# How to Answer “When Should I File for Social Security?”

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Chances are you have been presented with this question by a client on more than one occasion. The answer is not as easy as you might think. Given the fact that roughly 50% of married couples and 70% of singles, age 65 or older, rely on Social Security for more than half of their retirement income, encourage your clients to carefully consider their needs and goals before taking the plunge by asking these 5 important questions.[1] Subscribing to one belief system, such as “everyone should file at age 62” or “everyone should file at age 70,” is a dangerous proposition. Here is why: no two situations are alike. Therefore, adopting a methodology as a baseline in your conversations with clients is never a good idea. At the end of the day, your clients must make the decisions that are right for them, but asking these questions may help them make a more informed choice.

**Question #1: Are you healthy?**

At the most basic level, most of us know that the choice of when to file for a retirement benefit (or spousal, for that matter) falls somewhere in between age 62 and age 70. Claiming at the earliest possible age results in monthly benefits over a longer period but at a reduced rate, assuming average life expectancy. Waiting to full retirement age (FRA), which ranges from age 66-67, depending upon year of birth, produces a promise to pay 100% of the claimant’s Primary Insurance Amount (PIA), while waiting to as late as age 70 provides monthly delayed retirement credits beginning at FRA up to age 70. The underlying design of the increase for the longer you wait is based upon the Social Security Administration’s (SSA) theory that, given average life expectancy, currently 83 for a 65-year old male and 87 for a 65-year old female, the cumulative benefits will be close to the same, regardless of when someone files.[1]

But even by SSA’s own estimates, one in three 65-year-olds can expect to live to at least age 90 and about one in seven to age 95. So, relying too heavily on the “average” could be problematic, particularly for a longer than anticipated lifetime. Further, most people underestimate their own life expectancy. So, while beginning with “Are you healthy?” is a great place to start, helping your client thoughtfully consider alternatives in case he doesn’t fall neatly into the “average” category is important, too.

Using perceived life expectancy as the primary claiming age determinant is less of a gamble when your client is single. Why? Because the monthly benefit only affects the lifetime income of one person, not two.

Here is a hypothetical example:

*Jacob is a single 61-year-old contemplating when to file. He has health concerns and both his father and grandfather died before reaching 75, due to a genetic predisposition to heart disease. Jacob would likely be better off filing as soon as he could, because he would receive more years of monthly benefits if he only lives to age 75.*

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But the lines get a bit blurred when you work with married couples, particularly when the two have a wide disparity in monthly benefits. We will talk more about that in the “Are you married?” section. Also, the collective life expectancy of two lives is always higher than the two independently. Using a hypothetical calculator, such as the one found through www.longevityillustrator.org/, can help in having a broader conversation about planning for the possibility that one of the two may live longer than expected.

Using the actual ages of your clients and health and lifestyle questions, the analysis will provide feedback on how likely each of them is to live to certain ages, up to age 100.

**Question #2: When would you like to file?**

This question should not be overlooked, even though the answer is more about a want than a need. In fact, it gives you a great place to start, particularly if you are providing a Social Security analysis. Chances are that when your client wants to file and when they should, after exploring their situation, may be two different things. Using their desired claim age as a basis for comparison with another option provides a perfect opportunity for you to demonstrate your value in holistic planning, and providing insight on how other sources of income can complement or cause potential issues with the desired plan will aid your client in making a more informed decision.

My advice is to put the two scenarios side-by-side and put your client in the driver’s seat by a thoughtful discussion of factors that they may not have considered. At the end of the day, the choice is theirs. By exploring their desired plan before pivoting to another option that may compliment their retirement income plan better, you are validating the fact that the decision is based on more than an economic need. Sometimes, suggesting that the lower wage earner file first, so that at least one of them collects that coveted check while the other spouse waits a bit longer, can provide a good balance.

**Question #3: Are you still working?**

Any time you encounter a client or prospect who intends to file for benefits prior to their FRA, your first question should be whether they are still working. Why? Because, unbeknownst to many early retirees, there is an earnings limitation for filers who claim prior to FRA and continue to work. Additionally, the earnings limit applies across the board to retirement, spousal, ex-spousal, and even survivor benefits.

Here is how it works: For an individual who files for benefits up to the year before she reaches her FRA, her earned income is limited to less than $18,240 (2020).[1] To the extent that her earnings exceed this threshold, earnings over this amount will cause $1 for every $2 of the excess to be withheld from her benefit.

Let us look at a hypothetical example:

*Susan plans to file for benefits at age 62. Her benefit at age 62 is $1,500 per month. However, Susan also earns $28,500 as a paralegal. Susan’s excess earnings are $10,260, causing 50% of that amount, or $5,130, to be withheld from her benefit. At $1,500 per month, that means that four months of benefits will be withheld prior to paying Susan her monthly benefit beginning in month five. SSA calculates the number of months by dividing the excess by the monthly benefit and rounding up to*

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*the next whole number. In this case, $5,130/$1,500 = 3.42 or four months.*

**Do not miss these important considerations:**

1. The earnings threshold increases to $48,600 (2020) for the calendar year in which an individual reaches full retirement age and any excess income only reduces benefits by one-third of that excess.
2. Once the month of FRA is reached, the earnings limitation no longer applies.
3. Earned income is truly that. IRA distributions, pensions, dividends, rental property, or any other form of passive income is not considered "earned income," and, therefore, will not cause benefits to be withheld based upon the rules outlined above.
4. Only the earnings of the claimant are considered, not that of the spouse.
5. Someone who files mid-year and has already exceeded the earning limitation may apply the special earnings limit for the remainder of the year. For more information, visit www.ssa.gov/planners/retire/rule.html.
6. If benefits have been withheld due to excess income, those benefits are not lost. At the filer's FRA, the Social Security Administration will re-calculate the monthly benefit to account for the months that were previously withheld.[1]

Hypothetical example:

*Susan elected to go ahead and file for benefits, despite knowing that some of her benefits would be withheld. By the time she reached her FRA, she had 16 months of benefits withheld over the prior four years. SSA will re-calculate her benefit as if she had filed at 63 and two months (62 + 14 months) and pay her the higher monthly benefits once she reaches FRA.*

Claiming benefits early to supplement earnings may not be the best option, given the fact that the monthly benefit may be permanently reduced by as much as 30% for the rest of the filer's life. Adding the complication of excess income and a potential pullback of a month's worth of benefits, likely will not adequately solve the need for predictable cash flow either. So, a careful consideration of alternatives should be part of the conversation.

**Question #4: Are you married?**

As previously mentioned, when you are working with a couple, the claiming age decision becomes a bit more involved. Now, instead of making a claim decision that will affect only one person's lifetime income, you are dealing with two lives and planning for the survivor. The "break-even" question, which seems to be a common question among near retirees deciding when to file, also must be looked at from the collective lifetime of the couple. We discussed the reasons why earlier.

Equally as important to broadening the life expectancy focus to consider the collective potential longevity of both, is helping your married clients understand how the monthly income will decline when one of them passes. I find that few consumers fully understand that, when the first spouse passes, the surviving spouse steps up to (or continues to collect) the higher benefit, but the smaller monthly benefit goes away. Planning for this within the scope of the survivor's overall income is essential to building a retirement income plan that does not require a drastic reduction in spending for the survivor.

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When there is a wide disparity in income benefits, the claiming age of the higher wage-earning spouse becomes even more important. Why? Because when the higher wage earner chooses to file will have a direct impact on how much the survivor will receive at the death of the first spouse.

Here is a hypothetical example:

*Kyle and Margie, both 61, are married. Kyle's projected benefit at his FRA of 66 and 10 months is $2,950. Margie's is an estimated $900 at FRA. Both have recently retired and plan to file for benefits at age 62. Assuming average life expectancy for both and a 1% COLA, the cumulative benefits during their lifetimes would be $1,019,144. But, if Kyle instead filed at age 70 and Margie claimed at age 62, the cumulative benefits increase by $173,493 more for a total of $1,192,637. In Scenario 1, where Kyle files at 62, Margie's survivor benefit would be $3,029 per month. In Scenario 2, waiting until his age 70 to file would produce a survivor benefit of $4,602, a 52% higher survivor benefit!*

While this example highlights the significance the higher wage earner's decision may have on the overall lifetime income of the couple, some married couples have similar work histories and, therefore, the conversation may look different. A strategy to consider is for the lower earning spouse to file first and the higher earned to wait to at least FRA or later, if possible.

**Question #5: Do you have other sources of retirement income?**

If the answer to this question is "not much," then there may not be a meaningful conversation to have in terms of leveraging other assets in the most tax-efficient manner, if necessity requires a certain filing strategy. Delaying retirement by a few years is an option to consider, and not just for those with limited assets.

The coronavirus pandemic has created market fluctuations that may require exit strategies to be re-evaluated for those planning to retire in the not-so-distant future. Working longer may help offset some of the financial strain experienced by some as a result of the pandemic and reduce the need to tap into retirement savings during a down market, and less time in retirement also allows the monthly Social Security income benefit to increase.

In addition to Social Security and continued work, retirement income is often supplemented with monies saved in employer-sponsored retirement plans and IRAs. Most retirees understand that pre-tax retirement accounts will be taxed when withdrawn but, unfortunately, the same level of understanding on the potential taxation of Social Security benefits does not always exist. Helping your clients understand the unique interplay between other sources of retirement income and Social Security benefits is important in helping them navigate their choice of when to file.

## Income Taxes and Social Security

If you are working with someone who expects to receive most of their retirement income from Social Security benefits, the chances are low that a portion of their benefit will be subject to ordinary income tax. However, those who expect to collect pensions, dividends, IRA and 401(k) distributions, earnings, and other sources of taxable income and even tax-free municipal bond interest should be prepared to potentially pay taxes on a portion of their benefits.

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| Provisional Income Amounts For: | | Then: [1] |
|---|---|---|
| Married, Filing Jointly** | Other Taxpayers | |
| $32,000 or less | $25,000 | Social Security income is tax free |
| $32,001 to $44,000 | $25,001 to $34,000 | Up to 50% of Social Security income is taxable |
| More than $44,000 | More than $34,000 | Up to 85% of Social Security income is taxable |

**If you are married, filing separately and do not live apart from your spouse at all times during the taxable year, up to 85% of your Social Security income is taxable.

Here is how it works. Step 1 is to determine the individual's combined income, sometimes referred to as provisional income, which is the sum of the following:

**MAGI* + nontaxable interest + 50% of the annual Social Security benefits**

Once the provisional income is determined (note that this is based upon the household's income, not just the benefit recipient's), then it is compared to the income thresholds based on tax filing status.

Notice that it does not take a significant amount of provisional income to push someone into the taxable category, particularly since part of the calculation includes half of the Social Security benefits received. If your client has a large part of their savings in their employer-sponsored retirement plan or IRA, or may have retired and wants to begin collecting their Social Security benefit while their spouse is still working, do you see the potential problem?

Here is another hypothetical example:

*Jack is 65 and earns $80,000 per year and his wife, Sarah, has recently retired at 62 and is eager to file for her benefit. Suppose her estimated benefit is $1,950 at her FRA of 66 and eight months. For starters, her benefit at 62 will be 28.33% less, or $1,398, since she plans to file four years and eight months prior to her FRA. Consider the impact of taxes on her benefit. The couple's combined income is:*

*$80,000+ His earnings*
*$0+ Nontaxable interest*
*$8,388 50% of her Social Security benefits*
*$88,388*

Their combined income exceeds the highest threshold of $44,000, causing as much as 85% of her benefit, or $14,250, to be taxable. Is this the best solution? Maybe not. Opening the dialogue and informing the client on the very real impact of taxes on an already reduced benefit, since she plans to collect it early, might lend itself to a better solution.

Incidentally, what if we replaced Jack's earnings with $80,000 in IRA distributions? Would we encounter the same result? YES! Because the IRA

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is taxable income, it simply replaces the earnings and 85% of Sarah's benefit is still taxable. Having a discussion about the interplay between Social Security benefits and other sources of retirement savings is where your real opportunity exists, because you can weave the claiming age decision into a broader conversation about the overall tax-efficiency of the retirement drawdown strategy.

Roth conversions are one of the best ways to tax-diversify qualified plans and IRAs. Serial conversions (smaller conversions over several years) may help mitigate the tax risk in retirement, and create less of a tax burden in one single year than converting all at once, and the fact that Roth IRAs are not subject to lifetime RMDs, like their Traditional IRA counterparts, is a bonus! Having a conversation as a precursor to the Social Security discussion that highlights the benefits of Roth IRAs as well as life insurance as sources of tax-free income during retirement can be a game changer on how the Social Security benefit itself is impacted by taxes down the road. Keep in mind that Roth conversions are taxable, so your client should always seek guidance from his/her tax professional before taking a course of action.

## Conclusion

You can never ask too many questions. Using these five questions as your guide may help uncover misconceptions and opportunities to improve upon a well-intentioned plan. Navigating the Social Security decision is one that most retirees will make and one of the most important, given that it is an income source that will last as long as they do. If you have additional questions or need assistance with a case or any of the material covered here, please contact your marketer.

## Source

[1]www.ssa.gov Benefit Planner: Income Taxes and Your Benefit, 2020

*Modified Adjusted Gross Income is Adjusted Gross Income, less the taxable portion of Social Security Benefits, if any.

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