Wealth Strategies
The In’s and Out’s of Social Security
Part 7 of 12
How and when to take Social Security can add undue stress to an already highly stressful time. While you are transitioning or planning how to transition into retirement, you have the added pressures of solving the Social Security riddle. There are rules, calculations, confusing acronyms, deadlines, and complex strategies all adding up to one not so simple decision: how and when to file for and begin taking Social Security benefits.

The Role of Social Security
What is Social Security? We go all the way back to August of 1935, when President Franklin Delano Roosevelt signed the Social Security Act of 1935 as a part of the “New Deal”. America was suffering and fighting its way through the Great Depression. Prosperity and financial security seemed unobtainable to most Americans. In order to help ensure economic stability, Social Security was established to provide benefits for retirees, disabled persons, and the families of retired disabled or deceased workers. Today, about one in four households benefit from some type of Social Security. Designed as a pay-as-you-go, the benefits received by Social Security recipients are funded by the payroll taxes paid by current workers.

The Taxman
Social Security benefits are not free money. It's important to remember that you may owe taxes on some portion of each check. To determine if you owe taxes on your Social Security benefits, first take half of your total benefit amount and add it to all of your other income for the year. This includes tax exempt interest and other otherwise excludable income. Once you begin receiving Social Security benefits, you will receive Form SSA-1099 annually from the IRS. The form contains the total benefit you received in that year. If this amount is over the thresholds for the year, you could owe taxes on some portion of the benefit. There are two threshold points. Over the first you may owe taxes on up to 50% of your benefit. Over the second you may owe taxes on 85% of your benefit. No one pays taxes on more than 85% of their Social Security benefit. Currently the thresholds are as follows:

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<thead>
<tr>
<th></th>
<th>50%</th>
<th>85%</th>
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<tbody>
<tr>
<td><strong>Single</strong></td>
<td>$25,000 and</td>
<td>over $34,000</td>
</tr>
<tr>
<td></td>
<td>$34,000</td>
<td></td>
</tr>
<tr>
<td><strong>Married filing joint</strong></td>
<td>$32,000 and</td>
<td>over $44,000</td>
</tr>
<tr>
<td></td>
<td>$44,000</td>
<td></td>
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Your adjusted gross income
+ Nontaxable interest
+ ½ of your Social Security benefits
= Your “combined income”

When Is The Right Time?
Like most things in the world of finance, there is no one-size-fits-all approach or answer. What is right for one person is likely not right for you and your
individual financial situation. Several factors go into making the decision to begin taking Social Security including your health, existing savings, expenses and current income. Let’s start with the basics.

Full Retirement Age, or FRA as it is commonly referred to, is the age at which you are entitled to your full retirement benefit through Social Security. The age is based on the year in which you were born, and therefore it is not the same for everyone. Depending on your year of birth, your FRA could be as early as 65 or as late as 67. In other words, you may choose to begin receiving your benefits as early as 62, or defer to as late as 70. Be warned, however, that taking your benefits earlier than FRA reduces your monthly benefit. Conversely, delaying the start of your benefits until after your FRA will increase your monthly benefit. The general rule is that for every year after age 62, your PIA, or Primary Insurance Amount, grows at roughly 7% year over year. And in the years between your FRA and 70 it grows at an even faster rate of 8%. The bottom line is the longer you wait, the larger each check will be.

For most of us, the decision comes down to three factors:

1. **Existing Savings**
   If you have accumulated sufficient savings and can make do for a few years without Social Security income, it is probably better to wait and let the Social Security check amount grow.

2. **Current Income**
   If you still have income, you likely don’t need that additional check rolling in. And let’s not forget that if you are making too much money, some of that check is going to be withheld to pay taxes, thus decreasing the benefit of filing early. For those of you who are still working at age 62, the odds are you will want to wait to file until the bulk of your outside income has halted.

3. **Health**
   The greater your life expectancy, the more advantageous waiting becomes, as you will be receiving a larger check for a longer time. Once you know your PIA, a breakeven point can be calculated. A breakeven point helps put more money in your pocket by waiting rather than taking Social Security benefits early. For most people this breakeven point is around 80 years old. If family history or genetics show early passing in their 70s, perhaps you should go ahead and start those checks at 62. If all your family has a history of living to be 100, it may be better to hold off on filing that claim.

**Maximize Your Spousal Benefits!**
Some households have income levels that vary greatly between the two partners. Perhaps one person took years off to stay at home and raise children. Perhaps one spouse never worked at all. Even though one person may have had limited or no work history, they are still entitled to a Social Security benefit.

The Social Security administration allows for a spousal benefit to help alleviate these types of situations. Once a person has turned 62, they are entitled to up to half of the working spouse’s
retirement benefit. If the person is eligible for a retirement benefit based on their own earnings history, they will receive 50% of the spouses or their own benefit amount, whichever is greater.

But be careful. Taking a spousal benefit before FRA, even if the earning spouse is at FRA, reduces the benefit amount. For example, say the working spouse is age 66 (past their FRA) and has a monthly benefit of $2,500. The non-working spouse decides to begin taking their spousal benefit 36 months before their own FRA of 64. The benefit the non-working spouse receives will not be 50% of $2,500, but rather a reduced amount of $1,125.

If your spouse takes their own retirement benefit earlier than FRA, not only is their benefit reduced, but the spousal benefit is reduced as well. Instead of 50% of yours, the benefit they receive will be 50% of yours, minus the reduction for starting before FRA. According to ssa.gov, “A spousal benefit is reduced 25/36 of one percent (0.69%) for each month before normal retirement age, up to 36 months. If the number of months exceeds 36, then the benefit is further reduced 5/12 of one percent (0.42%) per month”. This could result in the spousal benefit being reduced to as little as 32% of the working spouse’s benefit.

An often overlooked but very important feature of the spousal benefit is that it is available to a widow or divorcee as well. If you are currently divorced but were married for at least 10 years, you are still eligible to receive half of your ex-spouse’s benefit. Claiming the spousal benefit from an ex does not affect their claim at all.

What If I Change My Mind?
Perhaps you filed all your paperwork and began cashing your Social Security checks only to realize you have made a mistake. What now? Are you stuck taking the benefit?

The answer is no. As long as you are under 70, there are a few options even after making your election to receive Social Security retirement benefits. If it has been less than one full year since receiving the checks, you can simply withdraw from Social Security. Once you have withdrawn, you are eligible to re-enroll at a more advantageous date. Of course there are a few catches. First, you have to write a large check to the government. Every penny of the benefits you have received must be repaid. This includes checks made out to you, your spouse, or any dependents living or deceased. It also includes money that you never received such as money that was withheld to pay for Medicare part B, C, or D, any voluntary withholding, or garnishment on your benefit checks.

Be careful this time around. You can only elect to withdraw once per lifetime.

Another option is to simply suspend your benefits. The big benefit to suspending your benefits instead of withdrawing is that there is no substantial check to write. You owe nothing. The drawback is that when you do begin receiving your checks, the monthly amount will be reduced by the dollar amount you have already received. Just remember
that you will be billed separately for Medicare coverage and that failing to make those payments will jeopardize your medical coverage.

**Advanced Tactics**

Looking to really maximize your Social Security benefits? File and Suspend is a newer strategy that has gained popularity in the past few years. It was added to the program as part of the Senior Citizens Freedom to Work Act in 2000 and helps couples with different earnings credits to better plan for retirement. The strategy allows for one spouse to have their benefit amount continue to grow while still generating some Social Security income for the household. This is accomplished by the spouse with the higher PIA filing for their benefit, but immediately suspending the payment. The other spouse then files for their spousal benefit. By doing this, a check from Social Security arrives every month, while the higher PIA amount continues to grow until that person reaches age 70. At that point both spouses begin receiving checks, and because one benefit claim was suspended the total monthly amount is considerably higher.

A subtle but important nuance to the File and Suspend strategy is the claim-now and claim-more later approach. The important distinction to make here is to realize that either you or your spouse’s PIA is higher than the other, but not extremely higher in that your spouse would be better off with taking half of your benefit. Rather than both partners taking their own retirement benefit, the partner with the higher PIA files for the spousal benefit. This is to increase the current total Social Security benefit, while allowing their own to grow to the maximum amount at age 70. At age 70, the partner then switches to their own higher benefit amount.

**I’ll take my $1,000/month**

**I’ll wait until age 70 and receive a larger benefit**

**Without File & Suspend**

<table>
<thead>
<tr>
<th>Monthly income before age 70</th>
<th>$3,000</th>
<th>$1,000</th>
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<tbody>
<tr>
<td>Monthly income from age 70 on</td>
<td>$3,000 ($1,000 + $2,000)</td>
<td>$3,640 ($1,000 + $2,640)</td>
</tr>
<tr>
<td>Survivor benefit for spouse</td>
<td>$2,000</td>
<td>$2,640</td>
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**With File & Suspend**

**Annual difference in income and survivor benefit:** $7,680 ($640 x 12 months)
The Not So Basic Rules
There are many complexities within Social Security and a long list of tedious rules to remember.” This should be the first sentence. The basic Social Security benefit is referred to as the Primary Insurance Amount, or PIA. The calculation for PIA is rather complex, but the basic idea goes something like this: Your 35 highest earning years are compiled to make a benefit calculation and an index factor is used to adjust for inflation. That factor will always equal one for the year you reach 60 and every year thereafter. For all other years, the factor is the result of dividing the average wage index for the year in which you attain age 60 by the average wage index for that particular year. Each year’s earnings are multiplied by its corresponding index factor. These indexed earning years are added together and then divided by 420 (35 years in months). This number is what is known as Average Indexed Monthly Earnings or AIME.

Once the AIME is calculated, the next step is to derive the PIA. PIA is determined by applying a PIA formula to AIME. The PIA formula used depends on the year a person attains age 62. The formula is technically made up by the sum of three separate percentages of portions of average indexed monthly earnings. The percentages are dependent on the year in which the worker reaches age 62.

PIA is the benefit amount a person receives at full retirement age. Currently the maximum Social Security retirement benefit for a worker at full retirement age is $2,663 per month. It is important to note that filing your claim early reduces the benefit amount. For each month before normal retirement age the benefit is reduced by $2,663 per month. If the number of months is more than 36, the benefit is reduced by an additional $2,663 of one percent per month.

Simple right? To further the confusion, there are actually two other methods for calculation of the benefit amount. However, very few people are subject to these more obscure calculations. Fortunately, there is a PIA calculator on the Social Security Administration’s website to help you project what your benefit might be based on your current earnings and expected growth.

You can set up an account at:
http://www.ssa.gov/myaccount

The site allows you to keep track of your annual earnings and project what your future benefit will be. While you are there, double check that your prior year’s earnings history is accurate. You can also make sure your address and personal information are correct in order to receive any important updates. It is also the best place to get the facts on any changes to the program. There are a lot of rules, and the rules are subject to change! Work with a professional you trust. Let them guide you through all of your options, spelling out the pros and cons of each one.
Start Planning NOW
Social Security Retirement Benefits can be an important part of your financial planning to chart a path to a successful financial future. It is not only important to know but understand the details. How much can you expect? When is your FRA? How can you maximize your spousal benefits? Do any of the advanced strategies work for you? Timing is everything, especially with two people. Plan ahead!

About RFA

Reilly Financial Advisors is a fee-only Registered Investment Advisor, aimed at helping our clients both define and achieve their individual financial goals through four unique service offerings:

1. **Wealth Building** – for those still accumulating their investment portfolios

2. **Wealth Management** – for those who have amassed their savings and have specific needs associated with their wealth

3. **Wealth Legacy** – for those who have accumulated a significant amount of wealth and face unique wealth transition needs

4. **Corporate Retirement Services** – tailored solutions for plan sponsors and participants

RFA, founded in 1999, services clients around the United States and in more than a dozen countries worldwide. As an independent advisor, we are able to provide our clients with the highest level of Fiduciary services which allows us to make investment decisions based solely in the best interest of our clients. Our goal is to be our client’s first point of contact for all of their financial needs, serving as a trusted financial partner for the long term.