

# How Social Security Fits into Your Future

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## Summary

Most Americans are eligible for Social Security starting at age 62, whether they are retired or not. But you are probably better off not starting to take benefits that soon. This paper explains some basic features of Social Security (pointing you elsewhere for further details), discusses whether you can count on Social Security being there in the future, and explains the factors that determine when you are best off starting to receive benefits.

## Who gets Social Security, and who doesn't

There are three kinds of Social Security benefits, and two kinds of people who are eligible for them.

*The three kinds of benefits* are: retirement, disability, and survivor benefits.

*The two kinds of recipients* are: people who have earned benefits themselves, and people who are eligible because they are a dependent child or the spouse (or ex-spouse) of someone else who has earned benefits.

This paper focuses on retirement benefits. These can be paid starting as early as age 62 (but note that widows and widowers without dependent children are eligible at age 60 for survivor benefits).

In order to receive retirement benefits, you must earn them by paying "FICA" taxes that in most cases are automatically taken out of your paycheck. You need to have paid forty quarters (i.e., ten years total) of such taxes, or you can receive benefits if your spouse or ex-spouse earned benefits and either has started receiving them or is deceased.

The amount you receive also depends on what you (or your spouse) earned. The formulas are too complicated to explain here, but essentially, the Social Security retirement benefit is determined by your salary or wages during the 35 highest earning years of your career. If you did not work that many years, or if your earnings during any of those years were less than a certain relatively high amount (\$110,100 in 2012, a number that changes every year for inflation), you will receive less than the maximum annual benefit. The maximum benefit also changes each year, but in 2011 it is \$26,988 (at age 65).

Even the maximum benefit is not enough for most families to live on comfortably. But it provides enough income to keep you out of poverty. Of course, a majority of people will not qualify for the maximum amount, but most are entitled to something worth talking about. The main exceptions are employees of religious or government groups that have opted out of Social Security and in the latter case, other kinds of pensions should more than make up the difference. Other exceptions would be people who have recently immigrated to the U.S., or people who have not worked or have been paid "under the table."

If you are of retirement age and are (or have been) married, you are generally entitled to *one-half* the benefit that your spouse or ex-spouse would be entitled to. If this is more than the amount you would get based on your own earnings, you get the higher of the two amounts (*not* the total of them!).

If you have not yet started receiving benefits, the Social Security Administration (SSA) mails you every year an estimate of the retirement benefits you are earning. Your actual benefits could be higher or lower, though, depending on a variety of factors.

Social Security benefits are adjusted annually based on changes in the Consumer Price Index. The common notion that the elderly live on "fixed incomes" is, in fact, incorrect as far as Social Security is concerned.

The SSA should be your main source for further details, and especially for how the many rules apply to your particular situation. See the "For more information" section at the end of this paper for help in tapping into the Social Security Administration.

### **Will Social Security be there for you in the future?**

In a word: yes. If you are already retired, or are close to retirement, Social Security is almost certainly going to be there — at or close to its current level of support — for the rest of your life. If you were twenty or thirty years old, this would be less certain, but people in their fifties and above are pretty safe.

Political discussions of Social Security solvency are often misleading. There are, in fact, two *separate* trust funds run by the Social Security Administration, one that supports retirement, survivor, and disability payments, and another that supports Medicare. The Medicare fund has problems. But the fund that supports Social Security retirement benefits is projected to stay solvent until 2036. That may well be long enough to cover *you*.

Furthermore, according to projections, even if no changes were made to further strengthen Social Security's financial underpinnings, even when the trust fund ran out, there would still be enough money coming in from people who are working to support benefits for retirees at about three-fourths of the standard amount. So even if the fund were allowed to dry up completely, the worst outcome would be a reduction in benefits. Benefits would not be eliminated.

But that scenario is highly unlikely. Most voters in this country are either workers or retirees, and both groups have a big stake in the long-term solvency of Social Security. Any attempt to weaken the system, as we saw in 2005, raises such a political uproar that, frankly, it is hard to imagine how it could happen. Perhaps the "worst" that seems plausible for retirees is a change in the way future cost-of-living adjustments are made, since these are, apparently, somewhat more generous than they need to be, given the way retirees' expenses are actually affected by inflation.

In general, therefore, Social Security retirement benefits are one of the *safest* elements of your financial plan — safer, certainly, than your life expectancy, your health, the value of your home, or the earnings you might get on your savings and investments.

### **When should you start taking Social Security?**

Most people are not eligible to begin receiving Social Security benefits until age 62, even if they retire sooner. Furthermore, the longer they wait to take them, the higher their monthly benefits will be — up until age 70, after which such adjustments no longer apply.

The Social Security System assigns you a "normal" retirement age, sometime between age 65 and age 67, depending on what year you were born (65 if you were born in 1937

or earlier, 67 if you were born in 1960 or later, and in-between ages for birth years 1938 thru 1959). If you start taking retirement benefits before ñnormal retirement age,ö your normal benefit is reduced, and though you are still eligible for annual cost-of-living adjustments, your benefit continues for the rest of your life to be less than it would be if you had waited. Conversely, if you delay the start of benefits, you will get a permanent increase. In essence, therefore, while you can start collecting at age 62, the longer you wait ó up until age 70 ó the higher your benefits will be, for the rest of your life.

So, do you wait, or not?

If you are thinking about the long run, the decision to wait is really a choice between getting *bigger but fewer* checks (if you start later) versus getting *smaller but more* checks (if you start sooner). So how do you decide? There is no perfect way to decide, because you can't tell what's going to happen in the future. But these are the issues that, in principle, affect the decision:

- **Your health:** if you are unhealthy and likely to die earlier than most people your age, you should start collecting Social Security sooner. But if you have better than average health for your age, you may be better off waiting.
- **Your sex:** under Social Security, women get the same benefits as men (other things being equal), but women tend to live longer. Women are therefore more likely to be around to receive more checks, and so they tend to benefit more by waiting and having those checks be bigger.
- **Your marital status:** if you are married, your spouse will be eligible to receive one-half of your benefit once you start collecting and 100% of your benefit after your death, if those are greater than the benefit he or she would get based on his or her own earnings. If you take a reduction in Social Security by starting early, or take an increase by starting late, those adjustments can carry forward to the benefit your spouse would get. In such cases, there can be an advantage to starting later, therefore, depending on your spouse's age, health, working status, and other taxable income.
- **Your work plans:** up to ñnormal retirement ageö (as Social Security defines it, explained above), if you work while you collect Social Security, your benefits will be reduced by \$1 for every \$2 you earn above a certain amount (\$14,640 in 2012). The reduction is \$1 for every \$3 above \$38,880 in the year you actually attain your ñnormal retirement age.ö After that, there is no penalty. So unless your earnings are small, you may be better off waiting to sign up for Social Security until you are done working, or until ñnormal retirement age,ö whichever comes first ó though Social Security provides some degree of make-up, after normal retirement age, if you have lost benefits due to this ñearnings test.ö
- **Your income:** if you have taxable income from almost any source (not just work) above a certain amount, your Social Security benefits will be partly subject to income taxes. This dilutes the benefit of the payments you get. If your taxable income is high now but will be lower later, therefore, you may want to wait. (At least a portion of your benefit will be taxed if your Adjusted Gross Income [excluding any Social Security benefits] *plus* any tax-exempt bond or bond fund interest *plus* one-half of your Social Security benefits, exceeds \$25,000 for single taxpayers or \$32,000 for

married couples filing jointly. If that income amount exceeds \$34,000 [single] or \$44,000 [joint], up to 85% of your Social Security income will be taxed.)

- **Your investment strategy:** if you are a savvy investor and can reliably expect to get good returns in the future, there is an argument for signing up earlier for Social Security. Here's why: either you can invest the early payments and get good returns on them, or if you cannot afford to just set the money aside, it probably still means that you will be putting less of a drain your existing investments, which already pay you well. Conversely, if you are like most retired people and put your money into conservative savings and investments that don't pay off as well, there is no benefit here to starting early.
- **Your liquidity and cost of borrowing:** if you retire at or before age 62 and do not have other sources of ready cash, you might have no choice but to start taking Social Security as soon as possible or earlier than you would otherwise like. But if, in your case, the benefits of waiting are significant, and you can borrow money in the meantime at a reasonable rate, perhaps from a life insurance policy or a home equity loan, for example, holding off for a few years or longer could still pay off. The higher your borrowing costs, though, the less benefit you get from waiting.

If you use [RetirementWorks® II](#) to help you plan your retirement, these factors are already taken into account in the recommendation that is being made. If not, you will find it difficult to estimate what age is best. There are many articles available in financial magazines, both popular and technical, that give general advice on this subject. The advice is usually bad, though, because not all of the factors are taken into account. There is no general answer that is good for everyone, and you really need an individual calculation that considers all of these elements.

If you have already started receiving Social Security early and then realize that this was a mistake, it is permissible to pay back the benefits you have received and then refile for higher benefits at your normal retirement age. This unusual step can have unexpected effects on your benefits and your income taxes, though, so it is better to make the right decision in the first place.

Note that certain loopholes have been discovered in the Social Security rules that appear to enable some married couples to get extra benefits. For example, it appears that a higher earning member of a couple could delay taking his or her own benefit until, say, age 70 to get the maximum amount, but could start collecting a spousal benefit earlier than that. Or an older, high-earning spouse could apply for benefits, then *suspend* those benefits, but enabling a younger, lower-earning spouse to collect a spousal benefit in the meantime. We do not generally recommend use of these strategies, because they do not appear to be part of the real intent of the framers of the program, and therefore the loopholes could be plugged as part of the effort to improve Social Security's solvency. In that case, people who had adopted these strategies could be left high and dry.

When you do expect to start taking benefits, you should contact your Social Security office well ahead of time. They recommend no later than January of the year you plan to start.

**For More Information:**

For references to other sources of information and help with Social Security, see the 3<sup>rd</sup> bulleted section in "The Risk of Living Too Long" portion of the RetirementWorks, Inc. Retirement Readiness page on "Managing Risk," at:

[http://www.retirementworks2.com/RetireReady/RW\\_RetireReady\\_Security\\_Risk.htm#Living](http://www.retirementworks2.com/RetireReady/RW_RetireReady_Security_Risk.htm#Living) .