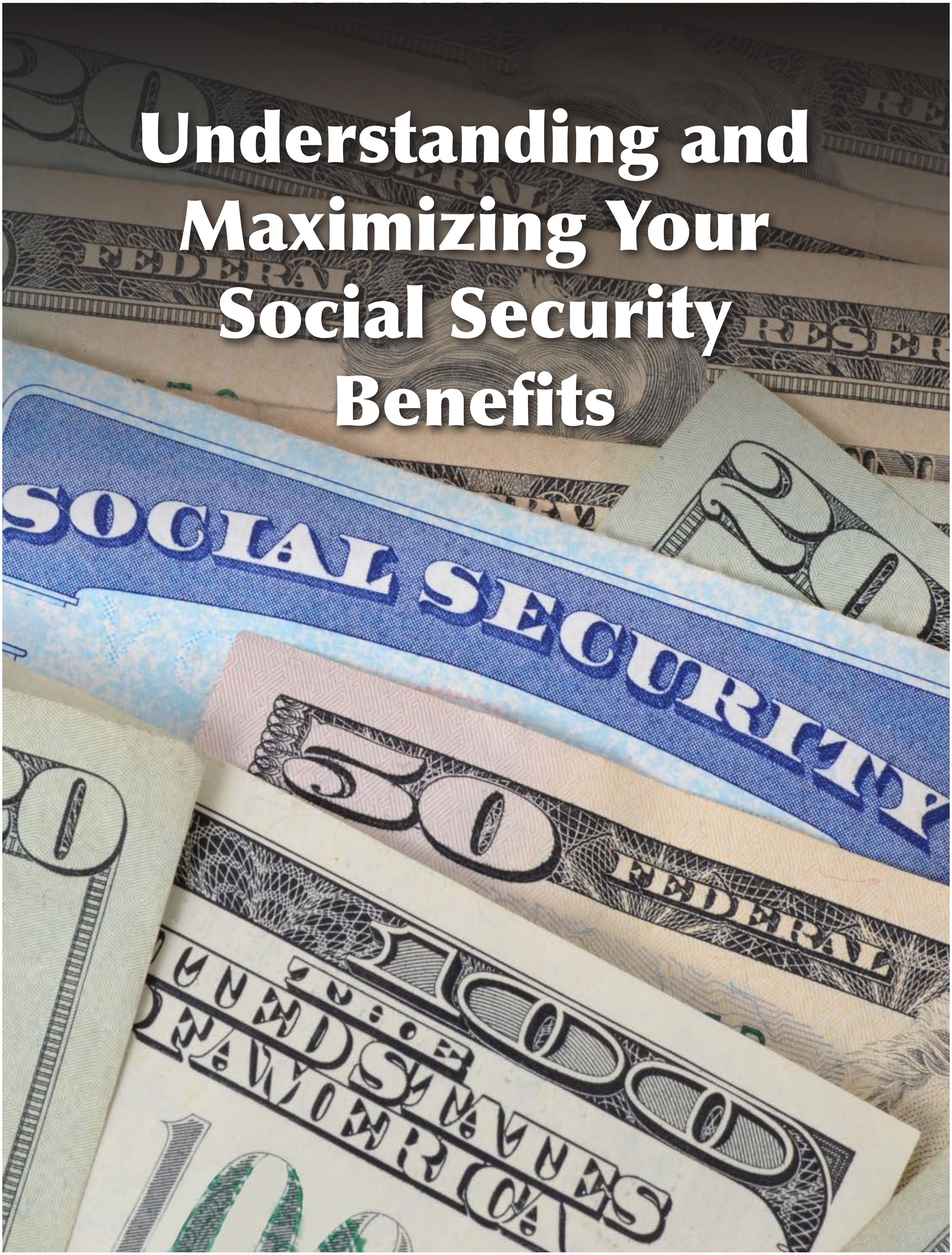
Understanding and Maximizing Your Social Security Benefits



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Before you retire, you should know what all your various sources of income will be, and how much you can expect to receive from each. Obviously, Social Security benefits will be one of those sources, but how much you can expect to receive depends on many factors. There are ways to maximize your benefits and get the most that you're entitled to, and there are strategies to minimize your tax burden from Social Security. The most important thing to consider in working toward those goals, however, is whether your Social Security benefits are coordinated properly with your other assets and sources of retirement income. We'll address that shortly, but let's begin with some basic facts about Social Security.

Money You Can't Outlive – Social Security is one of the few sources of income you can pretty much depend on for life. Once you start taking them, your benefits continue to your death, and the longer you live, the more you will extract from the system. For example, if your benefit starts at $2,000 per month, and you live 10 more years, you will receive over $300,000 in lifetime benefits. If you live 30 more years, you'll receive over $1 million over your lifetime, assuming annual cost-of-living adjustments (COLA) of 2.8 percent. That's good to know because retirees are living longer than ever. According to figures from the Centers for Disease Control and Prevention, there is a 50 percent chance that the average 65-year-old will live into their late 80s. For the average couple aged 65, there is a 50 percent chance that at least one spouse will live to age 92.

The System is Solvent – As you probably know, many have expressed concerns in recent years about the solvency of Social Security. That concern stems partly from the fact that people are—as noted—living longer, which means the Social Security Administration is paying out benefits longer than they had to in the past. Another problem is that when Social Security started there were approximately 40 people working and paying into the system for every 1 retiree. According to the most recent data, there are now only 2.8 people working and paying into the system for every 1 person taking benefits. Despite all this, estimates from OASDI (Old-Age, Survivors and Disability Insurance) indicate the current trust fund will not be depleted before the year 2033. If no changes are made to the system between now and then, however, a reduction of about 23 percent to everyone's Social Security benefit would be necessary after 2033. So, while the system is solvent for now, working Americans in their 40s and early 50s might want to keep pressure on their elected officials to address the important issue of Social Security reform sooner than later!

Your Benefit Depends on Two Primary Factors – When your Social Security benefit is calculated, it will be based primarily on two things: the age at which you apply for benefits and how much you earned over the course of your working career.

1. Your earnings – Social Security looks at your lifetime annual earnings, indexes them for inflation, and picks the 35 highest years' earnings to include in the calculation formula. The earnings are totaled and divided by 35 to come up with an average. If you don't have 35 years of earnings, the missing years are considered zeroes, which has the effect of lowering benefits for women who've taken time out of the workforce to raise children. They may, however, be eligible for spousal benefits.

2. Your age – Most people know that you can take Social Security benefits anywhere between age 62 and age 70. Depending on when you were born, the "normal retirement age" falls somewhere between 66 and 67. That is the age at which you are eligible to receive full benefits, also known as the "primary insurance amount," or PIA. The eligibility age for full benefits is 66 and four months for those born in 1956—up from 66 and two months for those born in 1955. If you take your benefits earlier than the "normal retirement age," you will get a reduction, potentially as high as 30 percent of what you would have gotten by waiting! Conversely, every year that you delay taking Social Security, you get an 8 percent increase per year in the benefits, topping out at age 70.

Resources

Based on the factors above, you can do some calculating on your own and determine approximately how much you can expect to receive from Social Security by taking advantage of a couple of different resources:

- Access your Social Security statement at www.ssa.gov/myaccount.
- Use the secure Retirement Estimator on this same website, which gives you your earnings history after you enter some personal data.
- Or you can use one of the three calculators available on the Social Security website at www.ssa.gov/planners/calculators.

Spousal Benefits

The spousal benefit is 50 percent of the worker's PIA if the spouse applies at full retirement age. For example, Bob's PIA is $2,000 and his wife Mary's is $800. If Mary applies for Social Security at her full retirement age, her benefit will be $1,000. That's half of Bob's benefit, and $200 more than Mary's benefit based on her own work record. Non-working or lower income spouses are also eligible for a spousal benefit that might be higher than their own, and a surviving spouse may also be eligible for a higher benefit. In some cases, both of these benefits can also be applied to divorced spouses.

Survivor Benefits

Survivor benefits can be complicated, but you should understand them because your current decisions will influence the amount of survivor benefits you may receive in the future. The two basic factors that influence the amount are: the age at which the deceased spouse first claimed his own retirement benefit (i.e., if he applied before full retirement age, the benefit will be lower), and the age at which the widow claims the survivor benefit.

Maximizing Benefits

The following are five steps you can take before you apply for Social Security to ensure you will maximize your benefits.

1. Improve your earnings record – Examine your earnings record from your latest Social Security statement online at www.ssa.gov/myaccount to determine if it's accurate, if there are any missing years, and if you can improve it by working longer.

2. Apply at the optimal time – The decision of when to apply for benefits is often complicated but critically important; it can make the difference of tens of thousands of dollars over your lifetime.

3. Coordinate spousal benefits – The goal is to maximize income for both of you while you're both alive, and to maximize income for the survivor after one of you dies.

4. Minimize taxation on your benefits – There are several strategies for doing this, including the following:

    - Reduce other income with tax-advantaged investments.

    - Anticipate Required Minimum Distributions (RMDs) from your IRAs, which could put you in a higher tax bracket and subject your Social Security benefits to taxation.

    - If possible, convert a traditional IRA to a Roth IRA.

    - Delay Social Security, thereby reducing the number of years that your benefits are subject to tax.

    - Reduce your expenses and pay down debt, and continue to manage your taxes throughout retirement.

5. Coordinate Social Security with your overall retirement income plan – For most people, Social Security is not enough to live on in retirement; you need to supplement your benefits with other sources of income. Making sure those other income sources are allocated correctly and aligned properly with your benefits is the single most important factor for maximizing Social Security.

Changes for 2020

As mentioned above, the eligibility age for full benefits changes this year to 66 and four months (up from 66 and two months) for those born in 1956. There are some other noteworthy changes to Social Security this year, including the following:

- The maximum payout for those retiring at full retirement age increases 8 percent to $3,011 a month, or $36,132 a year—up from $2,687 a month, or $32,244 a year in 2017.

- Annual COLA will increase by 1.6% in 2020.

- The income ceiling for workers contributing 6.2 percent of their wages to Social Security rises to $137,700—a change that is expected to affect about 12 million of the 175 million Americans who pay Social Security taxes.

- For recipients who are still working while they collect benefits, those younger than full retirement age, can earn a maximum of $18,240 without being penalized. Above the limit, $1 in benefits is deducted from every $2 earned. For workers who will reach their full retirement age in 2020, the earnings limit is $48,600. There is no limit after full retirement age is reached.

- As of 2017, Social Security statements are no longer being sent via "snail mail" to most recipients. You now need an online account at ssa.gov in order to access that information. In addition, security measures for individual accounts have increased; you now need an email address or cell phone number as a second form of identification for accessing your account.

Don't Try this at Home!

Despite the availability of governmental resources to help you calculate your Social Security benefits on your own, the complexities of the system, and the number of variables involved in successfully maximizing your benefits, ideally make this a job for a professional. Remember, the most important factor for maximizing your benefits is coordinating them with your other sources of retirement income, and making sure your asset allocation is secure and properly aligned with your Social Security strategy. A qualified financial advisor (ideally one who specializes in retirement income) can work with you to make Social Security the significant and dependable part of your retirement plan that it should be.

These same advisors may also have software that allows you to input your personal data and find out specifically how to squeeze the maximum amount that you're entitled to out of Social Security, based on your data and your personal situation. It's not uncommon that the difference between the number one best method and the number two best method for an individual amounts to more than $100,000 of cumulative benefit over the course of a lifetime. That's the kind of difference that a qualified professional with the right tools and training can make!

1. U.S. Centers for Disease Control and Prevention (cdc.gov)
2. Social Security Administration (ssa.gov)
3. American Association of Retired Persons (AARP.org)