Cashflow Flexibility: Adjusting Social Security Benefits

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You may want to delay the start of social security for the long-term benefit. But how do you live between now and then? Perhaps you had a plan to defer, but something has happened to change your situation - maybe you lost your job! What adjustments could you make?

There are a large and ever-expanding number of articles and books on Social Security. There are a surprising, and even overwhelming, number of alternatives depending on your family situation, including each family member's age, longevity, and earnings history. However there is little discussion about using some of your Social Security while deferring other parts, and taking advantage of options to increase flexibility. Perhaps you are deferring your Social Security until age 70, but at age 69 discover you have a health condition and won't live very long. There's a flexibility option that allows you to receive benefits as if you had started them earlier!

There is also little discussion about using *some* of your Social Security benefit to live on while deferring another part of your family benefit to build for your long-term advantage.

A thoughtful and informed decision-making process can substantially improve your lifetime financial situation. In general, if your health and longevity is at least average compared to the whole US population, you are better off not to start Social Security benefits early – to wait to start benefits.

Delaying start of Social Security benefits can be an important wealth-building and risk reduction step, for several related reasons.

- The later you start, up to age 70, the bigger your benefit will be for the rest of your life.
- Benefits are tax-advantaged - yours may be completely tax-free, but is always at least partially tax-free.
- Delaying start pushes the maximum amount of money into your oldest years – you can't outlive it. Your eldest years are often when you have the fewest choices and highest financial risks.
- Delaying the start pushes gives you the largest total benefits over your lifetime if you live past your life expectancy.
- The benefits are inflation adjusted (unlike most traditional pensions). If inflation were 3% a year, if you start benefits at age 70 your benefit will be twice as big at age 93.
- Benefits are "automatic money." They just keep showing up in your bank account. Once started, there's very little you can do to goof them up.
- Delaying your benefit can increase your spouse's benefits, maximizing what the two of you receive over your combined lifetimes.

A full discussion of SS strategies is well beyond the scope of these notes – entire books have been written about SS strategies[i],[ii],[iii],[iv]. Additional resources are mentioned below.

> **SS** is used as an abbreviation for Social Security and **FRA** for your SS Full Retirement Age. Your FRA is 66 if you were born between 1943 and 1954, and is later if born after 1954. **PIA** is Primary Insurance Amount – your benefit if you start receiving SS at your FRA.

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The reality is many Americans have few financial resources other than Social Security. If this is you, you may need to claim Social Security as soon as you can. First, think carefully about other choices you have.

- If you are like most people, using almost any other resource to live on while delaying SS will work out better over your lifetime. Delaying even a year helps your long-term picture. If your FRA is 66, and your PIA were $1000:
  - Starting SS at age 62 reduces your monthly benefit by 25% from your PIA. You receive $750.
  - Starting SS at age 70 increases your monthly benefit by 32% from your PIA. You receive $1,320.
  - Delays beyond your FRA grow your benefit by 8% a year, and the inflation adjustment makes the growth even bigger. The benefit you and potentially your spouse have at age 70 determines the benefit you will have for the rest of your life.
- A strategy to delay benefits is especially important for couples, as the spouse living the longest will end up receiving the higher of the two spouses' benefits, and often at a time they need it the most.
  - Two rules of thumb for couples when deciding how to claim SS benefits are:
    - The spouse with the higher PIA benefit amount should chose when to start benefits based on the life expectancy of the spouse who is expected to live the longest: if the longest life expectancy is past 80, the spouse with the higher benefit should claim as late as possible (e.g., age 70).
    - The spouse with the lower PIA benefit amount should begin benefits based their own earnings based on the life expectancy of the spouse expected to die the earliest: If that is relatively soon, the lower benefit spouse should claim as early as possible.

  An example for a higher-income couple: "The mid-market's largest off-balance-sheet assets are lifetime income sources, such as Social Security and pensions, according to T. Rowe Price and Social Security Administration data presented in The Impact Report. If the higher earner ($100k/year) of a couple died at age 80 and the lower earner ($50k/year) died at 95, a couple could increase their combined benefits from Social Security by 50 percent to $2.425M from $1.647M if they both delayed benefits until age 70. The 4 percent sustainable withdrawal approach ignores this valuable asset."[v]

- How might you get cash to live on while delaying your SS benefit:
  - Draw down a portion of a retirement account. You have always heard that holding off tapping IRAs until 70.5 is a good plan, but trading IRA withdrawals for delayed SS can be a better plan. Being in a lower tax bracket before age 70 can make this a good plan.
  - A Reverse Mortgage can work well if you have enough equity in your home. Cash from a reverse mortgage is tax-free.

- You don't quite have enough SS credits to be eligible for benefits? You've heard you need 10 years of SS work. Credits are often referred to in terms of "years of work", with 4 credits making up a year of work. Maybe you have 9 "years of work". It doesn't take working a full year to get a year of SS credit. It takes earning $1,200 in 2014 for one SS Credit. If you earned $4,800 in an hour, you get a full "year" of Social Security credit. If that were all you were short of qualifying for SS, a small amount of work could have enormous benefit. Self-employment might be a good alternative for you as the rules for self-employment SS credits are similar.

Between the extremes of starting SS as soon as possible and delaying as long as possible there are in-between approaches. You may be able to get some cash earlier while preserving some of the long-term advantage of delaying. That's the goal of the most of following hints.

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You just need SS for a period of time now: You may be able to start and then stop collecting benefits. Once stopped your retirement benefits continue grow until you reach age 70.

- *Withdraw application: You started benefits in the last 12 months, and can stop now at any age before 70:* If you began SS benefits less than 12 months ago and you change your mind about starting, you can *withdraw* your SS claim and re-apply at a later date. You can do a withdrawal either before or after your FRA. If your request is approved, you must repay all the benefits you and your family received based on your retirement application. Then your retirement benefits would grow as if you had never started. A withdrawal might work well if you started benefits when unemployed, and you found a good job within a year. Note that a withdrawal is different from just suspending: withdrawal is stop and repay; suspension is just stop.
- *Suspend benefits: If you have reached FRA but are not yet age 70:* you have started benefits, but decided you do not really have to have the SS checks immediately. You prefer to let your benefits grow as much as possible. You can *suspend* your own retirement benefit payments even if you have already started. For example, if you are 64 and unemployed, you can start your SS retirement benefit right away, and then when you are at your FRA of 66 and perhaps employed again, you can suspend your benefit. When you later resume benefits, perhaps at age 70, the benefits will not only have grown 8% a year due to Delayed Retirement Credits, but also will also have added inflation adjustments. For more on this, go to the SS website www.ssa.gov and do a search for "Suspending Retirement Benefit Payments" and "If You Change Your Mind"
- *You qualify for more than one type of benefit* (your own, spousal, divorced, widow/widower, disabled): you may be able to start one benefit and allow the other to grow before starting it. One benefit would give you some cash now, and the other more income through the lifetime of the one to live longest. Typically, if one spouse starts early it is best for the one with the lower benefit to start, delaying the higher benefit.
- *You are any age between 62 and 70:* You just lost your job, and you think you may need to start your Social Security retirement benefits immediately, but are not sure yet. Consider immediately starting the process to get benefits, but do not finish the startup steps now. Starting is as easy as getting on the SS website for a few minutes. Once you get an application number (hang onto it), stop. The web will show you a date 6 months later by which you need to finish the application. If you decide you need the cash now, you can finish the application within the 6 months and you will get checks from the day you started the application. It will be just like you finished the application the first day. If you decide to wait until later to start befits, perhaps because you got a new job, you do not have to do anything and the application cancels itself at the end of the 6 months.
  - This 6-month interval allows you time to size up your situation, including learning more about your SS choices before you have to make a decision.
- *You and your spouse have both reached your own FRAs:* one of you can file and suspend. That means one can file for retirement benefits and suspend (don't start) payments. The other can then apply for spouse's benefits on the one who filed and suspended. As neither of you have started your own retirement benefits both grow with delayed retirement credits. **File and suspend in this situation effectively provides you several years of additional benefits without any long-term reductions.**
- *Age 62+ and have a child under 19: At 62 you can file for your own benefits and if your child is under 18, or under 19 and a full-time elementary or high school student, both you and your child can receive SS benefits. If you start benefits early, you can then suspend your benefits at FRA so your child can continue to receive benefits and yours will start growing again at 8% a year.*
  - *If you have reached FRA, you can file and suspend, and your child can receive benefits without any reduction in yours. If either you or your child is disabled, there is more flexibility. In addition, your grandchildren can qualify if their parents are deceased or disabled.*

- *Widow, widower? Age 60+.* You may be eligible for benefits on your prior spouse's record. If you qualify for benefits as a widow or widower, you may choose to apply for survivors benefits now and delay your retirement benefit until later. If you delay receiving your retirement benefit until your FRA or later, your retirement benefit will be higher. Widows/widower's benefits can start as early as age 60, or even earlier if caring for your child who is under age 16.
- *Divorced?* If you have been divorced for at least 2 years, and not remarried, and you and your ex-spouse are each at least 62, you can start spousal benefits based on your ex's benefit if it is larger than yours is. Once you reach your FRA, and you are eligible for a spouse's benefit and your own retirement benefit, you have a choice: you can choose to receive only the divorced spouse's benefits now and delay starting, or if already started, suspend your own retirement benefits until a later date. Your delayed retirement benefits can continue to grow at 8% a year, plus inflation.
- *Getting Social Security while you are working:* You may have heard that you will **lose** some of your SS if you work while you receive Social Security. This is both right and wrong – here is the rest of the story. If you are receiving SS, after your FRA you can earn any amount without any benefit reduction. Before your FRA if you earn "too much" there is an earnings offset that reduces your **current** benefit.
  - The missing piece of the story is that when you reach FRA your monthly benefit is automatically recalculated and **increased** to make up for any benefit you weren't paid due to earning too much. The increased amount means that by your life expectancy (about age 81) you will come out even, and then as you age beyond then you and potentially your spouse will be ahead for the rest of your lives. SS is designed so you should not be penalized over your lifetime if you have earned income while getting benefits. SS both wants you to work, and wants you to get your full benefits!
  - For example, if your FRA is 66: Say you started SS retirement benefits at 62, but "lost" a year's worth of benefits by age 66. At age 66, your benefit amount is increased as if you had actually started benefits at age 63, rather than age 62. www.ssa.gov/retire2/whileworking.htm . Having your current benefit reduced sounds bad at first. However, it is often a strongly positive result over your lifetime and especially over your and your spouse's combined lifetimes. It has the same effect as if you had chosen to delay SS benefits to maximize your lifetime benefit. The biggest long-term benefit you could get is if your earned income is enough to eliminate all your SS benefits between age 62 and 66: then your benefit is recalculated as if you had delayed filing until age 66, which is effectively what happened.
  - Once you reach FRA, then you can further improve your benefit by suspending it, up to age 70.
- *Once you have reached FRA:* perhaps you want to try holding off starting your retirement benefits so they can keep growing, but you are worried about losing your job. If you do lose the job you will need every penny you can get.
  - You can receive retroactive benefits for up to 6 months. This does not require any special planning to receive the retroactive benefits.
    www.ssa.gov/OP_Home/handbook/handbook.15/handbook-1513.html
  - As a contingency plan, if you do a file and suspend at FRA of age 66: meaning you file for your retirement benefits, but suspend receiving them. Then if you decide you need to start up before you turn 70, you can also ask to be paid some or all of the suspended benefits. For example, if you just turned 68, you can ask to start benefits then. You could get 2 years of back benefits, or no years of back benefits, or anywhere in between. www.ssa.gov/retire2/suspend.htm
    - Receiving back benefits will have the effect of reducing the size of benefit payments compared to not receiving any benefits until a later age.
    - There is no downside to doing the file and suspend. Note that only one spouse of a married couple can apply for benefits and have payments suspended.

- You wish you hadn't started SS so early: In summary, there are three things you can do:
  - If it is within 12 months since you filed, you can file Form 521 and pay back all the benefits you have received to date. This works at any age.
  - Once you have reached Full Retirement Age, you may suspend your benefit for any time up to age 70.
  - Work and earn enough to reduce your current benefit, increasing your future benefits.

- Where to get more information:
  - The Social Security website is www.ssa.gov. It is quite readable and is authoritative information. For example, see "Retirement Planner: Other Things To Consider"
  - The endnotes on the last page have references to well-regarded books on Social Security.
  - The SS offices and the toll-free number are good resources. They can tell you what you are eligible for, but cannot advise you on choosing among your options. In addition, they will not know the rest of your financial picture and any options among resources you have.
  - Michael Kitces, a financial planner, has excellent blog posts on file-and-suspend and on the value of delaying benefits.
  - Jim Blankenship, also a financial planner, also has a number of excellent blog posts on Social Security, and is now working on the third edition of his book on Social Security.
  - AARP has a Social Security Q&A tool on their website with answers to lots of common questions.
  - There is an exploding amount of information on the web; you need to verify what you find. Be careful to find authoritative sources. Many words have specific technical meanings, so read carefully. For example, the word withdraw does not mean the same thing as suspend.
  - A useful discussion for survivors and divorces is in a whitepaper on the Prudential website.
  - You may be more comfortable talking with a private expert in SS who can analyze the specifics of your situation, and perhaps even do your Social Security filing online for you. There are a number of private SS consultants around the country – generally veterans from SS. You will pay them a fee, perhaps a few hundred dollars.
  - Many financial advisors can do detailed social security analysis for you.
  - There are a number of excellent software packages to help you with strategy. Some offer analysis that is more detailed. Some are more carefully checked than others. For example, see www.socialsecuritysolutions.com . Others are www.troweprice.com/socialsecurity , www.socialsecuritytiming.com and www.socialsecuritychoices.com .

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[i] Reichenstein, William and Meyer, William (2011). *Social Security Strategies: How to Optimize Retirement Benefits*.
[ii] Landis, Andy. (2014) *Social Security, The Inside Story: 2014 Edition*.
[iii] Joseph Matthews (2014) *Social Security, Medicare & Government Pensions: Get the Most out of your Retirement and Medical Benefits*. Nolo Press, Nineteenth Edition.
[iv] Blankenship, Jim. (2013) *A Social Security Owner's Manual, 2013 Edition: Your Guide To Social Security Retirement, Dependent's, and Survivor's Benefits.* The 2015 edition is coming out in December, 2014. Also see his blog: www.financialducksinarow.com
[v]

http://www.onefpa.org/journal/Pages/Still%20MIA%20Comprehensive%20Retirement%20Income%20Best%20Practices%20for%20the%20Mid-Market.aspx