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Key Points

- *Deciding when to start receiving Social Security is a consequential decision and is different for everyone*
- *Your Social Security benefit may be reduced depending on your age and income*
- *There are thousands of filing strategies, expert retirement advisors can help you make the best decision*

One of the biggest decisions you face in your lifetime is when to retire. There are many factors one must consider when making such a consequential life decision. What income will be required to meet your living needs? Do you have enough in savings to last through retirement? How long will you live? When should you begin taking Social Security? Considering all of these questions together will lead to the best outcome. The focus of this paper is to describe which variables should be taken into consideration when planning your Social Security strategy.

History

Social Security was created in 1935 when President Franklin D. Roosevelt signed the Social Security Act into law. A 65 year-old legal secretary named Ida May Fuller of Ludlow, Vermont was the first recipient of a monthly retirement check on January 31st in 1940 for the amount of \$22.54. Her life expectancy was 75 years and she ended up living to be 100, collecting total Social Security payments of \$22,888.92 along the way (while only paying \$24.54 in total taxes into the program).¹

Today, there are over 58.7 million Americans collecting Social Security benefits which account for about 40% of the average American's income in retirement.² In 2016, \$957 billion dollars were collected in revenue and \$911 billion paid out in the form of benefits. The current surplus of \$2.8 trillion is set aside in a trust fund to be used to pay for future benefits. While those funds are waiting to be paid out they are invested in guaranteed securities, and as of 2016 the annual rate of return on those investments was 3.154%.³

With the advent of modern medicine, people are living longer, putting a strain on the funding parameters of the entire system. The combined trust fund reserves are currently growing and will continue to do so through 2021. However, beginning in 2022, the cost of the program is expected to exceed income. Without changes, in 2034 the Social Security Trust Fund will only be able to pay approximately 75 cents for each dollar of scheduled benefits.⁴

¹ www.SSA.gov.

² https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/

³ <https://www.ssa.gov/oact/progdata/fundFAQ.html>

⁴ These estimates are based on the intermediate assumptions from the Social Security Trustees' Annual Report to Congress and can be found on your most recent Social Security Statement.

Eligibility

In order to be eligible to collect retirement benefits you must accrue 40 “credits” by working, with a maximum of four credits available each year. In 2018, you got one credit for each \$1,320 of wages you earned. So once you’ve earned \$5,280 for the year you have earned your maximum credits. If you receive an estimated benefit calculation from the Social Security Administration then you have already earned the 40 credits necessary for a future benefit. However, this doesn’t mean you have earned your maximum benefit. Your actual monthly retirement check is calculated by taking your average indexed monthly earnings during the 35 years in which you earned the most.⁵

The Social Security Administration generates funding for the program from payroll taxes they collect out of your wages. Currently, both you and your employer each pay 6.2% into the Social Security Trust Fund on your first \$128,400 in earnings. If you are self-employed then you pay both the employer tax and the employee tax for a total of 12.4%.

Filing Ages

Deciding when to file for benefits is perhaps one of the most perplexing decisions retirees have to make and also one of the most important. At birth, our average life expectancy is 78 years. However, if you make it to age 64 then life expectancy is 82 for men and 85 for women. If you are married and both you and your spouse make it to age 65, there is a 90% chance one of you will live to be 90. This means your savings have to last longer than previous generations and your claiming decision has a direct impact on how long your savings will last.

The earliest someone can begin receiving retirement benefits is age 62 and even then the benefit will be a reduced amount. Full retirement age is the age at which a person may first become entitled to full or unreduced retirement benefits. If you were born before 1938, your full retirement age (FRA) is 65. In 1983, the law changed and gradually increased the full retirement age to 67 for people born 1960 and later.

While the Social Security Administration will allow you to collect benefits before your Full Retirement Age, they provide you an incentive not to do so.⁶ For example, if your full retirement age is 66 and you begin taking your benefit at 62, you have permanently reduced your benefit by 25%. This also has consequences for any spousal benefit your significant other may be entitled to in the future. Claiming early continues to be the most popular age for people to start receiving Social Security as nearly half of Americans claim at age 62.⁷

Conversely, the longer you delay taking benefit payments you get credit in the form of an increased monthly check. Every year you delay taking your benefit after your full retirement age your monthly benefit amount will grow by 8% until age 70. So if your full retirement age is 66 and you delay payment until age 70 then your benefit will have grown by 32% at age 70. Your maximum benefit is the amount you are entitled to at age 70, thus you should begin your benefit no later than age 70 since it will not grow any further.

| Full Retirement Age | |
|---------------------|---------------------|
| Year of Birth | Full Retirement Age |
| 1943-1954 | 66 |
| 1955 | 66 and 2 months |
| 1956 | 66 and 4 months |
| 1957 | 66 and 6 months |
| 1958 | 66 and 8 months |
| 1959 | 66 and 10 months |
| 1960 and later | 67 |

| Full Retirement Age: 66 | |
|-------------------------|-----------------------|
| Age Receiving Benefits | Reduction in Benefits |
| 62 | 25.0% |
| 63 | 20.0% |
| 64 | 13.3% |
| 65 | 6.7% |
| 66 | 0.0% |

⁵ When computing a worker’s benefit, the SSA first adjusts or “indexes” his/her earnings to reflect the change in general wage levels that occurred during the worker’s years of employment. This ensures the future benefits reflect the universal rise in the standard of living that occurred during their working lifetime.

⁶ If you choose to take payment early, you must realize you are permanently reducing your benefit by five-ninths of 1% each month before your full retirement age, with a maximum of 36 months. If you start more than 36 months before your full retirement age, then you are reducing the benefit further by five twelfths of 1% per month.

⁷ <http://money.usnews.com/money/retirement/articles/2013/09/09/the-most-popular-ages-to-claim-social-security>

Spousal Benefits

If you are married then both you and your spouse are eligible to receive benefits. Regardless of whether or not your spouse has ever worked, he or she may be eligible for a spousal benefit at 62 based off of your earnings record. If your spouse is under full retirement age and qualifies on their own record, the Social Security Administration will pay that amount first. But if he or she also qualifies for a higher amount as a spouse, they'll get a combination of benefits equal to the higher amount. At your spouse's full retirement age their benefit as a spouse can be equal to one-half of your full retirement amount. These benefits paid to your spouse do not reduce your retirement benefit.

A common mistake often made by couples trying to utilize Spousal Benefits revolves around what is known as "Deeming". The Social Security Administration "deems" you to be applying for your own personal benefit if you are applying for a spousal benefit before your full retirement age. This is important because if your intent is to claim spousal benefits and you unintentionally claim your own benefit, you have permanently reduced your own personal benefit since you hadn't reached your own full retirement age. In 2012, 6.8 million people were simultaneously receiving two benefits at the same time and many of these were most likely unaware they fell under the deeming rules.⁸

Widows and widowers can also receive survivor benefits beginning at age 60. They have the option to begin benefits on one record and switch to a full benefit on the other record. There is a one-time death payment of \$255 that can also be received if your spouse worked long enough before passing away. Additionally, if you are divorced but were married to your former spouse for more than 10 years you may be eligible to receive monthly benefits on their record once you reach age 60.

Taxation and Other Benefit Reductions

Many times people continue to work while receiving Social Security benefits. However, depending on your age you may be forced to return a portion of your Social Security if you make more than a certain amount. Your benefit will be reduced by \$1 for every \$2 of earned income above \$17,040, in 2018, if you retire before your full retirement age. So if you plan to take Social Security early while continuing your career, realize you may only end up getting 50% of the already reduced amount.

Once you reach Full Retirement Age the earned income penalty no longer applies. Although, for earned income over \$45,360 in the year of reaching your Full Retirement Age, your benefit will be reduced by \$1 for every \$3 earned.⁹

| Benefit Reduction for Earned Income in Early Retirement (2017) | | | |
|--|---------------------------------|--|---|
| | Age 62 to Normal Retirement Age | Year of Reaching Full Retirement Age - Months Prior to Attaining FRA | Month Attaining Full Retirement Age and Greater |
| Earned Income | > \$17,040 | > \$45,360 | No Limit |
| Reduction in Benefit | \$1 for every \$2 earned | \$1 for every \$3 earned | Not Applicable |

Your Social Security benefit might also be taxable after you reach your full retirement age depending on your combined income. To calculate your combined income you add your adjusted gross income (this includes Traditional IRA distributions), your nontaxable interest and one-half of your Social Security. Depending on your marital status 50% to 85% of your benefit may be taxable at your marginal tax rate.

⁸ <http://time.com/money/3102016/social-security-spousal-benefits-deeming-mistake/>

⁹ For the purpose of this calculation, earned income is defined as wages or net earnings from self-employment. Capital gains, investment earnings and interest, annuity gains and other government benefits do not count.

| Amount of Benefit Subject to Federal Income Tax (2018) | | |
|--|--|--|
| | 50% of Benefit Subject to Federal Income Tax at Your Marginal Tax Rate | 85% of Benefit Subject to Federal Income Tax at Your Marginal Tax Rate |
| Individual Filers | Combined Income of \$25,000 to \$34,000 | Combined Income More Than \$34,000 |
| Joint Filers | Combined Income of \$32,000 to \$44,000 | Combined Income More Than \$44,000 |

It's not just taxes that eat into your Social Security check, Medicare Part B and D premiums will be deducted from your monthly benefit check. In 2018, most people will pay \$134 each month for Part B and it is automatically taken from your monthly Social Security check.

Your Personal Benefit Decision

So when should you claim your benefit? The decision to claim early at a reduced amount, wait until you reach full retirement age or even delay further is "Needs Based". Even though you are now aware the maximum amount you can receive means delaying until age 70, it doesn't necessarily mean you should. Each family has different factors to consider and each situation is different. If you have sufficient resources and/or want to keep working as long as possible then you can be flexible with your decisions. If you must retire before your full retirement age or don't feel you will live long in retirement it may be in your best interest to begin payment earlier. The best advice is to talk with a retirement expert and formulate a filing strategy based off of your unique situation. Depending on your position, there could be thousands of different filing strategies for you to consider. With our Social Security software we can advise you on the best approach to maximize your Social Security benefit. So make time several years in advance of your earliest possible retirement date to sit down with an advisor and crunch the numbers.