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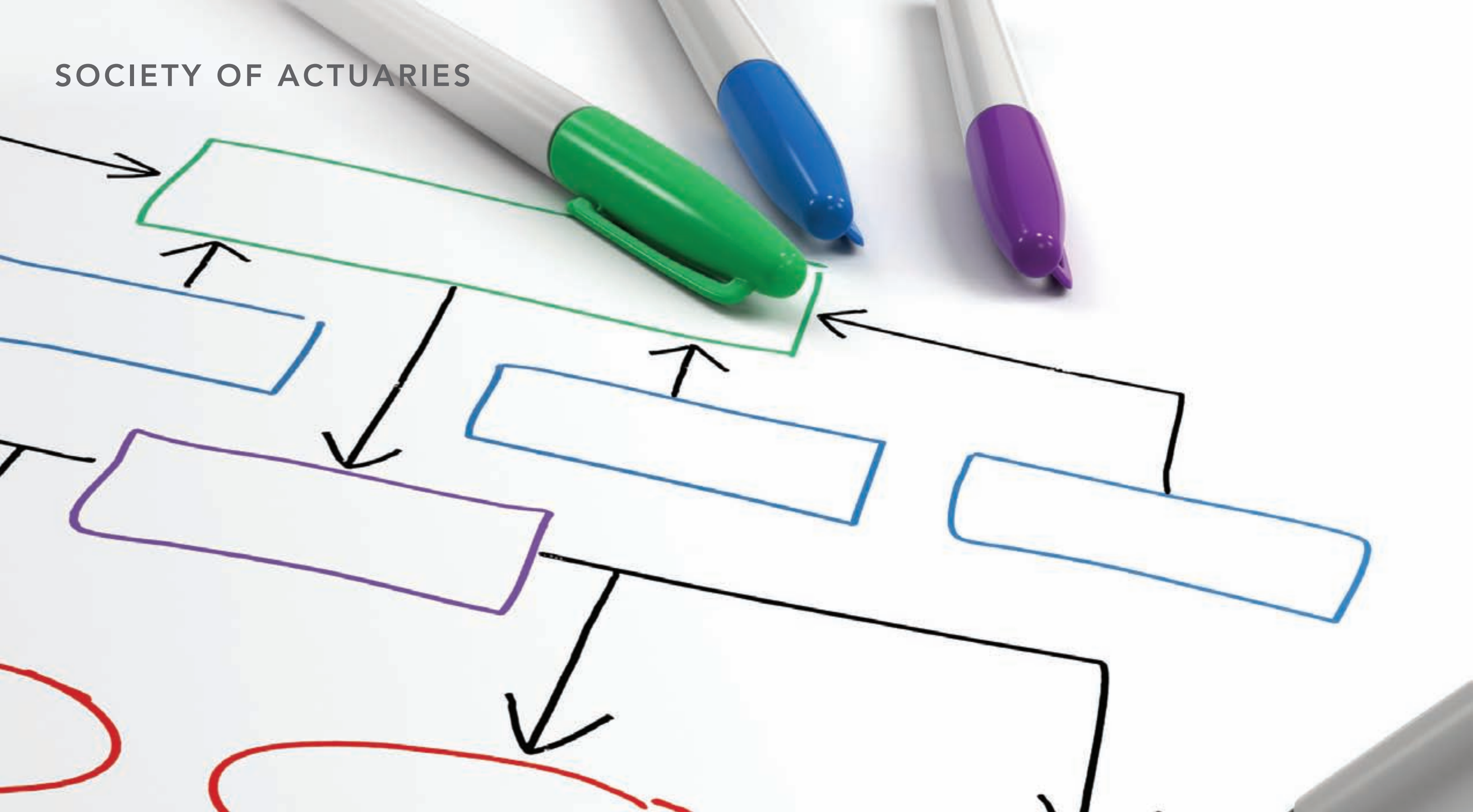

Deciding When to Claim Social Security

MANAGING RETIREMENT DECISIONS SERIES

Actuaries
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A KEY PART OF THE JOURNEY toward retirement for many Americans is deciding when to start taking Social Security benefits.

Many people decide to claim their benefits without checking out their options. Perhaps they do not know that options exist or they may think the options won't make much difference for their retirement. However, options do exist, and the selection can be very important to retirement security for single individuals and even more so for couples. This Decision Brief discusses many of these options.

People can begin taking Social Security benefits starting at age 62. Most people claim their benefits at the time they retire. However, because monthly benefits increase with claiming age, delaying Social Security may be a good idea if the person has other retirement assets.

Most everyone needs to give a lot of thought to whether to claim early, at full retirement age or at a later date (up to age 70). Personal circumstances, resources and goals often influence the decision, as do finances, taxes and Social Security rules. Health and life expectancy are factors too.

Get the details: The Social Security Administration website, www.ssa.gov, provides a wealth of information. It also includes an online calculator that enables people to get a personal estimate of their Social Security benefit.

Availability of Other Assets

Unfortunately, many Americans have only small amounts of other retirement assets to bridge the gap before taking delayed Social Security benefits. Data from the most recent Federal Reserve Survey of Consumer Finances indicate that, for families where the head of household is age 55–64, median financial assets only total about $70,000. For lower-income families, the dollar levels drop dramatically.

The best option for people with insufficient assets may be to build a more secure retirement by working longer, if they are able to do that.

Those who continue to work should also consider delaying Social Security until after they stop working. For workers under the full retirement age (age

Disclaimer

This Decision Brief is not intended to provide advice for specific individual situations and should not be construed as doing so. It is an information tool for general guidance. Individuals needing advice should seek the services of a qualified professional. Keep in mind that the tax code can change, the taxation of products and strategies vary, and individual tax needs and issues are unique. Consideration of tax issues is beyond the scope of this work.

66 for those born between 1943 and 1954), delaying Social Security avoids the impact of the Earnings Test, whereby earnings over a threshold ($14,160 in 2011) result in a portion of Social Security benefits being withheld.

Another consideration: Delaying Social Security increases survivor benefits that may be payable to the spouse. Unfortunately, people often overlook providing for spousal protection in deciding when to claim Social Security.

If working longer is not possible, people may consider using home equity to provide additional funds—an option that, unfortunately, carries risk. In any event, many Americans will be unable even to consider improving their retirement prospects by delaying the claiming of Social Security.

For those who do have the financial flexibility to defer taking Social Security, it is worth developing a detailed understanding of how Social Security works and giving careful consideration to alternative claiming strategies. The following discussion focuses mainly on those who do have the financial flexibility to consider alternatives.

Single Individuals

A person can claim Social Security as early as age 62, but with reduced benefits. The reduction scale varies slightly based on year of birth. For those born between 1943 and 1954, the age-62 benefit is 75 percent of the benefit at full retirement age (FRA)—age 66 for this group.

How Social Security Benefits Vary by Claiming Age

Claiming Age	Monthly Benefit	Multiplier
62	$1,125	0.75
63	$1,200	0.80
64	$1,300	0.87
65	$1,400	0.93
66	$1,500	1.00
67	$1,620	1.08
68	$1,740	1.16
69	$1,860	1.24
70	$1,980	1.32

Based on example where full retirement age (FRA) is 66, and the primary insurance amount is $1,500.

Benefits increase for those who claim later than FRA, up to age 70. Reductions and delay credits apply for each month they claim benefits early or delayed.

For those with average life expectancy, the present value of benefits is roughly the same regardless of the age at which they start claiming Social Security. That means these beneficiaries will receive roughly equivalent amounts in lifetime benefits regardless of the age at which they start to collect those benefits. Those who wish to protect against longevity risk may benefit from delaying making claim until age 70 if they have other sources of funds or income available.

Considerations concerning the taxation of Social Security benefits, discussed later, may also favor later claiming.

Couples

Social Security planning for couples should be based on joint life expectancy, and delaying Social Security can yield even bigger benefits than for single people. Couples may also benefit from coordinated strategies; for example, one partner could delay claiming as long as possible while the other partner could begin benefits as early as possible.

Each partner in a married couple may receive:

- A retired worker benefit, determined by length of employment and earnings; **OR**
- A spousal benefit, half the other spouse's base worker benefit or primary insurance amount (PIA) regardless of the other spouse's claiming age, with reductions for beneficiaries claiming before their own full retirement age; **OR**
- A survivor benefit, based on the deceased spouse's actual benefit level, with reductions if the surviving spouse claims before his or her own FRA.

One or both partners may be dually eligible. That means one or both could be eligible for benefits based on either their own working record or their spouse's. However, no person can simultaneously receive more than one type of Social Security benefit.

Retired worker benefits can be increased by claiming later than FRA, but spousal and survivor benefits max out at the FRA of the person receiving the benefit.

For one spouse to begin receiving a spousal benefit before FRA, the other spouse needs to claim his or her own benefits. However, the other spouse can "claim and suspend" at or after FRA to continue earning delayed retirement credits. (Divorced unmarried spouses with more than 10 years of marriage are eligible for spousal and survivor benefits under Social Security. Such divorced spouses can claim early spousal benefits without any requirement that their ex-spouse claim first.)

Married people may choose to begin benefits in one category and switch to another. For example, those at their FRA or older could begin receiving their spousal benefit, and then at age 70 begin receiving benefits based on their own work record with delayed retirement credits. This flexibility is not available to married individuals beginning benefits before their FRA, however; they will receive the greater of the spousal benefit (reduced for early claiming) or a reduced benefit based on their own work record.

> **Heads up:** Couples can increase their total benefits by coordinating their choices of claiming dates. For some, it may be a good strategy for the lower earner to begin benefits at the earliest age allowable, and for the higher earner to delay claiming based on that person's own work record until age 70. The higher earner may also be eligible for spousal benefits between FRA and age 70. (Divorced couples who remain on good terms may also be able to take advantage of coordination strategies.)

Widows

Maximizing Social Security benefits may be extremely important to the economic well-being of widows. There are many instances of women moving into, or getting closer to, poverty when they become widowed or a few years thereafter, and a greater percentage of widows live in poverty than is the case for the general population. Careful Social Security planning can lessen the chance of becoming poor.

The most important Social Security planning should happen while both members of a couple are still alive. In the most common case, where the husband is older and earns more, his following a strategy of delaying the claiming of

Good to Know
The considerations for widows discussed here may also apply to widowers and divorced spouses after the death of the ex-spouse.

Social Security will provide him with a higher Social Security benefit and will provide a higher survivor benefit as well.

After widowhood, the surviving spouse may face additional strategic choices in claiming Social Security. If a widow does not have a significant earnings record of her own, the key strategic choice is when to begin receiving widow's benefits. She can claim as early as age 60, but if she has a job or financial resources that allow her to wait, and if her health is reasonably good, it may make sense for her to delay claiming benefits.

Waiting provides some increase in the present value of expected benefits. More importantly, it provides significant longevity insurance if the widow lives a long life.

If both the widow and her deceased husband had significant earnings, the claiming options increase. For example, if the widow has had modest earnings, it may make sense for her to consider claiming her own worker benefit if she is between age 62 and her FRA and, then at her FRA, switching to the unreduced survivor benefit based on her deceased husband's work record. (Survivor benefits are reduced if claimed between age 60 and the FRA but are not increased after the FRA.)

If both the widow and her deceased husband had substantial earnings, a different strategy may work best. In this case, it may make sense for the widow to claim the survivor benefit at the earliest possible date (age 60, or earlier if disabled or with dependent children), and then at age 70 switch to her own worker benefit. In this way, the widow maximizes her own worker benefit.

Special Income Tax Considerations

Social Security benefits are partly taxable, with the actual percentage taxable varying from 0 percent to 85 percent as a function of overall income. Because increases in regular income increase the portion of taxable Social Security benefits, the taxpayer may end up paying not only the marginal tax on regular income but also additional tax because of the Social Security.

Example: Assume that George and Ruth, who are married, are funding retirement with $30,000 in annual Social Security benefits and $30,000 in annual 401(k) withdrawals. If the two are in the 25 percent tax bracket and take an additional $1,000 in 401(k) withdrawals, the amount of their Social Security that will be taxable will increase from $6,850 to $7,700 because of the additional $1,000 of taxable income.

The additional taxes for George and Ruth will be $462.50 (25 percent of $1,000 plus 25 percent of the $850 increase in their Social Security subject to tax). The effective marginal tax rate on the $1,000 they receive will be 46.25 percent. (The marginal tax rate is the percentage of a person's income that the person must pay in taxes.)

The actual calculation for George and Ruth involves a complicated three-part formula. Testing with the formula demonstrates that higher effective marginal rates apply in a middle band of income, while normal marginal rates apply at high and low incomes. In this particular example, a higher marginal rate will apply for 401(k) withdrawal levels between $17,000 and approximately $52,000.

Single individuals or couples impacted by these high marginal rates may want to consider special tax planning strategies. For example, a strategy of delaying Social Security to increase lifetime income may also carry beneficial tax effects. Say that Mary uses her 401(k) funds to bridge the gap from retirement to the claiming of Social Security. In that case, the funds she withdraws will be taxed at only the base marginal rate. Then, when Mary later claims Social Security—at higher amounts reflecting delayed retirement credits—she will need to withdraw less money from her 401(k) than would be the case otherwise.

In general, taking taxation into account when planning the strategy for claiming Social Security may be a key factor in helping both single people and couples decide what to do.

Careful Consideration

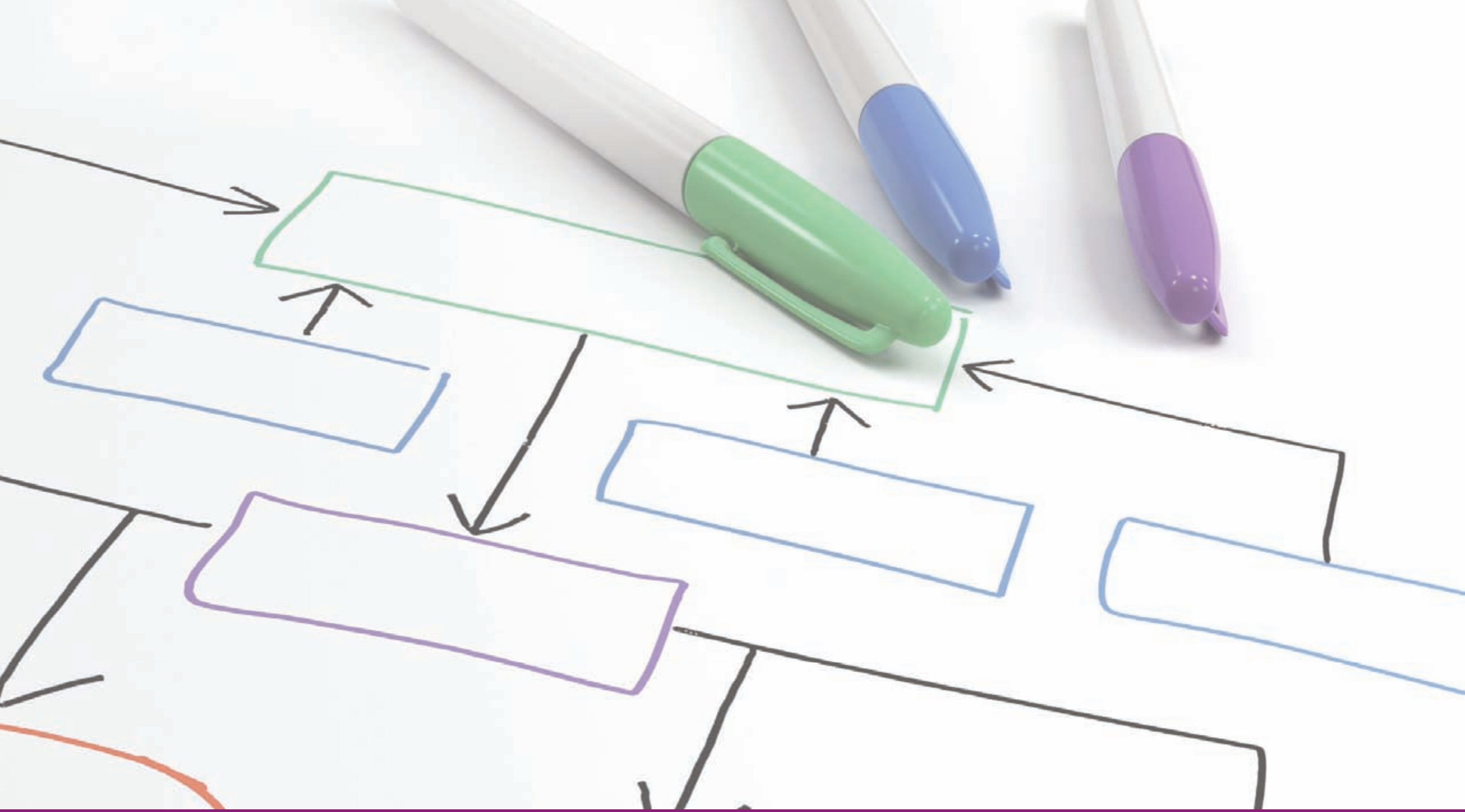
As the above discussion makes clear, deciding when to claim Social Security requires careful consideration. Fortunately, many resources are available. These include the Social Security Administration and written materials such as those below. Time exploring these and other resources will be time well spent.

Find Out More

- Mahaney, James and Peter Carlson. “Innovative Strategies to Help Maximize Social Security Benefits.” Prudential Insurance Company of America Retirement Report. Analyzes the impact and claiming strategy issues related to taxation of Social Security benefits.
- Meyer, William and William Reichenstein. “Social Security: When to Start Benefits and How to Minimize Longevity Risk.” *Journal of Financial Planning*. Discusses Social Security claiming strategies in depth.
- Reno, Virginia P. and Joni I. Lavery. “When to Take Social Security Benefits: Questions to Consider.” Developed by the National Academy of Social Insurance with support from The Actuarial Foundation. Covers claiming considerations and related statistics.
- Sass, Steven A., Wei Sun and Anthony Webb. “When Should Married Men Claim Social Security Benefits?” Issue in Brief. Center for Retirement Research at Boston College. Chestnut Hill, Mass. Highlights advantages for surviving female spouses if their husbands claim later.
- Schreitmueller, Dick. “Understanding Social Security.” Chapter 11 in *The Bogleheads’ Guide to Retirement Planning*. John Wiley & Sons. Eds.: Taylor Larimore, Mel Lindauer, Richard Ferri and Laura Dogu.
- Shuart, Amy N., David A. Weaver and Kevin Whitman. “Widowed Before Retirement: Social Security Benefit Claiming Strategies.” *Journal of Financial Planning*. Focuses on claiming strategies for women widowed before reaching retirement age.
- Sun, Wei and Anthony Webb. “How Much Do Households Really Lose by Claiming Social Security at Age 62?” Working Papers. Center for Retirement Research at Boston College. Chestnut Hill, Mass. Distinguishes between present value analysis and looking at later claiming as equivalent to the purchase of longevity insurance.

The Society of Actuaries would like to acknowledge the work of its *Committee on Post-Retirement Needs and Risks* in producing this series.

The committee's mission is to initiate and coordinate the development of educational materials, continuing education programs and research related to risks and needs during the post retirement period. Individuals interested in learning more about the committee's activities are encouraged to contact the Society of Actuaries at 847-706-3500 for more information. Additional information and research reports may be found at *http://www.soa.org*.



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