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Seven Retirement Myths Debunked

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Searching for "retirement planning rules" produces 221 million results on Google. Yes, there's a lot of advice out there. But even the most common tips can put you on the wrong path, leading to retirement planning mistakes.

Here are some of the leading legends, and why they should be taken with a large helping of salt:

Myth 1: You Should Max Your 401(k) Contributions

It's not a myth that participants in employer-sponsored retirement plans should take full advantage of any match that's offered. Say a hypothetical Viv Cook earns $100,000 a year; her employer promises a 100% match on up to 6% of pay.

"Viv should contribute at least $6,000 to her 401(k) this year," said IRA expert Ed Slott, a CPA in Rockville Centre, N.Y. The $6,000 employer match would be an instant 100% return, with no market risk. Hard to pass up.

Retirement Planning Mistake To Avoid

"But Viv shouldn't automatically go beyond $6,000 to the $19,500 upper limit this year ($26,000 for those 50 or older)," said Slott, founder of IRAhelp.com. Unmatched traditional 401(k) contributions only defer income tax, which is due upon withdrawal.

Especially if Viv could be in a higher tax bracket in the future, maxing her 401(k) each year could be a retirement planning mistake. Alternative uses for the unmatched dollars include paying down high-interest debt and funding a Health Savings Account for tax-free payment of qualified expenses. Viv also may be able to contribute to a Roth IRA or Roth 401(k), for investment flexibility plus freedom from required distributions, compared with a regular 401(k) account, and possible tax-free gains.

Such suggestions generated this comment from Slott: "I would add the myth that you cannot contribute to a traditional or Roth IRA if you are in a 401(k) or another company plan at work," he said. "That's not true, but even some financial advisors think this is the case." There are no IRS rules preventing you from having two or more 401(k) plans, but doing so can affect your tax deduction.

Myth 2: You Should Defer Tax In Retirement Accounts As Long As Possible

Deferring tax on potential investment income inside pretax retirement accounts is appealing. "However, the deferred tax will be due on future withdrawals, at whatever tax rates might apply then," Slott said. Required minimum distributions (RMDs) typically start at age 72 and continue indefinitely.

The longer withdrawals are deferred, the greater the expected buildup, and the larger taxable RMDs might be. If you're young and just getting started on retirement savings, you won't have to worry about it yet. But just keep in mind you will ultimately have to pay income taxes on your pretax retirement accounts.

"Between ages 59-1/2 and 72, you can take out as much or as little you want, without penalty," Slott said. Carefully monitoring distributions can keep income within relatively low tax brackets, generating more after-tax cash flow for productive purposes.

Myth 3: I Can't Collect Social Security Benefits Until I Retire

Assuming you can't collect Social Security until you stop working is another retirement planning mistake. It is possible to **collect Social Security** earlier.

"If you are contemplating filing for benefits while still making money from work, you should understand the annual earnings test," said Heather Schreiber, founder of HLS Retirement Consulting in Holly Springs, Ga. When you are under full retirement age (FRA) for the entire year, earnings over a yearly cap will reduce your benefit by 50% of the excess amount.

"If you earn $10,000 over $18,960 in 2021, $5,000 will be withheld before your monthly benefits will be paid," said Schreiber, who is the creator of the Social Security Advisor newsletter. This cap is reset each year.

In the year you reach FRA, the earnings test is easier to pass. And once you reach your FRA — now 66 to 67, depending on year of birth — the earnings limit will lapse.

"The good news is that any benefits withheld due to excess earnings are not truly lost," Schreiber said. At your FRA, your monthly benefit will increase to account for the dollars previously withheld.

Myth 4: Expenses Go Up In Retirement

It's true that the cost of living in retirement is likely going to go up due to inflation. And health care costs are expected to be a large part of your retirement costs.

However, you're probably going to spend less money on housing, transportation and food in retirement. Also, you probably won't have the costs of getting to and from work or joining the work crew for drinks. Some retirees add travel expenses in their retirement, and others are comfortable at home or in their gardens.

According to the U.S. Bureau of Labor Statistics, **expenses go down on average** as we age by about $10,000 a year between groups 55-64, 64-75 and 75 and older.

Myth 5: Everyone Retires At Age 65

"This retirement planning mistake can hit you in the pocketbook," Schreiber said. As mentioned, normal retirement age, also known as full retirement age, now ranges from 66 to 67.

So filing at 65 is earlier than your FRA, resulting in lower lifelong payouts. For example, if your FRA is 66 and 10 months (born in 1959), starting at age 65 would reduce your Social Security benefits by more than 12%.

Also, you can take early retirement beginning at the age of 62, but your Social Security benefits would be drastically reduced and would stay with you throughout retirement.

Myth 6: You Must Enroll In Medicare At Age 65

Most people sign up for Medicare at 65, but there are exceptions. "If you are still actively employed beyond age 65 and covered by a group health plan, you may be eligible for a special enrollment period (SEP)," Schreiber said.

Typically, if your employer has 20 or more employees, your SEP extends for eight months after the end of your employment or the group health coverage, whichever comes first. Delaying Medicare might be worthwhile if your current plan is appealing.

COBRA, employee retiree health plans and marketplace coverage don't count, so no SEP will be offered. "Understanding Medicare's enrollment deadlines can help avoid costly premium increases later," Schreiber said.

With no SEP, individuals typically can enroll in Medicare at 65. "You generally have a 7-month initial enrollment period beginning three months before your 65th birthday," Schreiber said. Missing this Go Zone may be a critical retirement planning mistake, triggering late enrollment penalties.

Myth 7: You Cannot Make A QCD If You Don't Owe RMDs

"The maximum qualified charitable distribution (QCD) is $100,000 per IRA owner per year, regardless of whether that is more or less than your RMD," said Natalie Choate, an attorney in Wellesley, Mass. That's the QCD maximum if your RMD is $20,000 or $220,000 or no RMD at all.

"If you don't believe that QCDs are possible without RMDs, then why does the tax code allow QCDs starting at age 70.5, even though RMDs don't start until age 72?" said Choate, whose landmark book, "Life and Death Planning for Retirement Benefits," is now in its eighth printing.

QCDs go directly from your IRA to eligible charities, without generating a tax deduction. People may ask, why bother? "With QCDs, you can satisfy your RMD without generating any gross income on your tax return," Choate said. From age 70.5 to 72, QCDs won't satisfy RMDs but they will reduce future taxable traditional IRA withdrawals.

Choate also cites the myth that you should not make a QCD in excess of your RMD. "If you've already satisfied your RMD — or if you don't have an RMD, as was the case with 2020's RMD waiver or for people between ages 70.5 and 72 — you should consider whether other ways to fulfill your charitable intent would be more favorable," Choate said. That might be donating appreciated stock held outside retirement plans or bunching non-QCD donations in order to claim itemized deductions in alternate years.

Avoid This Retirement Planning Mistake

But QCDs greater than RMDs might come out ahead. "Wealthy people with large IRAs always should be looking for tax-favored ways to reduce 'bad assets' such as tax-deferred dollars in retirement accounts, and QCDs are ideal for that," Choate said. For the not-so-wealthy as well, using QCDs to make charitable gifts can add value by reducing future taxable RMDs.