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summaries

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OPTIMIZING SOCIAL SECURITY BENEFITS IN RETIREMENT

Often times, individuals or households have predetermined the age for which they would like to begin collecting their entitled Social Security Benefits without any consultation from a professional. However, when asked why they perceive the age specified as the best option, the responses tend to lack proper consideration of the impact that it has on their overall plan. Importantly, an insufficiency of thoughtfulness when deciding the age to begin collecting can end up costing that household tens of thousands of dollars, if not more, over their extended lifetimes. Allow me to provide a theoretical scenario:

Jon (61) & Jill (61), wish to file and begin collecting social security at the age of 62. Jon is recently retired from a company where he had worked the majority of his career and is eager to tap into Social Security after "paying into it all these years", this statement is usually coupled sarcastically with a "before it dries up and goes away!" Jill never worked for wages. Once they were married, she took on the responsibility of raising their kids and running the household. Therefore, she is not entitled to any Social Security benefits on her own. She vocalizes her understanding of Social Security as "entitled to half of his."

Outside of this, Jon and Jill have amassed a comfortable amount of wealth - they have managed to accumulate a combined $1.5 million for retirement in 401(k), IRAs, and a Brokerage Account. Additionally, Jon gets a small pension from the company that he retired from that is currently paying out to him and will continue for the rest of his lifetime. The pension supports about 40% of what they spend and adjusts with inflation each year. Their furthered explanation, as to why beginning to collect from Social Security early would help them to support their lifestyle, is a logical one. Yet, their concern is not being able to afford a delay.

In terms of data gathering, an appropriate next step would be to dive into the numbers; what would be paid by Social Security at age 62, Full Retirement Age (FRA) at 67, as well as age 70, which is the latest age that they could defer to. It would also be mindful to look at account values and how they are invested, account for their current and estimated future effective tax brackets, as well as determine an appropriate lifespan for each of them.

While investigating statements we find that a largely held portion of new money recently flowed into their brokerage account from a recent inheritance on Jill's side of the family. Approximately $200,000 of the investments in this account received a step-up in basis upon the transfer from Jill's mother to her and have since accrued only minimal capital gains in the eyes of the IRS. One idea might be to allocate this portion of investible assets as a means of supporting the remaining 60% of their living expenses for the next 5-6 years, without triggering additional income

tax. The only taxes required would be on the capital gains accumulated since she inherited it, which would be minimal, and are subject to a much lower capital gains tax rate rather than income tax.

If we chose to defer until FRA and utilize the brokerage account as a source of income, then we can assume an approximate 6% annual increase to the receivable Social Security benefit amount for each year. That return would amplify their cash flow in future years substantially, affording them less reliance on their nest egg when adjusting to a new retirement lifestyle.

In this scenario, remember Jill mentioned that she would be “entitled to half of his?” This is only partially true. Jill is entitled to half of Jon’s FRA benefit, through what the Social Security Administration refers to as a Spousal Benefit, once she reaches FRA herself. If they were to choose a collection strategy beginning at age 62, Jill’s Spousal Benefit is then discounted based on the number of months that she collected early; in this case, resulting in a 32.5% reduction in her perceived Spousal Benefit. For illustrative purposes, refer to the calculations below:

Jon and Jill both collect at 62
Jon’s Age 62 benefit: $26,420 annually
Jill’s 67.5% Spousal benefit: $12,150 annually
Combined benefit: $38,570 annually

Jon and Jill both collect at FRA
Jon’s FRA benefit: $36,000 annually
Jill’s Spousal benefit: $18,000 annually
Combined benefit: $54,000 annually

Assuming Jon and Jill both live to be 93 years old, the difference in choosing to collect at age 62 versus FRA, would mean squandering approximately $208,330 in combined lifetime benefits. Admittedly, the longer that they chose to defer, the greater the lifetime benefits differential becomes. Contrarily, if they were to predecease the expected planning age, the variance becomes smaller. An objective for the professional would be to run a breakeven analysis on multiple scenarios and then present each one.

To conclude, this is just one example as to why planning with a professional is paramount to achieving a comprehensive understanding of your options when making an important life decision such as this one. Our philosophy is that your financial professional should bear the burden of heavy lifting and present you with the best options, while you get to focus on the things that are important to you.

All comments and suggestions are welcome.

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