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Social Security – Have You Considered These Techniques for Maximizing Your Benefit? April 1st, 2012

The Social Security Act was signed into law by President Roosevelt on August 14th, 1935. In addition to several provisions for general welfare, the new Act created a social insurance program designed to pay workers age 65 or older a continuing income after retirement. Social Security has undergone numerous revisions since 1935, including the addition of an earlier eligibility age of 62, but the goal of providing income to retired individuals has not changed.

Since your first paycheck as a teenager, you have been contributing to the Social Security system by means of the FICA deduction or through self-employment taxes. Your contributions, combined with those from other workers, fund a theoretical pool of assets which provides benefits to retirees, disabled workers and survivors of workers. The Social Security system continues to evolve, as increased life expectancies and the sheer numbers of retiring workers necessitate changes to the benefit system. The system currently allows for benefit initiation between age 62 and 70, and provides incentives for postponing collection of benefits until a later age. However, data provided by the Social Security Annual Statistical Supplement for 2011 shows that in 2010, 49% of women and 43.6% of men filed for benefits at age 62. More educated retirees tended to delay payments longer, but this was typically due to the level of their wealth and reduced need for additional cash. The delay in requesting benefits did not appear to be due to a better understanding of the benefits themselves. Given the reality that many individuals claim benefits as early as possible, we will explore some of the indicators that should prompt you to consider delaying your benefits until a later age.

Social Security benefits can be viewed as a type of annuity stream, where you are essentially weighing the trade-off of beginning an income stream early at a lower benefit amount versus delaying receipt of an incrementally higher benefit. Because of the potential for a long lifetime of payments from SS, your goal should be to maximize payments over your lifetime, as well as maximize the benefits that would go to your surviving spouse in the event of your death. To complicate matters further, the optimal starting age for SS also varies greatly depending on your financial assets, work status, marital status and family situation.

Since almost half of those aged 62 began benefits in 2010, it is appropriate to consider the hurdles that are encountered with this early start date. For those turning 62 this year, your full retirement age (FRA) for Social Security purposes is age 66. That means that if you decide to begin receiving benefits at the earlier age of 62, your benefit amount will be permanently reduced by 25%. In addition, the benefit received can be further reduced by earnings restrictions which are imposed in early retirement. If you earn over $14,640 in an early retirement year, your benefit amount will be reduced by $1 for every $2 over the earnings limit. Lastly, up to 85% of the Social Security benefit you do receive can be taxed as ordinary income. All of these factors can greatly affect the final benefit that ends up in your pocket. Therefore, it is wise to consider the implications of an early start in the context of your overall financial situation before automatically filing for benefits at 62.

Currently Single Individuals

If you are currently single and considering the appropriate starting age for SS benefits, make your financial advisor aware if you are widowed or have been divorced. This will allow them to consider all the possibilities you may have to maximize the benefit you ultimately receive.

Survivor Benefits:

One of the benefits of Social Security is to provide for survivors of a deceased worker. This survivor benefit can be a lifesaver, especially in the case where the deceased was the primary wage earner for the family. Survivor benefits provide for children up to age 18, as well as to the surviving parent until the youngest child reaches age 16.

If the survivor remains unmarried, they are also entitled to retirement benefits on the deceased's earnings record beginning as early as age 60, although at a reduced amount. However, if they do not have an earnings record of their own, this at least provides them with a basic retirement income stream.

Conversely, if a survivor has earned significant benefit eligibility of their own, claiming the survivor benefit in early retirement can provide additional cash flow, while allowing the benefit on their own earnings record to continue to grow untouched for them up to age 70. SS rewards a delayed retirement, through the use of annual deferral credits of 8% from FRA to age 70. As an unmarried survivor, you could claim the survivor benefit for years 60 – 70, allowing the benefit on your own record to continue to grow and then switch to your own earnings record for a significantly higher benefit beginning at age 70.

Divorced Benefits:

You are entitled to benefits on your divorced spouse's earnings record if you were married for at least 10 years and are not currently remarried. You must wait to claim benefits on your divorced spouse's record until that person reaches the minimum eligibility age for benefits (age 62). However, it is not necessary that they be receiving benefits in order for you to claim your benefits. This DOES NOT have any effect on the benefits that your divorced spouse will receive for their current family, in either retirement or survivor benefits. It was originally designed to benefit the non-working former spouse who may not have had sufficient employment credits on their own social security employment record to qualify for benefits. Even if you qualify on your own earnings record, the benefit you would receive as a former spouse may be higher than the resulting benefit based on your own record and is therefore worth exploring.

Currently Married Couples

When a married couple considers when to initiate Social Security benefits, it becomes a matter of coordinating and maximizing their combined benefit. The following list details some of the circumstances to be considered for couples:

1) What is the earnings history of each spouse?

(a) Do both spouses qualify on their own earning records?

(b) Are the earning levels fairly equal?

2) What are the ages of each spouse?

3) Are there medical issues which could significantly shorten the life expectancy of one spouse?

4) Are there other financial assets which will be available to meet expenses in retirement?

5) Was either spouse employed in a role where FICA taxes were not withheld (federal pensions, railroad benefits) that will result in a Government Pension Offset to SS benefits?

6) Is either of the spouses still employed and earning an income?

These considerations will help to determine the best approach for a married couple. Below are a few of the specific techniques within Social Security for use with spouses.

File and Suspend:

Who should consider this method?

Married couples with one non-working or low earning spouse (A) who wants to take advantage of a higher spousal benefit, while delaying receipt of the working spouse's (B) SS income to maximize their benefit amount upon receipt.

How does it work?

At age 62 or later, spouse (B) files for SS benefits and then immediately suspends receipt of the benefit. Once the "File and Suspend" has been accomplished, spouse (A) is then eligible to file for spousal benefits based on spouse (B)'s record.

What is the result?

If spouse (A) is Full Retirement Age, this would result in a spousal benefit of 50% of spouse (B)'s full benefit amount. This technique gives the non-worker or lower wage earner eligibility for a higher spousal benefit, while allowing the working spouse to defer receipt of their own benefit until FRA or even to age 70 to maximize their own benefit.

Restricted Application:

Who should consider this method?

Married couples in which spouse (A) is already drawing benefits based on their own earnings record, and spouse (B) has reached FRA but wants to defer their own benefit to age 70 to take advantage of the additional 8% annual deferral credits.

How does it work?

Remember, spouse (A) is already receiving benefits on their own record. Upon FRA, spouse (B) can file a "restricted application" with SS to request spousal benefits only. This entitles them to 50% of spouse (A)'s SS benefit, which they can claim for the years between 66 and 70. At age 70, spouse (B) will switch to their own earnings record and begin to receive benefit of the higher age 70 amount.

What is the result?

Spouse (B), who deferred their benefit to age 70 is able to postpone and grow their own SS benefit, but in the meantime, is receiving 50% of spouse (A)'s SS benefit. It increases overall cash flow and better protects the survivor by maximizing the amount they would ultimately receive. **Remember that it is critical that the spouse who initiates the "restricted application" be Full Retirement Age to make this technique work**.

Withdrawal of benefit:

Who should consider this method?

This method should be considered for individuals who begin receiving benefits, but then for whatever reason, change their mind within 12 months.

How does it work?

Within the first 12 months of receiving SS benefits, individuals can choose to withdraw from benefit receipt, pay back the benefits they have received and restart SS benefits at the increased age for a higher monthly benefit.

What is the result?

The Social Security “do-over” option has been drastically altered in the last two years. Prior to 2010, you could begin benefits early and be paid those benefits for many years. You could then decide to stop the benefit, pay back to SS the sum total of all benefits you had received over the years and then re-start as though you had never received any benefit at all. Your new benefit would have increased significantly from all the advantages of deferral of benefit increases over the years. Late in 2010, SS greatly restricted this option so that it is now available only as a short-term change. **In addition to the do-over being restricted to the initial 12 months of benefit receipt, it is further restricted in that it can occur only once in a lifetime.**

The information provided above is not an exhaustive list and there are caveats to particular techniques which will need to be vetted for your situation. However, as you contemplate the age at which you should begin Social Security benefits, explore the ssa.gov website and talk with your financial advisor to educate yourself about all the options available to you. Then the decision to apply for benefits will be an informed one that takes into consideration all of the unique circumstances of your family situation. By looking at Social Security from a comprehensive standpoint, you can make the decision which has the highest potential to maximize benefits for you and your survivors.