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The Savvy Investor

10 Biggest Retirement Mistakes

If you are approaching retirement age or have already retired, make sure you understand the rules and deadlines for claiming Social Security, enrolling in Medicare and taking distributions from retirement plans. Here are ten common retirement mistakes, not necessarily in any order.

1. Taking a check

If you decide to transfer your 401(k) or other retirement assets to an IRA, make sure they go directly to the new custodian. If your employer cuts you a check, the company will be required to withhold 20% for taxes and you will have to roll the entire amount — including the 20% you didn't receive — into an IRA within 60 days. Any money not deposited into the IRA would be treated as a taxable distribution, subject to taxes and early withdrawal penalties.

2. Claiming Social Security early while you continue to work

If you collect Social Security benefits before your normal retirement age of 66 and you continue to work, you could temporarily lose benefits. Earn more than $17,040 in 2018, and you'll forfeit $1 in benefits for every $2 you earn over that limit. The earnings cap disappears when you turn 66 and benefits lost to the earnings cap are restored in the form of higher monthly benefits.

3. Failing to coordinate Social Security benefits with your spouse

For most married couples, the main goal should be to maximize benefits for the surviving spouse, who is likely to be the wife. That means if the main breadwinner is the husband, he should delay collecting Social Security retirement benefits until age 70 when benefits will be worth the most. They would pass to the spouse as a survivor benefit if he dies first.

4. Leaving Social Security benefits on the table

Even if one spouse delays collecting retirement benefits until age 70, he or she may still be able to file for spousal benefits at age 66 (if born on or before Jan. 1, 1954). Spousal benefits are worth 50% of the other spouse's full retirement age benefit amount. Meanwhile, their own retirement benefit will earn delayed retirement credits worth 8% per year up to age 70, boosting benefits by up to 32%.

5. Not planning for health care costs in retirement

If you retire before you are eligible for Medicare at 65, finding health insurance can be difficult and expensive. You can extend employer coverage under COBRA for up to 18 months, but you'll have to pay the full premium without any help from the boss. Depending on your health, it might be cheaper to find an individual policy with a high deductible and contribute to a tax-deductible health savings account.

6. Failing to sign up for Medicare Part B on time

Once you are eligible for Medicare, you must enroll in Medicare Part B, which covers doctor's visits and outpatient services, during the seven-month period that starts three months before your 65th birthday. Miss that initial enrollment deadline and you will incur a late-enrollment penalty that permanently boosts your Part B premium by 10% for every year you delay. The penalty is waived if you have health insurance coverage from your employer or your spouse's employer. Once you enroll in Medicare, you can no longer contribute to an HSA.

7. Tapping retirement accounts too soon

If you tap your retirement funds before age 59½, you'll owe a 10% early-withdrawal penalty on top of the federal and state income taxes you'll pay on each distribution. But if you are at least 55 when you leave your job, you can take distributions from your 401(k) without paying a penalty (although you will still owe income taxes on your withdrawals). If you transfer your funds to an IRA, you lose the "55-and-out" option.

8. Interrupting early IRA payouts

There is a way to avoid early withdrawal penalties if you tap your IRA before you are 59 ½. You must take "substantially equal periodic payments" from your IRA based on your life expectancy for at least five years or until you are 59½, whichever is longer. But if you deviate from the payout schedule, you'll owe a 10% penalty retroactive to your first withdrawal, plus interest.

9. Mishandling company stock

Rolling your 401(k) into an IRA is generally a good idea, but it may not be the right decision if you own highly appreciated company stock inside your plan. A special rule for what is called "net unrealized appreciation" allows you to move your employer's stock out of your 401(k) if you take a lump sum distribution when you retire or leave your job. Roll your stock into a brokerage account and the balance of your 401(k) into an IRA. You'll pay taxes immediately on the original basis of the stock, but you can take advantage of lower long-term capital gains rates, rather than ordinary income taxes, when you sell the stock.

10. Ignoring minimum distribution rules

You are required to start withdrawing from your IRA by April 1 following the year you turn 70½, and to take withdrawals by Dec. 31 of that year and each year afterward. Miss the deadline and you'll owe a tax penalty of 50% of the amount you failed to withdraw. You can skip the required distribution from your 401(k) if you are still working, but not your IRA.

Be sure to check with us before taking Social Security.