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When Should I File for Social Security? Answer This Client Question with A Handful of Your Own

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Chances are that you have been presented with the when-should-I-start question by a client or prospect on more than one occasion. If you are subscribing to the "run and hide under your desk" or "go ask your CPA, attorney, clergy…" approach, you're missing a prime opportunity.

The fact that roughly 37% of men and 42% of women, age 65 or older, rely on Social Security for more than half of their retirement income is sobering enough.[1] Social Security was never intended to replace more than 40% of the average retiree's pre-retirement income.

Given the importance of Social Security for countless retirees, you've got your work cut out for you in many ways. You're called upon to help your clients navigate a major life transition, often with scant assets—assets that might have to stretch over a time horizon longer than anticipated, possibly with unexpected risks emerging. You may have uncomfortable conversations about whether retiring now is possible or should be delayed to avoid near disaster in the years ahead.

Such conversations can be tricky. Nevertheless, as a financial professional, you are in an appealing position. Helping guide pre-retirees in a thoughtful and meaningful way carries its weight in gold. Urging difficult conversations to occur sooner rather than later can produce a retirement that can better hurdle the potential roadblocks along the way.

As the title of this article indicates, individuals and couples navigating the transition from working to retirement frequently pose the "when should I file for Social Security?" question. Don't run from it! And don't adopt rules of thumb, either. That's where you lose credibility and forfeit opportunities.

Instead, respond by asking the five pivotal questions revealed below. Then thoughtfully listen to your clients' answers, allowing them to become part of their own strategic solution. Educate them about their options rather than allowing them to rely upon misinformation, fear of Social Security's potential insolvency, or what their neighbor said they should do. My mantra has always remained the same—empowered clients make happy clients.

Introduce Accurate Information About Insolvency

Before getting into the five conversation-starting questions, it's important to touch on Social Security's financial status. Will retirement benefits run dry? No, that won't happen, just as it hasn't happened in years past when the trust funds were on the brink of depletion.[2]

In fact, the 2022 report from Social Security's OASDI Board of Trustees, released June 2, 2022, is the same old story, even with the pandemic factored in. Short-term, there has been a slight improvement over last year's version given the effects of COVID-19, with OASDI (Old-Age, Survivor, Disability Income) reserves expected to cover full benefits through 2035 rather than 2034.[3]

Long-term, Washington must act if full benefits are to be maintained beyond the mid-2030s. Even without such help, though, ongoing payroll taxes can support 80% of promised benefits, which is much better than the 0% some people fear.

Bottom line: Acknowledge client concerns about Social Security but navigate the conversation with what-if planning scenarios. Don't let scare headlines be the sole reason your clients file early

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for Social Security, sacrificing the increased cash flow that comes from waiting. Instead, use the following five questions as the backbone of a claim-timing decision.

Question #1: Are you healthy?

Many pre-retirees know that the choice to file for retirement benefits (or a spousal benefit, for that matter) ranges from age 62 to age 70. Claiming at the earliest possible age results in monthly benefits for a longer period of time but at a reduced amount.

Waiting to full retirement age (FRA), which ranges from age 66-67, depending upon the year of birth, produces a promise to pay 100% of the claimant's Primary Insurance Amount (PIA) while waiting until as late as age 70 provides monthly delayed retirement credits after FRA.

The underlying design of this age-based benefit increase is the expectation that, given average life expectancy, cumulative benefits will be about the same, regardless of when someone files. However, the Social Security Administration (SSA) bases its calculations upon life expectancy tables that haven't been revised since the 1980s, making this assumption actuarially false, given today's longer life expectancies (currently 84 for a 65-year-old male and 87 for a 65-year-old female).

For example, suppose 60-year-old Edward is healthy, with a monthly Social Security benefit of $2,000 at his FRA (age 67). Assuming a 0% cost-of-living adjustment, he would need to live just beyond age 78 to have received more in cumulative Social Security benefits by forgoing income for 5 years by filing at age 67 rather than 62. If Edward waits until age 70, he'll be ahead in total benefits once he reaches 82. In both scenarios (living until 78 or 82), Edward likely would be ahead by waiting because the break-even occurs before he reaches the average life expectancy of a 65-year-old man.

Using anticipated life expectancy as the primary claiming age determinant could potentially be perceived as less of a gamble when a client is single. Why? Because the monthly benefit only affects the lifetime income of one person. On the flip side, having the retirement savings of only one individual to supplement Social Security over what could be a lengthy retirement period also raises questions about long-term income sustainability. Here is a hypothetical example:

Jacob is a single 61-year-old with health concerns. Both his father and grandfather died before reaching age 75 due to a genetic predisposition to heart disease. Jacob likely would be better off filing as soon as practical because he would receive more years of monthly benefits if he only lives until age 75. However, it pays to stress-test other scenarios, such as living to age 80 or longer, using other retirement savings to bridge income until a later claiming date in case he doesn't follow the same path as his father and grandfather.

When you work with married couples, the lines get a bit blurred, particularly if the two spouses have a wide disparity in monthly benefits. (More about that in the "Are you married?" section below).

Also, the joint life expectancy of two lives is always higher than the two individual life expectancies. Using a hypothetical calculator, such as the one found through www.longevityillustrator.org, can help to generate a broader conversation about planning for the possibility that one of the spouses may live longer than expected.

Use the actual ages of your clients as well as health and lifestyle questions to analyze and provide feedback on how likely each of them is to live to specific ages. The longer the life expectancy, the more delaying retirement benefits by one or both might make sense.

Question #2: When would you like to file?

This question should not be omitted, even though the answer may be more about a want than a need. In fact, the answer gives you a great place

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to start, particularly if you provide a Social Security analysis. Chances are that when your client wants to file may differ from when they should file.

Using the desired claim age as a basis for comparison with another option provides a perfect opportunity for you to demonstrate your value in holistic planning. You can provide insights on how other sources of income can complement or cause potential issues with the desired plan, helping your client make a more informed decision.

Remember that most near-retirees assume that their retirement date and claim date should be identical. Your valuable contributions on timing can help them separate the two, if advisable. For example, would it make sense to bridge income from another source, allowing Social Security benefits to increase by deferring?

My advice is to place the two scenarios side-by-side, then put your client in the driver's seat after a thoughtful discussion of tactics that might not have been considered. Ultimately, each individual client or couple can make an informed choice. By exploring the desired plan before pivoting to another option that may better suit the overall retirement income plan, you are increasing the likelihood that the decision is designed to meet needs as well as wants.

Sometimes, suggesting that the lower wage earner file first will be acceptable to a married couple. In this approach, one spouse will collect that coveted Social Security check while the other spouse waits longer, thus providing a good balance between immediate gratification and long-term income viability.

Question #3: Are you still working?

When you encounter someone who intends to file for benefits before their FRA, always ask this question. That's because, unbeknownst to many early retirees, an annual earnings test (AET) limits benefits for certain filers who claim before FRA while continuing to work. The AET 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 before the year the worker reaches FRA, earned income is limited to $19,560 (in 2022). Any excess earnings will cause $1 for every $2 of that excess to be withheld from Social Security benefits before the first dollar is paid![4] That's the rub that catches many unsuspecting workers off guard. Here's a hypothetical example:

Susan plans to file for benefits at age 62 when Social Security would pay her $1,500 per month. However, Susan also earns $28,500 per year as a paralegal. Here, the excess earnings are $8,940, causing 50% of that amount--$4,470--to be withheld from her benefit. With a monthly benefit of $1,500 per month, three months of benefits will be withheld before paying Susan her benefit in month four.

The SSA calculates the number of months of withholding by dividing 50% of the excess by the monthly benefit and rounding up to the next whole number. Here, $4,470/$1,500 = 2.98 rounded up to 3 months of withholding before Susan's benefits begin.

When discussing the AET, emphasize these critical considerations:

1. The AET threshold increases (to $51,960 in 2022) during the calendar year in which an individual reaches FRA. Then, 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 strictly defined. IRA distributions, pensions, dividends, rental property payments, or any other form of passive income is not considered "earned income." Such cash flows will not cause benefits to be withheld, based upon the rules outlined above.
4. Only the claimant's earnings are considered, not that of a spouse.

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5. Someone who retires and files for Social Security mid-year and has already exceeded the annual earnings limitation may apply the monthly special earnings limit for the remainder of that year. For more information, visit [ssa.gov/planners/retire/rule.html.](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 SSA will recalculate the monthly benefit to account for previously withheld amounts.

Suppose, in our Susan example; she elects to file for benefits at age 62, despite knowing that some of her benefits would be withheld. By the time she reaches her FRA, suppose she has had a total of 16 months of benefits withheld over the prior five years. The SSA will recalculate her benefit as if she had filed at 63 + four months (16 months after her actual filing date), then pay her the higher monthly benefit amount once she reaches FRA.

Claiming Social Security early to supplement earnings may not be the best option, as the claimant's monthly benefit will 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 delay of benefits means that the early start probably won't adequately meet the need for predictable cash flow. Therefore, carefully considering alternatives should be part of the conversation with pre-FRA seniors who continue to work.

Question #4: Are you married?

As previously mentioned, the claiming age decision becomes more involved when working with a couple. Instead of making a 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 concern among near-retirees deciding when to file, should be explored while considering the couple's joint life expectancy, as explained.

Just as important as broadening the life expectancy focus to both lives is helping 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 Social Security benefit, but the smaller monthly benefit goes away. Planning for this decline in the survivor's overall income is essential to building a retirement income plan that does not require a drastic spending reduction for the survivor.

When there is a wide disparity in income benefits, the claiming age of the higher wage-earning spouse becomes even more important. Why? Because the age at which the higher wage earner chooses to file will directly impact 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 67 is $2,950 a month, and Margie's is an estimated $900 a month at her FRA. Both have recently retired and plan to file for benefits at age 62. Assuming average life expectancy for both and a 1.0% annual COLA, the cumulative benefits during their lifetimes would be $1,018,353. But, if Kyle instead filed at age 70 and Margie claimed at age 62, the cumulative benefits would increase by $160,841, to a total of $1,179,194. In Scenario 1, where Kyle files at 62, Margie's survivor benefit would be $3,060 per month. In Scenario 2, waiting until his age 70 to file would produce a survivor benefit of $4,599 a month, a 50% increase!

This example highlights the significance of the higher wage earner's decision on the couple's overall lifetime income. Some married couples have similar work histories so the comparison may look different. A strategy for a similar-income couple to consider is for one spouse to file first if both are opposed to delaying, perhaps at FRA, and the higher earned to wait beyond FRA, if possible.

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

If the answer to this question is "not much," there may not be an opportunity to leverage other assets in the most tax-efficient manner if necessity requires a specific filing strategy. Delaying retirement by a few years is an option to consider, and not just for those with limited assets.

In addition to Social Security benefits and continued earnings from work, retirement income is often supplemented with savings in employer-sponsored retirement plans and IRAs. Most retirees understand that withdrawals from pre-tax retirement accounts will be immediately taxed, but 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 essential in helping them navigate their choice of when to file.[5]

Income Taxes and Social Security

When working with people who expect to receive most of their retirement income from Social Security benefits, chances are low that any of those benefits will be subject to federal income tax. State taxation of Social Security benefits varies, with many states offering exemptions.

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 Social Security benefits. 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: adjusted gross income + nontaxable interest + 50% of annual Social Security benefits.[5]

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

Provisional Income Amounts For:		Then:
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.

Note that it does not take a significant amount of provisional income to push someone into the taxable category because part of the calculation includes half of the Social Security benefits received. Suppose your clients have a large part of their savings in their employer-sponsored retirement plans, IRAs, or may have retired and want to begin collecting their Social Security benefits while their spouse is still working. Do you see the potential problem?

Let's use another hypothetical example to illustrate:

Suppose Jack is 65 and earns $80,000 per year; his wife Margaret has recently retired at 62 and is eager to file for Social Security. Suppose her estimated monthly benefit is $1,950 at her FRA of 67. For starters, her benefit at 62 will be 30% less, or $1,365, because she plans to file five years before her FRA. Consider the impact of taxes on her reduced benefit. The couple's combined income is:

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$80,000+	His earnings
$0+	Nontaxable interest
$8,190	50% of her annual Social Security benefits
= $88,190	Combined Income

Their combined income exceeds the highest threshold of $44,000, exposing as much as 85% of her annual benefit, or $13,923, to income taxes. The calculation is a bit more complex than this, but you get the point.

Is this the best solution? Maybe not. Opening the dialogue and informing clients on the impact of taxes on an already reduced benefit might lead to a better solution.

What if we replaced Jack's earnings with $80,000 in IRA distributions? Would we encounter the same result? YES! Because IRA withdrawals are taxable income, they replace the earnings in this calculation, again causing as much as 85% of Margaret's benefits to be taxable. Discussing the relationship between Social Security benefits and other sources of retirement savings is where your real opportunity exists because you can weave the claiming 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 the holdings of retirees with qualified plans and IRAs. Serial conversions (smaller amounts over several years) may help mitigate the tax risk in retirement and create less of an overall tax burden than converting a lump sum. As a bonus, Roth IRAs are not subject to lifetime RMDs, unlike their Traditional IRA counterparts!

As a precursor to the Social Security claiming discussion, a conversation highlighting the benefits of Roth IRAs and life insurance as sources of tax-free retirement income can be a game changer, reducing how taxes impact Social Security benefits down the road. Remember that Roth conversions are taxable, so clients should always seek guidance from their tax professional before acting.

Conclusion

You can never ask too many questions when it comes to helping your clients plan for their retirement and about Social Security claiming in particular. Using these five questions as your guide may help uncover misconceptions and opportunities to improve a well-intentioned plan. Navigating the Social Security claiming 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.

Sources:

[1]https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf

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[3]https://www.ssa.gov/oact/TRSUM/

[4]https://www.ssa.gov/benefits/retirement/planner/whileworking.html

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