Timing is Everything:

The Right Social Security Claiming Decision Can Make or Break Your Retirement

MANY AMERICANS DON'T THINK ABOUT SOCIAL SECURITY UNTIL LATE IN THE GAME.

After all, Social Security is a massive bureaucracy. It's going to do what it is going to do. Why even bother?

But it pays to learn a little about Social Security and begin to think strategically about your future benefits. Yes, you actually have a great deal of control over how and when you receive your Social Security benefits. With the right strategy, you can enjoy bigger benefits longer.

WHAT IS SOCIAL SECURITY?

The thing we call "Social Security" is actually called "Old-Age, Survivors, and Disability Insurance" (OASDI). It was created by the Social Security Act of 1935. The Social Security Administration administers it, using your Social Security number to track your status within the system.

Social Security is a kind of insurance. A large group of people (in this case, most U.S. taxpayers) pay a "premium" in the form of payroll taxes. Under the right circumstances, U.S. citizens and authorized residents can claim cash benefits from the Social Security Administration (SSA).

Social Security benefits significantly bolster the standard of living for many Americans, especially those with reduced earning potential, for instance people of advanced age or with disabilities.

In fact, 37.8% of senior citizens in America would live below the poverty line without Social Security benefits.

Who receives Social Security benefits?*

Roughly 65 million Americans receive Social Security benefits.

As the full name (OASDI) implies, three groups of people may be eligible for Social Security Benefits:

- **Elders.** About 46.7 million retired or elderly workers and another 2.9 million spouses and children of retired or elderly workers receive Social Security benefits. Eligible workers can start to claim their benefits between the ages of 62 and 70. The longer you wait, the bigger the benefit. Between the ages of 62 and 70, the benefit you are eligible for could increase by as much as 77%.

  To claim retirement benefits, a worker must have paid into the Social Security system for at least 10 years. Depending on how much you paid and how long you wait to claim your benefits, the benefit could be higher or lower. The amount of your benefit is based on your highest 35 years of adjusted earnings. Since a dollar you earned 25 years ago would buy a lot more than a dollar you earn today, all past earnings are adjusted to be equivalent to dollars you earn in the year you turn age 60. The statement does not outline which years are your highest 35 earning years after the adjustment.

  Even if you don't qualify for a benefit based on your own work record, you may qualify for a spousal benefit based on an eligible worker's record if you are married or were married at least 10 years and then divorced.
- **Survivors.** About 5.9 million widows, widowers, and children of deceased workers receive Social Security benefits.
- **Disabled Persons.** Roughly 8.1 million disabled workers and another 1.4 million spouses or children of disabled workers receive Social Security benefits.

**https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf 12/1/2021*

How is the Social Security program funded?

The Social Security program is funded through a dedicated payroll tax, currently assessed at 12.4%. Self-employed persons pay the full 12.4%. Employees pay 6.2% of their wages, while the employer is responsible for the other 6.2%. The money goes into a Social Security trust fund.

When are Social Security benefits paid out?

Social Security benefits are paid the month after they are earned — i.e., June benefits are paid in July.

Social Security benefits are paid out the second, third, or fourth Wednesday of the month, depending on the beneficiary's birthday.

- Beneficiaries with birthdates between the **1st and 10th** of the month get their benefits on the **second Wednesday of the month.**
- Beneficiaries with birthdates between the **11th and the 20th** get their benefits on the **third Wednesday of the month.**
- Beneficiaries with birthdates between the **21st and 31st** get their benefits on the **fourth Wednesday of the month.**

What do you need to account for when determining your claiming strategy?

Marital Status
Married, widowed, or even divorced persons may be eligible to claim Social Security benefits based on their spouse's work record instead of their own, or in some circumstances in addition to their own. The higher wage earner in a married couple needs to pay special attention to the impact of their claiming decision on the survivor benefit.

Age
You can claim Social Security retirement benefits as early as age 62, but the longer you wait, the higher the benefit.

Longevity
As life expectancy has increased over time and interest rates have declined, Social Security rules have not kept up, making it advantageous for most people to delay benefits. If you are in poor health and have a shorter life expectancy, with no dependents who may receive a survivor benefit that is impacted by your claim age, it might be prudent to claim your benefits early. Even a smaller benefit may be a better deal if you can collect it for longer.

Birth Year
You can claim Social Security benefits as early as age 62 and claim the largest possible benefit if you wait until age 70. However, the "full" Social Security benefit kicks in when you reach "full retirement age" (FRA). Your full retirement age is between age 66 or 67, depending on your birth year.

Persons born between 1943 and 1955 have a full retirement age of 66. Persons born after 1960 have a full retirement age of 67. For persons born between 1955 and 1960, the full retirement age falls somewhere in between 66 and 67. Each year of birth after 1954 increases full retirement age by 2 months. For example, someone born in 1956 has a full retirement age of 66 and 4 months.

Different Retirement Income Streams
When to claim your Social Security benefits may depend on your other retirement income streams, like income from 401(k) and IRA accounts, personal investments, and continuing wages or salaries. Which accounts or income streams you use to supplement Social Security or to use while delaying a benefit can have a significant impact on your tax picture in the near-term and on the risk profile of your long-term financial plan.

SOCIAL SECURITY FOR SINGLE INDIVIDUALS

Single individuals are eligible for Social Security retirement benefits based on their work record and no one else's. They have the sole right to claim the benefits to which they are entitled as they see fit.

Single individuals should consider their age, life expectancy, supplemental income streams, and the impact on their tax situation in their strategy for claiming benefits.

SOCIAL SECURITY FOR COUPLES

Married couples may shortchange themselves if they strategize claiming Social Security benefits like single people do. The best strategies for couples consider the life expectancy of both spouses and coordination of multiple benefits.

Strategies

Claiming Early

Suppose one member of a couple has a shorter life expectancy due to health issues or family history. In that case, it may make sense for the lower earning spouse to claim Social Security early — possibly at the earliest possible age of 62. The benefit might be lower, but you will collect it for longer.

Another situation that may justify an early claim is debt. To the extent you are paying interest on debt, particularly if the interest rate is relatively high, getting some Social Security flowing into the household earlier may be beneficial.

A third situation that may justify an early claim is illiquidity of other assets. For example, if you have a small 401(k) and a defined benefit plan that doesn't start until age 65 but you retired early, claiming Social Security to help bridge the gap until the pension start date can also make sense.

Each of these situations should be evaluated individually, because in most cases, it will make sense to delay at least one member of the household's benefit well beyond the initial eligibility age.

Delaying Benefits

Couples in good health with a lengthy joint life expectancy may get a better deal if they wait to claim until full retirement age or later. Waiting may allow them to claim a larger benefit for an extended period. Delaying from age 62 to age 70 increases monthly benefit amounts by approximately 77%.

Split Strategy

If two spouses earned significantly different incomes during their careers, a "split strategy" for claiming benefits might make sense.

In a split strategy, the lower-earning spouse claims benefits at the earliest possible age of 62, or at the point when the earnings test no longer applies, creating a trickle of Social Security income while one or both spouses may still be working. Then the higher-earning spouse claims benefits at the latest possible age of 70, resulting in a much larger influx of Social Security income to carry the couple into retirement.

This strategy could also set the lower-earning spouse up for a much higher survivor benefit in the event of the higher-earning spouse's death.

Spousal benefits

Married

If a married person is currently collecting Social Security benefits, the spouse can claim 50% of that benefit as a spousal benefit. This benefit can be claimed as early as age 62. Still, the benefit will be permanently reduced if claimed before the full retirement age. For people born after Jan. 2, 1954, a claim for spousal benefits will also be a claim for retirement benefits.

Divorced

Divorced spouses can sometimes claim a spousal benefit based on their ex-spouse's record, even if the ex-spouse has remarried and even if the current spouse has claimed a spousal benefit. Divorcees whose spouses have passed away may also be eligible to claim a survivor benefit.

Conditions apply, including but not limited to the following:

- The ex-spouse must be qualified to receive Social Security benefits.
- You must have been married to the ex-spouse for at least 10 years.
- You must not be currently married.

Widow(er)

Widows and widowers of deceased spouses may claim a survivor benefit as early as age 60. You may be eligible for the deceased spouse's entire Social Security benefit, but the benefit will be permanently reduced if the surviving spouse claims it before they reach full retirement age.

Widowed spouses who are already collecting Social Security retirement benefits are eligible for whichever is larger — the retirement benefit or the survivor benefit.

Widowed spouses who are not collecting Social Security retirement benefits can claim a survivor benefit as early as age 60 and switch to their own retirement benefit any time up to the age of 70. Since their eligible retirement benefit increases over time, they might become eligible for a retirement benefit that is larger than the survivor benefit.

Survivor benefits are unaffected if the widowed spouse remarries after age 60, however if the remarriage occurs prior to age 60 survivor benefits may be lost.

TAXATION OF SOCIAL SECURITY

When do Social Security benefits become taxable?

Most recipients will be liable for taxes on some or even most of their Social Security benefits. Below a certain income threshold, Social Security benefits are not taxable, but that threshold is very low. Moreover, a portion of your Social Security benefits count toward that income threshold.

For recipients with gross income over $25,000 as a single individual or over $32,000 (including 50% of total Social Security benefits received) as a married couple, 50% of their Social Security benefit is taxable income.

For recipients with gross income over $34,000 as a single individual or $44,000 as a married couple, 85% of their Social Security benefit is taxable income.

What you need to consider to keep taxes low

- **Use Roth accounts.** Contributions to Roth IRA and Roth 401(k) accounts are after-tax dollars. Not only are the distributions not subject to taxation, but they don't count toward your income threshold. With enough retirement income from your Roth accounts, you could end up with a much smaller portion, or even 0% of your benefits taxable.
- **Take taxable distributions early.** Consider taking bigger distributions from traditional IRA and 401(k) accounts *before* you start collecting benefits. That way, the taxable distributions do not count as income and push you into a higher percentage of taxable benefits during the time you are receiving Social Security.

- **Harvest capital losses.** Each dollar of capital loss often represents a 15% tax savings as most people fall into a 15% capital gains bracket. For some, it may represent an 18.8%, 20%, 23.8%, or more, depending on the interactions with the net investment income tax and other income streams.
- **Harvest capital gains.** Harvesting capital gains can be a good option if you fall in the 0% capital gains bracket, resulting in a free step-up in basis. This situation is often present for those who are between early retirement and age 72. Sometimes it can make sense to harvest capital gains up to $100,000 or slightly more if you can keep all the other ordinary income off the table.

THE FUTURE OF THE SOCIAL SECURITY PROGRAM

For decades, Social Security took in more tax revenue than it paid out in benefits, building up a surplus that peaked at $2.9 trillion in 2019.

However, as more people retire and fewer people work, Social Security has begun to pay more benefits than it receives in tax revenue. This deficit will cause the surplus in the trust fund to dwindle.

If no action is taken, the trust fund is expected to exhaust the surplus by 2034. The SSA will continue to collect taxes and pay benefits. Still, current estimates suggest that without the surplus in the trust fund, it will only be able to pay out 78% of the scheduled benefits.

How have shortfalls in Social Security funding been addressed in the past?

After decades of generous benefit increases and cost-of-living adjustments (COLAs), Social Security faced a funding crisis in the late 1970s, a period of high inflation and stagnant wages ("stagflation"). The situation quickly deteriorated because the COLA was pegged to prices, not wages. As prices increased and wages decreased, the SSA took in fewer taxes while paying out bigger benefits, putting the fund on track for depletion by 1983.

A National Commission on Social Security Reform (NCSSR) headed by Alan Greenspan recommended that the Reagan Administration defer COLAs for six months, change the tax schedule, introduce phased increases in the full retirement age from 65 to 67, and introduce taxation on Social Security income. Signed into law in 1983, the changes led to three decades of surplus revenues for the SSA.

Potential changes to Social Security

Various changes have been proposed to help the trust fund remain solvent and pay all scheduled benefits.

Increasing Full Retirement Age
The full retirement age was increased, in phases, from 65 to 67 as part of the 1983 amendments to the Social Security Act. Some policymakers and experts have suggested increasing the FRA again to 69 or later.

Increasing Taxes
The current Social Security payroll tax rate is 12.4%, with most workers splitting the burden with their employer. The SSA has proposed increasing that tax rate to 14.8%, 15.9%, and even as high as 19.4% to preserve the long-term solvency of the fund. The proposed changes would phase in over decades.

Chained CPI
In 2017, the "chained" consumer price index (chained CPI) was added to the tax code to replace the more traditional CPI-W. Generally speaking, it elevates wage earners to higher tax brackets faster. If applied to Social Security, workers may be eligible for smaller cost-of-living raises over time.

Benefit Cuts
As gross wages plummeted during the COVID-19 pandemic, and tax revenues with them, whispers renewed of possible benefit cuts to prevent (or delay) a more drastic benefit cut if the trust fund depletes its surplus.

It's difficult to build a long-term plan around a policy change that hasn't happened yet. When and by how much benefits could be cut makes a big difference in how to strategically time your application for benefits. For example, let's consider a bad-case situation in which benefits are cut by 24% by 2029.

Suppose a retiree who is 62 years old in 2021 is eligible for a $1,770/month benefit if he applied immediately, or a $3,016/month benefit if he waited until age 70. He will turn age 70 in 2029, when the benefit drops by 24% to $2,292. If he waits to claim until 70 and he lives to be 85, he will collect approximately $412,000 in total benefits over the remaining 15 years of his life.

However, if he claims his benefit at age 62, he could collect the smaller benefit for eight years before the cut, for a total of $169,920. The benefit would drop to $1,345 in 2029 due to the 24% benefit cut, but he will still collect $242,100 over the remaining 15 years of his life, for a total of approximately $412,000. In this case, benefits for claiming early or delaying until 70 are roughly the same if a benefit cut of 24% in 2029 were to materialize.

By the way, If no benefit cut materializes at all, this retiree would collect roughly $75,000 more by delaying claiming.**

***(Source SocialSecurityTiming.com – analysis performed effective 1-2-2021, Client DOB 1-2-1959, Inflation 0%, Discount Rate 0%, Primary Insurance Amount of $2,500).*

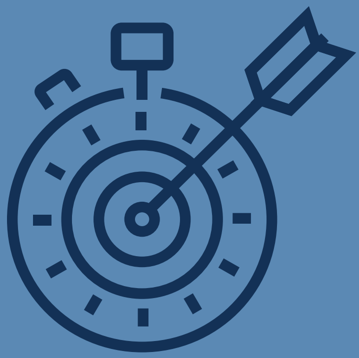
TALKING TO YOUR FINANCIAL ADVISOR ABOUT WHEN TO CLAIM BENEFITS

Social Security is a complicated government program. Americans approaching retirement age shouldn't strategize for their Social Security benefits alone, especially if they are not experts themselves. Instead, reach out to your financial advisor and start putting together a strategy for when to claim benefits.

What questions should you ask?

Questions to ask your financial advisor about Social Security strategy include:

- **When should I claim Social Security benefits?**
- **How should I pay for upcoming expenses?**
- **What do we need to do to keep taxes in retirement low?**
- **How would cuts to Social Security benefits impact my retirement strategy?**
- **How can I make my Social Security benefits stretch a little further?**
- **What processes do you have in place to analyze the options?**



This information is intended to be educational and is not tailored to the investment needs of any specific investor.

NOTES:

This article is intended solely for general educational purposes. It is not intended for the purpose of providing specific legal, accounting, tax or other professional advice to any particular recipient.

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