall
  - If You Qualify but Transfer Your Funds to an IRA, You Must Wait until 59 ½ to Avoid the 10% Penalty Tax
- If You Qualify, You Must Still Pay Ordinary Income Tax
- See Your Tax Advisor!

To summarize the ‘55’ exception (#1), you don’t pay the penalty if you take funds directly from your PSP (or another 401(k) or a 403(b)) in the year you become 55 or older and have separated from service. It is important to remember this rule requires you to stay in your PSP: you can’t use this rule on an IRA. It’s also important to remember any of these exceptions only get you out of the penalty tax, not out of income taxes. Sorry, you still have to pay those.
2. Substantially Equal Periodic Payments

- No 10% Penalty
- Annuitization, 72(t) Distribution Applies to Periodic Distributions From
  - IRAs
  - Defined Benefit Retirement Plans
  - Defined Contribution Retirement Plans
- Payments for the Greater of:
  - Five Years
  - Age 59 ½
- Distributions are Taxed as Ordinary Income

Exception #2 the SEPP or 72(t) is a great exception. It allows you to avoid the 10% penalty tax at any age if you take a regular payment, at least annually (but it can be more frequently, like monthly), that is designed to last over your lifetime, or you and your spouse’s lifetimes, at a reasonable rate of interest. There are other methods of using the 72(t) as well, like buying a commercial annuity, or using other forms of calculations. The 72(t) is nifty, but you have to know that you are stuck with the distribution as you calculated it for the longer of 5 years or until you are age 59½. So if you start a distribution at age 52, you must continue it until you become 59½. A distribution of less or more subjects you to the penalty tax. If you were 57 when you started a 72(t), you’d have to continue it until you were 62, since 5 years is longer than the 1½ years it takes to get to 59½.

Let’s take an example of a 72(t): Cindy is 52 and has $140,000 in her PSP. She has 30 years of service and is retiring. Cindy wants to take a regular monthly distribution on her account and of course doesn’t want to pay the penalty tax. Here’s what she does: First she rolls her PSP into an IRA. For purposes of this example, let’s suppose she sets up the IRA at Fidelity, where the PSP is administered currently. She then calculates her 72(t) based on the IRS rules (actually, she asks her brother-in-law the CPA to do it for her: 72(t) is complex and you should probably get help). Her 72(t) comes out to about $811 month. So, Cindy can take $811 a month between now, when she’s 52, and 59½. Note the distribution is about 7% of her total, so she’ll have to be careful about her investments. If she makes more than 7%, her IRA will grow. If she makes less than 7%, it will shrink.
72(t) is complex. To see more have a look at IRS Publication 590 http://www.irs.gov/publications/p590/index.html, and go see an independent financial advisor. Another decent resource is at http://72t.net/5tpp/irc72tcalculator.aspx
Social Security

- Social Security was Meant to Provide A:
  - Supplement to Our Retirement Income
  - Floor of Protection
- Eligibility for Social Security Benefits
  - Based on “Quarters of Coverage”
- Your Quarters of Coverage Determine whether You are “Fully Insured” or “Currently Insured”
  - Determines Benefits You Will Receive

Social Security is another source of retirement income. The Social Security System provides us with a **supplement** to our retirement income.

A. Haeworth Robertson, Chief Actuary of U.S. Social Security, 1975-1978 stated: “Social Security is merely a floor of protection upon which we build through supplemental private savings, insurance and retirement programs.” Since the purpose of Social Security is to provide only a minimum standard of living, those depending solely on Social Security during retirement will be unlikely to meet their everyday living expenses.

To find out whether you’re covered by Social Security Retirement Benefits, you need to determine the periods of time during which you paid Social Security taxes. These time periods are called “quarters of coverage”. A quarter of coverage is a calendar quarter (a 3 month period ending March 31, June 30, September 30, or December 31) of any year. An individual earns a quarter of coverage if he or she has a specified amount of earnings during a calendar year (formerly, had to earn money in each quarter). Your quarters of coverage determine whether you are “fully insured” or “currently insured”, which in turn determines what benefits you will receive. All the time you worked counts toward your quarters of coverage. Generally the highest 35 years of average indexed earnings are used to calculate your benefit.
Fully Insured Status

- Must Be **Fully Insured** to Collect Retirement Benefits:
  1. 40 Quarters (10 Years) of Coverage (if born in 1929 or later)
     or
  2. 1 Quarter of Coverage
      - For Each Year After 1950
      (or after the year in Which You Became 21, if later)
      - And before the year of your Disability, Death or Year of Attaining Age 62
  - In Any Case, You Must Have at Least 6 Quarters of Coverage.

To be fully insured, you need 40 quarters of coverage, which for most of us, is really easy, since we’ve been working for more than 10 years and paying into Social Security. Fully insured does not mean maximum benefit, it means you’re in the system.
Determining Your Benefit

- Contact Social Security for an Estimate of Your Retirement Benefit
  - (800) 772-1213 or www.ssa.gov
- Annual Estimates Automatically Provided to Tax Payers Age 25 & Over
- Your Average Indexed Monthly Earnings (AIME) Determines Your Primary Insurance Amount (PIA)
- Your PIA is the Amount You Would Receive at Your Full Retirement Age (FRA)

To determine your Social Security Retirement Benefit you must first calculate your Average Indexed Monthly Earnings, or AIME, which is based on your Social Security earnings after 1950. Rather than performing the laborious calculations yourself, you may want to simply ask Social Security for an estimate of your retirement benefit. You can call them at (800) 772-1213 or go to their web site at http://www.ssa.gov/ You may have already received an “Earnings and Benefit Estimates Statement”, because, since October of 1999, the Social Security Administration has been sending them to anyone age 25 or older, who is not yet receiving benefits.

Your Average Indexed Monthly Earnings determines your Primary Insurance Amount, or PIA, for all subsequent calculations of benefits to which you and family members are entitled. The Primary Insurance Amount is the amount you will receive if you retire at your Full Retirement Age (FRA).
Social Security benefits may be adjusted annually for inflation, and the percentage increase is announced each November. Once the increase is announced, your Social Security benefit will increase automatically, effective with the January payment.

Social Security pays your full Social Security benefit at your Full Retirement Age, or FRA. Your FRA is based on the year of your birth. The chart on the next page helps you look up your FRA.
<table>
<thead>
<tr>
<th>Year of Birth</th>
<th>Full Retirement Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1938</td>
<td>65</td>
</tr>
<tr>
<td>1938</td>
<td>65 and 2 months</td>
</tr>
<tr>
<td>1939</td>
<td>65 and 4 months</td>
</tr>
<tr>
<td>1940</td>
<td>65 and 6 months</td>
</tr>
<tr>
<td>1941</td>
<td>65 and 8 months</td>
</tr>
<tr>
<td>1942</td>
<td>65 and 10 months</td>
</tr>
<tr>
<td>1943 - 54</td>
<td>66</td>
</tr>
<tr>
<td>1955</td>
<td>66 and 2 months</td>
</tr>
<tr>
<td>1956</td>
<td>66 and 4 months</td>
</tr>
<tr>
<td>1957</td>
<td>66 and 6 months</td>
</tr>
<tr>
<td>1958</td>
<td>66 and 8 months</td>
</tr>
<tr>
<td>1959</td>
<td>66 and 10 months</td>
</tr>
<tr>
<td>1960 or later</td>
<td>67</td>
</tr>
</tbody>
</table>

For example, if you were born before 1938, your Full Retirement Age is 65. If you were born in 1953, you receive full benefits at a Full Retirement Age of 66. Full Retirement Age is important because it determines how much you will receive at different ages. This is also important when you want to collect a benefit before your Full Retirement Age.
Early Retirement
Full Retirement Age 65

<table>
<thead>
<tr>
<th>Age</th>
<th>Reduced Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>62</td>
<td>80.00%</td>
</tr>
<tr>
<td>63</td>
<td>86.66%</td>
</tr>
<tr>
<td>64</td>
<td>93.33%</td>
</tr>
<tr>
<td>65</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

If you retire earlier than FRA, your benefit is reduced to a percentage of your Full Retirement Benefit. If you were born before 1938, your Full Retirement Age is 65. If you started collecting benefits at 62, you’d get 80% of your Full Social Security Benefit. This is called Early Retirement for purposes of Social Security. Why this is really important, is that your supplement (either the interim or the 30 and out supplement) drops off and your total pension is reduced. If you chose to not collect your Social Security benefit your supplement still drops off at age 62 plus one month.
### Early Retirement Reductions

<table>
<thead>
<tr>
<th>Years Before FRA</th>
<th>Percentage Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>First 3 Years</td>
<td>36 Months × ( \frac{5}{9} ) = ( \frac{180}{9} ) = 20%</td>
</tr>
<tr>
<td>Each Additional Year</td>
<td>12 Months × ( \frac{5}{12} ) = ( \frac{60}{12} ) = 5%</td>
</tr>
</tbody>
</table>

This graphic shows the calculations for benefit reductions for early retirement.

- **Thirty-six months times 5/9 of 1% gives you a 20% reduction for the first 3 years.** So, you keep 80% of your Full Retirement Benefit.

- **Then, 12 months times 5/12 gives you a 5% reduction of your Full Retirement Benefit for each additional year prior to your Full Retirement Age.**
Early Retirement
Full Retirement Age = 66

<table>
<thead>
<tr>
<th>Age</th>
<th>Reduced Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>62</td>
<td>75%</td>
</tr>
<tr>
<td>63</td>
<td>80%</td>
</tr>
<tr>
<td>64</td>
<td>86.66%</td>
</tr>
<tr>
<td>65</td>
<td>93.33%</td>
</tr>
<tr>
<td>66</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

For those individuals born between 1943 - 1954 (baby boomers) with a full retirement age of 66, how much will their benefits be reduced if they choose to take an early retirement?

This chart shows the same pattern of percentage reductions in benefits over the first 3 years prior to full retirement age of 66. That’s the same **5/9 of 1% reduction for each of the first 36 months**, resulting in a **20% reduction for the initial 3 years**. We also see the **5/12 of 1% reduction for each month in excess of the first 3 years**, resulting in an additional **5% reduction for the 4th year before full retirement age**. With a full retirement age of 66, our baby boomers could retire as early as age 62, with 75% of their Full Retirement Benefit.

Anyone with a Full Retirement Age of **67** would experience the same pattern in reductions with an additional 5% reduction for the year they turn 62, giving them 70 percent of their Full Retirement Benefit.
Delayed Retirement

- Working Full-Time Beyond Full Retirement Age Increases Your Benefit Two Ways:
  1. You Add High Earnings to Your Record, Resulting in a Higher Benefit
  2. You May Receive Delayed Retirement Credits, which Increase Your Benefit by a Certain Percentage

If you chose to work past your FRA, you get a bigger benefit. Working past FRA can add higher earnings to your earnings record. In addition, you can get delayed retirement credits, which actually increase your benefits.
Delayed Retirement Credits

<table>
<thead>
<tr>
<th>Year of Birth</th>
<th>Yearly Percentage Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1931 – 1932</td>
<td>5.0%</td>
</tr>
<tr>
<td>1933 – 1934</td>
<td>5.5%</td>
</tr>
<tr>
<td>1935 – 1936</td>
<td>6.0%</td>
</tr>
<tr>
<td>1937 – 1938</td>
<td>6.5%</td>
</tr>
<tr>
<td>1939 – 1940</td>
<td>7.0%</td>
</tr>
<tr>
<td>1941 – 1942</td>
<td>7.5%</td>
</tr>
<tr>
<td>1943 or later</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

If you look at this chart you can see that working beyond your FRA can provide an increase in your benefit. Find the year of your birth and you can see the percentage increase for each year worked. Note that you’re giving up a year of benefit to get a bigger benefit later. Most of the time, you’re better off taking your benefit at FRA rather than waiting.
A big issue for you to consider about Social Security is what happens if you decide to work while collecting Social Security. This is called the Earnings Limitation, and can dramatically reduce your benefit if you work while collecting Social Security benefits before your Full Retirement Age. The benefit loss is significant. For example, suppose you were born in 1943, so your FRA is age 66. Suppose further that you are working at a part time job, and in 2011, your supplement drops off your pension and your Social Security begins at 80% of your Full Retirement benefit (since you’re 63). For every dollar you make from your job up to $17,040, you have no reduction of your Social Security benefit, so you receive your pension, your Social Security and your paycheck. [http://www.ssa.gov/](http://www.ssa.gov/)

However, watch what happens if you make $18,040, or $1,000 over the limit. You went over the earnings threshold by $1,000, so you lose $500 of your Social Security benefits. In addition, you still pay taxes on your earnings, so you had to pay income tax and Social Security taxes on the extra thousand. Say you had a good job that paid $45,000. You’d lose your whole Social Security benefit. In this case, you’d be better off not taking Social Security and waiting until you have reached your Full Retirement Age.

It is recommended that you visit [https://www.ssa.gov/pubs/](https://www.ssa.gov/pubs/) and search for the publication entitled *How Work Affects Your Benefits*. It explains the rules you must follow in order to avoid an overpayment, and it give some great examples for different scenarios that could apply to your individual situation.
The big reduction in Social Security benefits applies to the years before FRA is reached. In our example above, working for the years when you were 63-66 would have the earning limit of $17,040 (This can change on a regular basis). In the year you reach your FRA, the limit jumps up to $45,360, and the amount of benefit lost is $1 for every $3 over the Threshold for 2018.

Once you reach FRA, there is no earnings threshold, nor is there any benefit lost.

The only kind of earnings that count is earned income, which is wages or salary, or money you earn from self-employment. Interest, dividends, pensions, PSP withdrawals, IRA withdrawals, do NOT count against the earnings limit.
Another big issue that affects your Social Security is that Social Security may be partially taxed. Depending on how much you make from other sources, (which also includes part of your Social Security benefits), you may pay taxes on your Social Security benefits. If you look at the figure above, a married couple with Modified Adjusted Gross Income of $32,000 to $44,000 may have up to 50% of their Social Security benefits taxed. If their Modified Adjusted Gross Income is over $44,000, up to 85% of their Social Security benefit is taxed.

At first this might aggravate you (who isn’t aggravated by taxes?) just remember that your pension supplement was fully taxed, so you actually get a tax break, even if you pay tax on 85% of your Social Security benefit. Modified Adjusted Gross Income (why is it always complicated?) is basically all of your income, including interest, dividends, pension, PSP or IRA withdrawals, plus ½ your Social Security benefit. So the bottom line is that people with low incomes don’t pay tax on Social Security, and people with incomes above $25,000 or so may have a portion of the Social Security benefit taxed.
Social Security taxation is complicated, so we’ll refer you to the IRS publication http://www.irs.gov/pub/irs-pdf/p915.pdf.
You may also want to talk to your tax or financial advisor when you start receiving Social Security.
Additional Social Security Benefits

- Disability Benefits
  - Provide Security for those Severely Disabled Before Age 65
  - Considered Disabled if Impairment:
    - Prevents Any Substantial Gainful Work
    - Is Expected to Last, or has Lasted, at Least One Year or Expected to Result in Death

- Survivor Benefits
  - Provide Security to Family of Deceased Worker
    - Widow/Widower, Unmarried Children, Divorced or Widowed Children, Grandchildren, Great Grandchildren

There’s more to Social Security than just retirement benefits. You can also receive Social Security disability benefits for a total and permanent disability before FRA. It’s really important for you to note that you are only eligible for disability benefits if you had coverage in the Social Security system for 5 of the 10 years preceding the disability. This means if you retired prior to age 57 for example (the early retirement age of 62 minus 5 years), and didn’t have any wages covered in the Social Security system, you might not be eligible for a disability benefit if you became disabled.

Survivor benefits provide a benefit to the family of a deceased worker, and cover the surviving spouse, some children, grandchildren and great grandchildren (depending on their age and dependency).
Applying for Social Security

- Apply 3 to 6 Months Before You Expect Benefits
- Documents Needed for Your Appointment:
  - Social Security Card
  - Copy of W-2 Federal Income Tax Forms for Two Years Prior to Year of Filing
  - Birth Certificate or other Evidence of Age
  - Marriage Certificate
    - (For Spouse’s or Survivor Benefit)
- Generally, Original Documents are Required

You should apply for Social Security three months before you expect to receive benefits. You can apply in person or on-line.

The on-line application is secure and easy, or you can apply in person at the local Social Security office. You generally need your Social Security card, and original (or true copy) of your birth certificate, the last two years W-2 forms (if you worked for the two years prior to applying for benefits). If you apply for survivor’s benefits or spousal benefit, you may also need an original (or true copy) of a marriage certificate. Original documents are usually required. Original means the original or a true copy from the registering office. If you had military service or certain other forms of service, you may need additional information. To see more about the process, go to http://www.ssa.gov.

Another option is to call Social Security at 800-772-1213 to schedule an appointment to apply in-person at your local Social Security office with a face-to-face appointment.
A big issue is retiree medical. It’s very important for you and your family to understand your benefits and stay abreast of any contract changes. A critical aspect of medical benefit is how your benefits interweave with Medicare. When you reach age 65, you must apply for Medicare.
Conclusion

- Set up your own analysis
- Compare bottom line
- Look into a good PSP mix
- Watch your taxes
- Plan out your retirement

What’s the bottom line for you? Make sure you make a good comparison on your after-tax work or retirement situation. Make sure you use your PSP to your advantage and watch out for taxes.

And when you get to the bottom line, remember why you work in the first place. Sometimes you sow, sometimes you reap.