

## **Understanding Ins and Outs of Social Security Benefits is Vital for Retirement Planning**

**By Scott Whyte, AAMS®**

Social Security is an important part of any retirement planning discussion. Understanding the ins and outs of Social Security Benefits and how they work in conjunction with your investment portfolio, pension and other sources of retirement income can be confusing. Once you understand what benefits you and your spouse may qualify for, deciding when to start the benefits, and how those benefits will impact other areas of your retirement plan such as pension payments or withdrawals from your portfolio, takes serious planning and consideration.

The most important factors to consider with regard to Social Security Benefits can be summarized by the following:

- Individual benefit amount and whether it makes sense to apply based upon your earnings or your spouse's earnings.
- Age at which you are eligible for and/or should begin taking benefits.
- Maximum benefit you qualify for and the impact of taking benefits before or after your Full Retirement Age (FRA).
- Tax implications of drawing benefits prior to FRA.
- Whether you should delay drawing Social Security Benefits and draw from your portfolio instead.

## **Understanding your Benefit Amount**

In looking at Social Security, the first thing you need to understand is how your benefits are calculated. The Social Security Administration sends us a Social Security Benefit statement on an annual basis which gives a breakdown of your potential benefits. If you have one of those statements, that would be a great place to start. In the absence of that document, you can also request a statement online at the Social Security website at [www.ssa.gov](http://www.ssa.gov) or by contacting a local Social Security office. In addition, the Social Security website provides you with a variety of resources to determine benefits you may be eligible for and includes online tools and calculators to help you estimate your potential benefits.

Also, keep in mind, that for a spouse who earned significantly less than their higher-earning spouse, it may also make sense to apply for benefits based on their spouse's earnings rather than their own earnings. Generally, the benefit will amount to  $\frac{1}{2}$  of the higher-earning spouses benefit if you take benefits at your Full Retirement Age. If you start drawing at age 62, you could receive as little as 32.5% of the higher-earning spouse's benefit amount. This calculation will not show up on your personal benefit statement, but should always be considered in any planning scenario.

## **Benefit Amount Changes Based on When You Take Benefits**

For most people, as long as you have worked for 10 years, you become eligible for Social Security Benefits at age 62. However, by taking benefits at age 62, you will receive a permanently reduced benefit. Therefore, many people wait until their Full Retirement Age (FRA), which I will explain in more detail below, is reached to take benefits. If you can wait beyond your FRA to take benefits (up to age 70) you will receive an even higher monthly benefit amount than if you started drawing benefits at FRA.

Your Full Retirement Age (FRA) is based on the year you were born and you can find the chart that shows the age progression in the retirement planning section at [www.ssa.gov](http://www.ssa.gov). In general, persons born between 1943 and 1954 reach FRA at 66. If you were born after 1954 and up to 1960, your FRA increases by two months each year. If you are born after 1960, then 67 is your FRA. For example, if you were born in 1960 or later, your FRA would be 67. Therefore, if you took your Social Security Benefits at

age 62, the amount you would receive would be reduced by 30 percent, and the reduction rate would diminish each year by 5-6% until age 67 when you would have no reduction in benefits. You should also factor in any benefits your spouse will get as well when planning your Social Security Benefit strategy. There are some studies that indicate a couple may maximize their benefit payouts if the lower earning spouse begins collecting benefits as early as age 62 and the higher earning spouse waits until 68 or older to begin collecting. While there may be some benefits to this approach, a fair treatment of the topic must be saved for a separate discussion.

## **Determining When to Take Your Benefits**

Deciding when you and your spouse should take your Social Security Benefits is a very personal and irrevocable decision. First, many people are working well into their 60s and may not need the money at age 62 or even at their Full Retirement Age. However, some people have health conditions that preclude them from working and Social Security Benefits become a much more vital part of their retirement income earlier than most other individuals. It is also important to factor into your Social Security Benefit decision any other sources of income you may be receiving such as a pension and/or withdrawals from a retirement portfolio. For example, if you are comfortable living off of your company pension and do not need additional income to supplement your living expenses, you may wish to delay Social Security Benefits rather than taken them early which, ultimately, increases the monthly amount that you receive for the rest of your life. Also, if you receive a pension, but your spouse does not, it may be necessary for one or both of you to take Social Security Benefits early in order to supplement the pension amounts.

## **You Could Lose Benefits by Taking Them Too Early**

If you continue working and decide to draw benefits prior to your Full Retirement Age (FRA) you may lose some of your monthly benefit. For instance, if you are still working at age 62 and start drawing benefits, you will lose \$1 in benefits for every \$2 of earned income over \$14,160 (amount is adjusted annually for inflation). However, if you are not working, but your spouse is working, you will not lose benefits. This particular aspect of Social Security is tied to your individual earnings rather than joint earnings. In most situations, it does not make sense to draw Social Security Benefits prior to FRA while you are working and earning more than \$14,160.

## **You May Pay Taxes on Your Benefits**

You may pay taxes on Social Security depending on a variety of factors. No one will pay taxes on more than 85 percent of their Social Security Benefits. For joint filers, you will generally pay taxes on your Social Security Benefits if your "combined income" is above \$32,000. Combined Income is calculated as follows:

Your adjusted gross income  
+ Nontaxable interest  
+ ½ of your Social Security benefits  
= Your "combined income"

Thus, by owning municipal bonds or bond funds you will not necessarily avoid paying taxes on your Social Security benefits as the interest on those investments is added back into the equation. However, deferring income by avoiding or reducing withdrawals from IRAs or deferring income by investing in an annuity can help you to avoid paying tax on your Social Security Benefits. Remember though, that avoiding taxes on your benefits may be insignificant when compared to the increased costs of a variable annuity or IRA if you do not carefully consider all costs and fees associated with those programs.

## **Delaying Benefits by Drawing from Your Portfolio**

Generally speaking, I'm not a big fan of drawing from your investment portfolio in order to delay the drawing of your Social Security Benefits, but it could make sense in some situations. The problem with this strategy is that an investment portfolio tends to be more volatile and fluctuates more so than the steady and reliable fixed income you would receive when taking Social Security Benefits. Further, the erosion of your investment principal in the early years of retirement if the market performs negatively while you are drawing from it may be difficult to recover from. What you are banking on, or hoping for, is that the increased monthly Social Security Benefit would offset the lost opportunity of potential gains that you could earn from your investments. While that may seem a reasonable assumption during market downturns to think in that mindset, history has proven that the investment markets provide returns that exceed the increases that you would receive by delaying your Social Security Benefits.

In summary, there are a variety of important factors to consider when making decisions about your Social Security benefits. Some issues such as divorced spouse benefits or widow benefits were not included in this article in order to keep it a reasonable length, but you may need to consider those or other issues as well. Furthermore, the long-term viability of the Social Security program has been called into question for a variety of reasons, but most planners including ourselves consider that the program will continue to pay for the foreseeable future. While these decisions can be easy for many of us, not all situations are easy to wade through. As always, if we can be assistance in helping you with your Social Security planning or retirement planning in general, please do not hesitate to contact us at 248-932-5200.

*Scott Whyte is a financial advisor with Bloom Asset Management and has been successfully serving client's investment needs since 1988. Scott joined Bloom Asset Management in 2000 and provides Financial Consulting and Investment Management services to individual, small business and high net-worth clients. Prior to joining Bloom Asset Management, Scott was Vice President and Branch Manager at Charles Schwab's Southfield, office where he was responsible for \$1.5 billion in client assets.*

*Scott has received his designation as an Accredited Asset Management Specialist (AAMS) through the College for Financial Planning in Denver, Colorado. He also held various licenses through the National Association of Securities Dealers (NASD) while working in the financial services industry.*

*Scott lives in Troy, Michigan with his wife and three children, including one set of twins.*