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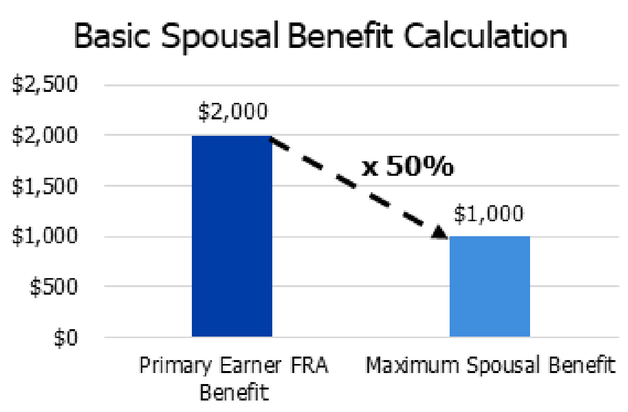
WHEN TO CLAIM SOCIAL SECURITY - PART THREE

The following is the third article in a four-part series on Social Security. In the previous post we discussed how delaying benefits allows your retirement benefits to grow, which in turn creates a breakeven age at which the reward for delaying benefits catches up to the cost of missing out on benefits in the early years of retirement. In this post, we'll take a deeper dive into spousal benefits to understand how married retirees can get the most out of their Social Security benefits. Our final post will discuss putting it all together to make a decision on when to claim Social Security benefits.

SOCIAL SECURITY AND SPOUSAL BENEFITS

The basic formula to calculate spousal benefits is simple. An individual can claim 50% of their spouse's Social Security retirement benefit once they've reached full retirement age (FRA). For example, if you have a FRA monthly benefit of $2,000, your spouse would be able to claim a benefit of $1,000 based on your work record. Although this formula may seem basic, there are a number of additional rules and requirements that create complications.



It should be noted that spousal benefits are available even if each spouse is eligible for benefits based on their own work record. In fact, when you file for benefits, the Social Security Administration (SSA) will automatically choose the highest eligible benefit amount available to you, whether based on your record or that of your spouse's. If you are eligible for a monthly benefit of $1,250 based on your work record and a spousal benefit of $1,000 from your spouse's benefit, you will automatically receive the higher $1,250 benefit. Likewise, if the benefit on your own record was $750, you would receive the higher spousal benefit of $1,000 [1].

For couples with approximately equal Social Security retirement benefits, there might not be an option to collect spousal benefits. The SSA does not allow you to collect spousal benefits while delaying your own benefit – you must take the highest benefit amount available to you at the time of claiming whether it's a spousal benefit or your retirement benefit. Despite this limitation, there are still opportunities for planning as it relates to timing of Social Security and survivor benefits, which will be discussed later on in this article. Ultimately, spousal Social Security benefits add a significant amount of complexity while also providing a number of planning opportunities for married couples as it relates to the decision of when to claim benefits.

Spousal Social Security benefits add a SIGNIFICANT AMOUNT OF COMPLEXITY while also providing a NUMBER OF PLANNING OPPORTUNITIES for married couples

SPOUSAL BENEFITS – COMPLICATING FACTORS

Although it may seem simple, there are a number of rules that make spousal benefits much more complicated. Below are 4 key considerations to keep in mind when evaluating Social Security benefits [2].

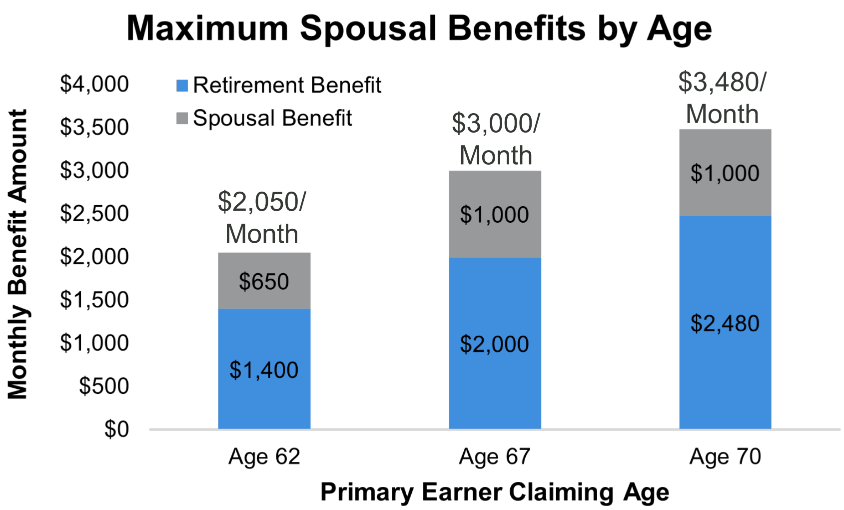
1. Early spousal benefits are reduced more than early retirement benefits

As mentioned in our previous article, retirees can begin claiming Social Security benefits as early as age 62 at a reduced benefit amount. For individuals with an FRA of 67, drawing their own benefits at age 62 results in a 30% reduction in benefits. What's less commonly known is that if your spouse chooses to claim spousal benefits early, the eligible spousal benefit is reduced by 35%, rather than 30%. It should be noted that an individual's decision to claim a reduced benefit early on their own record does not reduce the spousal benefit amount - spousal benefits are only reduced if the spouse chooses to claim benefits before their own FRA.

As an example, if your monthly benefit at full retirement age (also known as your Primary Insurance Amount, or PIA) is $2,000 and you both choose to file for Social Security at age 62 rather than FRA, you and your spouse would see a reduction in total benefits from $3,000 per month ($2,000 retirement benefit + $1,000 spousal benefit) to $2,050 per month ($1,400 retirement benefit + $650 spousal benefit). This effectively "locks in" a $950/month lower benefit amount for the rest of your life!

2. Delaying your own benefit past FRA doesn't increase your spouse's benefit

Although the spousal benefit is reduced if you draw before FRA, your spouse's benefit does not increase if you delay past FRA. If you choose to delay your retirement benefits until age 70, your $2,000 monthly benefit would increase to $2,480 (24% increase) but your spouse's maximum spousal benefit is fixed at $1,000 (50% of your $2,000 FRA benefit). Your resulting total combined family benefits would be $3,480 ($2,480 retirement benefit + $1,000 spousal benefit).



3. You must be collecting your own benefits for your spouse to collect

You must be drawing your own retirement benefits in order for your spouse to be eligible for spousal benefits. If you decide to wait until age 70 to claim your benefit, your spouse cannot begin taking spousal benefits until you begin collecting at age 70. This can become especially important if there is an age difference between you and your spouse.

4. Your spouse's age in retirement also matters

Finally, the spousal benefit calculation is also affected by the eligible spouse's age. Let's say that you have reached full retirement age and are drawing Social Security benefits but your spouse is only 62. Even though you 1) have reached FRA, and 2) have started drawing benefits, your spouse's benefit amount will still be reduced by 35% if they claim spousal benefits at age 62. In order to receive the maximum spousal benefit, the younger spouse also must wait until they reach their respective FRA to earn the maximum spousal benefit.

A NOTE FOR THOSE WITH SPECIAL CIRCUMSTANCES

For divorced spouses, widows, and spouses caring for minor children, **benefit calculations are complicated and don't follow all the rules outlined in this article.** Careful consideration should be made when applying for Social Security benefits that may require meeting with the SSA to ensure benefits are drawn appropriately.

SURVIVOR BENEFITS

Survivor benefits are another important feature of Social Security for married couples to consider. When one spouse dies, the surviving spouse has the option to "step up" into the higher of their benefit or their deceased spouse's benefit. In most cases, when the higher-earning individual dies, the surviving spouse will stop receiving benefits on their own record and instead earn the higher amount as a survivor benefit. As such, the spouse with the higher primary insurance amount can lock in a higher survivor benefit for their spouse by delaying benefits until age 70 [3].

The spouse with the higher primary insurance amount can LOCK IN A HIGHER SURVIVOR BENEFIT for their spouse by delaying benefits until age 70

SPOUSAL BENEFITS - TWO SIMPLE EXAMPLES

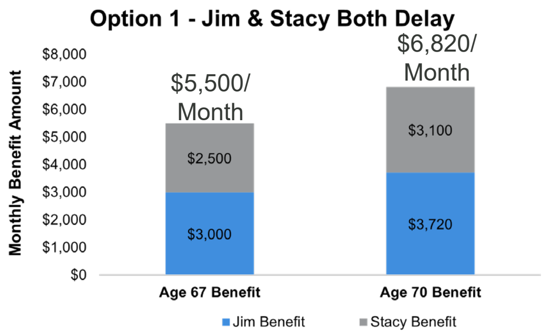
The best way to see how spousal benefits works is often through examples. Using the two simple case studies below, we'll explore a few of the potential Social Security strategies available to couples in more detail [4].

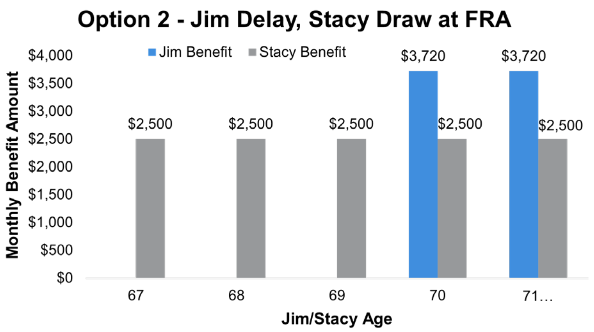
CASE STUDY EXAMPLE #1 – JIM AND STACY

Jim and Stacy are currently age 60 and have a full retirement age of 67. Jim has a monthly benefit (PIA) of $3,000/month based on his earnings record while Stacy has a benefit of $2,500/month based on her work record.

At first glance, it looks like there would be no advantage for Jim and Stacy to take spousal benefits. Although Jim's benefit is higher than Stacy's, she is only eligible to collect 50% of his PIA amount as a spousal benefit which means that her eligible spousal benefit amount ($1,500/month) is lower than the retirement benefit she would receive based on her own work history ($2,000/month).

However, there are still planning opportunities for Jim and Stacy. One strategy for Jim and Stacy is to both delay benefits until age 70. By doing so, they will each receive a 24% increase in their benefit amount and ensure they receive the maximum retirement benefits available to them on a monthly basis. As seen in the chart to the right, this increases their monthly Social Security benefit by $1,320/month for the rest of their lives.





Another strategy might be for Stacy to collect on her benefits at age 67 while Jim delays until age 70. As shown in the chart the left, this will result in a smaller combined monthly benefit at age 70, but allows the couple to begin drawing a portion of their benefits sooner. Also, by having Jim delay to age 70 this strategy preserves the maximum potential survivor benefit as Stacy would receive Jim's full delayed benefit of $3,720/month should Jim pre-decease her.

CASE STUDY EXAMPLE #2 – MIKE & SUE

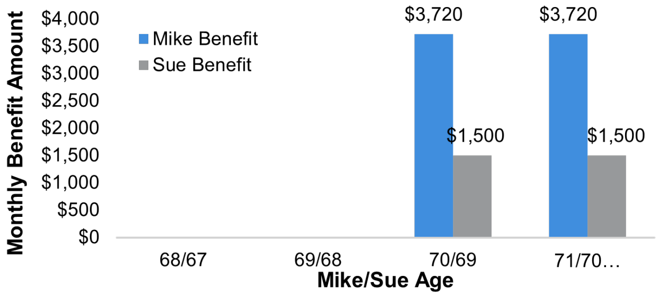
Mike is 60 and Sue is 59 and they both have a full retirement age of 67. Mike has a PIA of $3,000/month based on his earnings history on his record and Sue has a monthly benefit of $500 on her own record.

For Mike and Sue, the advantage of a spousal benefit can be seen right away. Sue's benefit on her own work record ($500/month) is significantly less than the spousal benefit she is eligible to receive based on Mike's work history ($1,500/month). Even after seeing the obvious benefits of taking a spousal benefit, there are still even more planning opportunities for Mike and Sue given their unique circumstances.

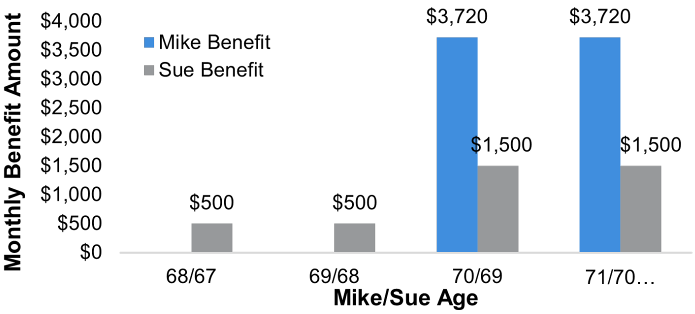
One strategy might be for Mike and Sue to take their respective benefits at their respective full retirement ages of 67. In this case, Mike receives $3,000/month when he turns 67 and Sue draws spousal benefits of $1,500/month when she reaches age 67. Another strategy, as seen in the chart to the right would be for Mike to delay benefits until age 70. This maximizes his possible retirement benefit and locks in the highest survivor benefit for Sue.

One downside to this strategy is that Sue must wait until Mike claims benefits before she can claim spousal benefits. Sue is forced to wait until age 69 to collect the maximum spousal benefits, despite the spousal benefit being capped at $1,500/month.

Option 1 - Mike Delays, Sue Takes Spousal



Option 2 - Mike Delays, Sue Draws at FRA



Mike and Sue do have another option, however. Because Sue is eligible for benefits based on her own work record, she can begin taking her monthly benefit of $500 when she reaches age 67. Although smaller than the maximum spousal benefit, this allows Sue to collect a partial benefit from ages 67-69 while Mike is delaying his benefit. Once Mike claims his benefit at age 70 Sue then steps up into the maximum spousal benefit of $1,500/month. By combining strategies in this way, Mike and Sue get a more immediate benefit from Social Security, while also preserving the highest possible retirement and survivor benefits.

SUMMARY

Due to the complicating factors involved with spousal benefits and Social Security, there is no one-size-fits-all strategy for Social Security. Differences in age, primary benefit amount, and life expectancy between spouses can create large differences in benefits among different individuals and couples. However, these same complications also lead to a number of planning opportunities.

As stated previously, we at JVL Wealth Strategies believe that each situation is unique and the decision on when to claim Social Security should be viewed in context of a holistic financial plan – not as a one-off decision. As always, don't hesitate to contact us if you have any questions about Social Security spousal benefits.

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REFERENCES

[1] https://www.ssa.gov/benefits/retirement/planner/applying7.html#h2
[2] https://blog.ssa.gov/do-you-qualify-for-social-security-spouses-benefits/
[3] https://www.ssa.gov/benefits/survivors/
[4] Information gathered from SS Analyzer powered by Social Security Solutions