Planning for Retirement: Understanding Social Security Claiming Options

Introduction

Social Security is the main source of income for the majority of retired households (AARP, 2011). Deciding when to claim Social Security benefits is a challenging financial decision that requires an assessment of your life expectancy, ability to work, health care needs, spousal situation and financial solvency. Despite this complexity, many Americans seem to follow a simple rule: begin collecting Social Security as soon as possible. Claiming as early as possible can have dramatic negative effects on income and consumption in retirement. This brief provides a general discussion of Social Security claiming options, with an emphasis on alternatives to claiming as early as possible.

Claiming Later Can Payoff

Individuals can begin receiving Social Security benefits as early as age 62 or as late as age 70. Benefit levels increase each month the individual delays collecting until the maximum age of 70. An individual's "full retirement age" is between the ages of 62 and 70 and is adjusted based on year of birth. "Full retirement age" is misleading, however, since monthly benefit levels continue to increase if the individual delays collecting after this age. Only 24% of individuals claim at full retirement age or later.

Collecting reduced benefits for a longer period of time might seem better than collecting greater benefits over a shorter period of time. Nonetheless, increases in benefits for delayed claiming can far outweigh the reduction in the number of Social Security checks received. Compared to collecting at age 62, somebody who waits until age 70 receives a monthly benefit that is about 75% more in real (inflation-adjusted) dollars (Munnell, 2012)—over time, this means that people who delay collecting can receive much greater total lifetime benefits. Beginning at age 62, each year of delay brings an inflation-adjusted increase in benefits of approximately 7-8%. This is a nearly-risk free real return on investment that is hard to match in the financial market. Delaying has its costs, but in essence the costs buy an annuity that provides a boost in income for the rest of one's life. Delaying can be achieved by working longer or quitting work and spending down other assets before claiming.

Claiming Early Could Be a Necessity

For people with health problems, an inability to work or find work, or few financial assets, claiming Social Security may be the only option. Still, delaying even a few months results in larger monthly payments for the rest of one's life.

A key consideration is becoming eligible for Medicare at age 65. Except in a few special cases, you cannot be eligible for Medicare before age 65. You can receive Medicare without claiming Social Security. You can delay enrolling in Medicare, but for most people Medicare is better than their employer's coverage, and there may even be a penalty for delaying enrollment (a 10% premium penalty, currently about $100 per year). Good health insurance coverage protects financial assets but is often too expensive for retirees. As a result, employer-provided coverage is a major factor in the decision to delay retirement. Often, working until eligible for Medicare is a major determinant of when to retire.

Beware of the Hype about Social Security's Impending Bankruptcy

A common belief about Social Security is that because the system is 'going broke,' everybody should claim their benefits as early as possible. Even without <u>any</u> reform, Social Security will not become insolvent but will instead automatically reduce benefits (to about 75% of their current level) around 2033. Even with these reductions, it would still be the case that delaying leads to greater benefits. More importantly for people retiring soon, none of the reforms proposed by either major political party would affect current beneficiaries or people close to retirement age—making those changes is too politically infeasible.

Fear of Dying? How About Fear of Living Too Long?

Social Security is a form of insurance against outliving your savings. It provides an inflation adjusted annuity-like payment for life. A common concern is *"I may die too soon to realize the benefits of delaying my Social Security claim."* Except for people with serious illnesses (which likely reduce their ability to earn income in any case), there is a greater risk of living longer than you think than of dying too soon, so far as Social Security is concerned. Claiming as soon as possible constrains one's benefits for 20 or 30 years. Thus, there are two sides to the life expectancy coin (Munnell, 2012). As a point of reference, a 65 year-old man has about a 30% chance of living to age 90, and a 65 year old woman has a 40% chance of reaching that milestone (CNN Money, 2012).

Claimed Too Early?

There are ways to 'do over' a claim. First, an individual may be able to suspend his or her benefit claim, and then continue collecting at a higher level at a later age. Second, Social Security has provisions for repaying benefits received, which then allows the individual to collect the higher benefit going forward. Not surprisingly, the logistics of either suspending or repaying one's benefits are complicated, but it can be worth exploring these options to see whether it is possible to collect the higher benefits that come with delaying (Kotlikoff, 2012).

Spousal Issues

In order to qualify for Social Security Old-Age, Survivors, and Disability Insurance (OASDI) benefits, an individual must have 40 quarters of reported earned income subject to FICA payroll taxes. This amounts to about 10 years of employment on an individual work record (the current minimum earnings is $1,130 per credit, although this has been adjusted with inflation over time). Someone who does not meet the work requirements can claim on his or her spouse's record. This means that a wife could claim on her older husband's record, even if she keeps working. There are added benefits for any dependent children. There are many strategies that couples can explore, including claiming on one spouse's record earlier, and the other's later. Or claiming on one spouse's record, suspending the claim, and starting a spousal claim on that record. Remember that claiming early also affects spousal benefits, including the surviving spouse's benefit (usually half of the deceased's benefit). It is often helpful to talk to a Social Security counselor about these issues.

Divorced spouses and widowers/widows can claim on a former spouse's record, if the marriage lasted at least 10 years. Nonetheless, for divorced individuals or those with multiple long-term marriages, the ex-spouse's benefit level and claiming age can become quite complicated. See the resources below for more information.

Claim and Keep on Working

You can collect Social Security benefits and a paycheck. If you claim *before full retirement age*, benefits will be reduced 50 cents for every $1 earned over $14,640 annually (as of 2012). In the calendar year in which you reach full retirement age, the reduction is $1 for every $3 earned above $38,880 until the month one reaches full retirement age. After full retirement age, no Social Security benefits are withheld, regardless of how much an individual earns through work (Center for Retirement Research, 2009a, adjusted for 2012 dollars). These potential benefit reductions for people under full retirement age may feel like a 'tax,' but remember, these years of earnings are still added to the work record and will result in larger benefits later (Social Security will recalculate benefits and adjust future benefit amounts).

Farmers and Public Employees Face Unique Issues

Farm families face all of the same considerations discussed above, with the additional complexity of being engaged in a capital intensive family owned small business. Often, farm families use labor from all family members without formal reported earnings. This might result in a lack of the 40 credits needed to be eligible for benefits. Because farm finances often result in little or negative annual income, the reported earnings may not result in large benefits. The demands of working on a farm may also make working to full retirement age or to age 70 challenging. In some cases, a farmer's spouse who worked off the farm might have a better record on which to claim benefits.

Some public employees and railroad workers have been exempted from Social Security and do not have work records eligible for making a claim. Without a spouse in the system or other employment, these workers have to rely on their other pension benefits. It is important to note that at age 65, regardless of claiming status for Social Security, Medicare premiums are assessed. Signing up for Medicare and managing monthly premium payments is still tied to the Social Security Administration.

Conclusion

The complexity of the Social Security system can be overwhelming. This brief explores a few of the financial issues involved in deciding when to take Social Security benefits. Excellent resources are available online, at your local Social Security Administration office, or by calling Social Security at **1-800-772-1213**. An important first step for people of all ages is checking the accuracy of one's work record (SSA no longer mails out earnings statements annually).

Resources

AARP. 2011. "Social Security Is a Critical Income Source for Older Americans." http://www.aarp.org/work/social-security/info-09-2011/fs236-ss.html

Center for Retirement Research at Boston College. 2009a. "**Social Security Claiming Guide**." http://fsp.bc.edu/social-security-claiming-guide/

Center for Retirement Research at Boston College. 2009b. "**Social Security Fix-It Guide**." http://fsp.bc.edu/the-social-security-fix-it-book/

CNN Money. 2012. "Do I really need my savings to last me until I'm 100?" http://money.cnn.com/2012/04/27/pf/expert/life-expectancy-retirement.moneymag/index.htm

Kotlifkoff, Laurence. 2012. "**42 Social Security 'Secrets' All Baby Boomers and Millions of Current Recipients Need to Know - Revised!**" http://www.forbes.com/sites/kotlikoff/2012/07/03/42-social-security-secrets-all-baby-boomers-and-millions-of-current-recipients-need-to-know/

Munnell, Alicia. 2012. “**Deciding When to Claim Social Security**.”
http://blogs.smartmoney.com/encore/2012/06/22/how-not-to-decide-when-to-claim-social-security/

Social Security Administration. “**Retirement Planner: Benefits By Year Of Birth**.”
http://www.socialsecurity.gov/retire2/agereduction.htm

Social Security Administration. 2004. “**If You Are A Farm Worker**.”
http://www.ssa.gov/pubs/10074.html

Social Security Administration. 2005. “**A Guide For Farmers, Growers And Crew Leaders**.”
http://www.ssa.gov/pubs/10025.html

UW Extension
Cooperative Extension

The University of Wisconsin-Extension (UWEX) Cooperative Extension's mission extends the knowledge and resources of the University of Wisconsin to people where they live and work. Issue Briefs are an ongoing series of the Family Financial Education Team. This brief was drafted by J. Michael Collins, Assistant Professor in Consumer Finance and Extension State Specialist, and Collin O'Rourke, Outreach Specialist, Center for Financial Security © 2012 Board of Regents of the University of Wisconsin System.