Benefits Timing: Make Social Security Work for You

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Unlike most investments, your contributions to Social Security weren't exactly voluntary. That tiny issue aside, a great way to make Social Security work for you is to look at it as an investment. Some of the considerations in analyzing investments are evaluating risk, looking at the tax angles, contemplating your time horizon, and controlling your emotions. But one of the most critical decisions in investing is when to buy and when to sell.

The good news is that your *buy* decision has already been made: You're in the program or you aren't. The bad news? The *sell* decision takes some serious thought. For Social Security, the *sell* decision is choosing the date you begin to take benefits. This date may be as early as your 62nd birthday or as late as your 70th birthday. Of course, up until age 70, the later you wait to begin taking benefits, the higher your monthly benefit will be.

Social Security is designed to provide for you in your old age. The built-in incentives to delay starting benefits are significant. Financial planners often provide a source-of-income chart in their planning reports. In many cases, the Social Security component grows to become the largest single source of income in one's later years because Social Security payments have an annual cost of living adjustment. Other income sources either don't keep up with inflation or simply get spent down.

In this strategy, you discover factors that go into the decision of when to start collecting. ***Note:*** As with other investments, Social Security decisions are not one-size-fits-all. The government-sponsored Web site `www.ssa.gov` is chock full of information that you should become familiar with.

REMEMBER

You don't have to apply for Social Security benefits and retire at the same time. Look at your overall plan for income to see what's in your long-term best interest. See Strategy #66 for more information on how to make all your retirement income work together.

Look at the Tax Angles

As with other investments, one of the secrets of success is to understand the tax benefits and the tax traps. Look at the big picture to develop a strategy that avoids unnecessary taxes (as the saying goes, it's not what you earn; it's what you keep — legally). Here are two particular considerations to keep in mind:

- If you start taking your Social Security payout too early, before your full retirement age (between ages 65 and 67, depending upon your year of birth), you'll be subject to a 50 percent tax on earned income above the allowed limit for the year. In 2008, this limit is $13,560. (Check out *Working after Retirement For Dummies,* by Lita Epstein, for more information.)
- Social Security benefits may be taxable if your other income — including pensions, wages, interest, and dividends — plus half of your Social Security exceeds a base amount of $25,000 for singles or $32,000 for married couples. The tax may be anywhere from 50 to 85 percent of your Social Security benefit, depending on how much you exceed the base amount.

You can view delaying Social Security benefits as a deferred-income strategy, with the goal of maximizing ultimate return and peace of mind as well.

Sometimes things just don't seem to work out. If your nest egg has lost significant value, you may have to work longer to give it a chance to grow back. If you can't work full time, consider part-time work. If you can't work at all, you probably can't consider delaying your Social Security benefit. See Strategy #76 for ideas on how to allocate your remaining assets for this stage of your life.

If looking at the IRS tax tables makes your eyes glaze over, that's understandable. Just be sure to talk to your tax preparer and financial planner before filing for benefits.

Contemplate Your Time Horizon

The purpose of your Social Security income stream is to provide income when you're older and in less of a position to earn wage income. With any luck, you're in good enough health to be more concerned about running out of money than breath. But consider your health when deciding when to begin taking Social Security benefits:

- If your doctor is constantly giving you a hard time about a growing number of risk factors, maybe you're a good candidate for taking benefits as soon as possible (typically age 62).
- If there's a reasonable chance that you'll live past 80 ("the new 60"), you should consider delaying benefits for what'll seem like a long time — to age 66, 67, or even 70.

TIP

Even if you don't expect to live into your 90s, waiting to start your Social Security benefits until age 70 can have a significant effect if you die before your spouse, particularly if your lifetime earnings were much higher than your spouse's. When you die, your spouse has the choice of continuing with his or her own Social Security benefit or choosing to take the benefits of the deceased spouse. Obviously, if your spouse outlives you by many years or even decades, this can really add up.

Control Your Emotions

Finding reasons to make an emotional decision is easy, especially when it comes to money. Given that over 30 million retirees are currently receiving Social Security payments, there are plenty of stories out there to latch onto. If you're facing a Social Security payout decision in the next five to ten years and already thinking of one of the following reasons for taking an early payout, investigate further:

- **You don't think you're likely to live past the break-even age or average life expectancy.** According to government data, about one out of four 65-year-olds alive today will make it past age 90. One out of ten will celebrate a 95th birthday. Consider the role your Social Security check may play in your future.

  The *break-even age* is the point at which the higher benefits from waiting until age 70 becomes more than the money you received by starting early. For example, suppose you'd get $11,000 per year at age 62, but you'd get $20,000 per year by waiting until age 70. That means that you received $88,000 by the time you were 70, and the break-even is age 79 ($88,000 divided by the difference between $11,000 and $20,000 is about 9). If you live beyond age 79, all things being equal, you would be better off waiting until age 70 to begin your benefits.
- **You don't trust the government to continue paying benefits — maybe you'll buy an annuity instead.** If the government runs into trouble, how do you think company- or insurance industry–guaranteed income promises will fare, keeping in mind that they'd be holding a lot of government bonds in their portfolios?

Future benefits may be linked to your total income, so take this into consideration if you anticipate having a high lifetime income. If a couple thousand dollars per month is a big part of your upcoming retirement income plans, then you'll probably fly under the income limits.

- **You'll take the payout early and invest it to get a better return.** Nifty idea, but not thrifty. If you can afford to take the investment risk that'd be necessary to beat the rate of return you get by waiting, you probably don't need to take Social Security early and wouldn't want to for tax reasons. If your full retirement age is 67 (that is, if you were born after 1960), your monthly benefits are reduced by about 30 percent. If you were born between 1943 and 1959, you get an additional bonus of 8 percent per year by delaying your start date past your full retirement age. There isn't a low- to no-risk investment strategy around that can deliver those rates of return.
- **You don't want to take withdrawals from your IRAs too soon — they need to grow.** Yes, taking Social Security early may allow your IRA to grow for a few years longer. But after that, the smaller government check will probably require even larger IRA withdrawals.
- **Ouch! You already started taking benefits early and wish you'd waited. Isn't it too late?** Go to your Social Security office or `www.ssa.gov` and use Form 521, Request for Withdrawal of Application, to turn the clock back. You can actually halt your current benefits and, after paying back all you've received interest-free, have them restarted at a higher rate, reflecting your current age.

TOUGH TIMES

All the preceding scenarios are well and good, but for many, many people, the argument for cashing in on Social Security early is much simpler and much more emotional: They really need the money now. And that's a great reason. However, consider one point: You'll probably really, really need the larger amount later, so try to postpone benefits as long as possible. Each month you delay between the ages of 62 and 70, the amount you receive for the rest of your life goes up. Future inflation can add to your regret over a premature starting point. Consider that in 1979, 1980, and 1981, annual cost of living increases were 9.9 percent, 14.3 percent, and 11.2 percent, respectively.