

June *MoneyMinute* – When Should You Take Social Security?

It's a big decision, and once you make it, you can't change it.

About two-thirds of those eligible for Social Security collect their benefits early, but that is the wrong choice for many people.

Given that half of the 65-year-olds alive today will likely live beyond age 83, outliving one's assets is an all-too-likely possibility for some retirees. Delaying Social Security benefits helps to offset that risk. That could mean waiting until age 70, when beneficiaries collect the highest monthly benefit possible. (Taking benefits early, on the other hand, permanently reduces your monthly amount.)

Getting the most from Social Security involves making accurate predictions about your life span, inflation and investment returns. The best most of us can do is to make some informed guesses. But given that Social Security is the most fundamental part of our social safety net, it's worth the effort to look at the rules and weigh them against our own situation.

There are three thresholds for receiving benefits: early retirement, full (or normal) retirement and delayed retirement.

Full retirement: used to be 65 but is creeping upward. It will be 67 for those born in 1960 or later.

Early retirement: between 62 and full retirement

Delayed retirement: between full retirement and age 70

Early retirees get less money; delayed retirees get more. For example, a retiree born in 1943 who's eligible to collect, say, \$960 a month in benefits if retiring at 62 would get \$1,281 a month at 66, the full retirement age. But that person would collect \$1,670 per month by waiting until age 70, an 8% annual increase for the four years from full retirement age to 70.

Sometimes the decision about when to take Social Security comes down to a "break-even" calculation that gives you an idea of how long you have to live to come out ahead by delaying benefits. You may read in the financial press that the break-even age between taking benefits at age 62 vs. age 66 is in the early 80s.

However, the break-even calculations usually ignore the cost-of-living adjustments. Depending on the cost-of-living increase that is assumed and on whether you plan to spend or invest the after-tax benefits. The breakeven age could fall to the late-70s if you spent the benefit; however, if the after-tax benefits are always invested, then the break-even ages were well into the 80s.

How long might you expect to live? A 65-year-old man can now expect to live until age 82, on average, while a 65-year-old woman can expect to live until almost age 85. But remember that half of those people will live longer than that.

What are some of the reasons that you might decide to take Social Security as soon as possible?

- o You don't have enough income from sources other than Social Security to support your lifestyle.
- o You are in poor health or you have a family history of shorter life spans.

- o The psychological benefit of getting the money as soon as possible -- no matter the financial consequences -- is the key driver for your decision. Retirees have been paying into the system for many years, and some want to get something back sooner rather than later.
- o You believe that you can earn high returns investing the money.

What are some reasons to delay taking Social Security?

- o Your life expectancy is good.
- o You might work until full retirement age. Until that age, about half your benefit may be lost.
- o You want to ensure a larger survivor's benefit for your spouse. The monetary advantage is especially large when the lower-earning spouse is healthy and several years younger.
- o If only one spouse is the family breadwinner, then that spouse should consider delaying the beginning of benefits until he or she has reached full retirement age to increase the spousal benefits received by the non-working spouse.
- o You are concerned about taxes in retirement. Taking Social Security early and delaying retirement account withdrawals could have harsh tax consequences, especially once you start taking required minimum withdrawals from your retirement accounts after age 70 ½.

How are your Social Security benefits taxed? If you're filing jointly and a combination of your other income (including tax-exempt bonds) plus 50% of your Social Security is \$32,000 to \$44,000, you could **owe federal income taxes on up to 50% of your Social Security payment**. If your combined income is more than \$44,000, you could **owe taxes on as much as 85%** of your payout (for more information on taxation of Social Security benefits, see IRS Publication 915 at <http://www.irs.gov/pub/irs-pdf/p915.pdf>). But if you live off your retirement accounts in your 60s and delay Social Security until age 70, you might be able to reduce this tax hit. At a minimum, you will have more Social Security income which is at most 85% taxable, and less income from your retirement accounts, such as Traditional IRAs or 401ks, which are usually 100% taxable.

It's a complex issue ... **Here's our bottom line:**

- o Most should wait to full retirement age.
- o If you can afford it, wait until age 70. This decreases the risk of living too long and running out of money.
- o Before you start Social Security, consider taking large withdrawals from your IRAs especially in years when your other taxable income would be low. Use the withdrawals to convert to a Roth IRA if you can afford it.

For More Information

The Social Security Administration's (SSA) website, www.ssa.gov, includes all the rules and has life-expectancy tables. It has basic calculators to give you a rough idea of your benefits, and very detailed ones if you want a more accurate estimate. It also does some break-even calculations.

You can find some high-level articles on our <http://www.feelsonly.com/Articles.html> web site.

Visit the IRS website for IRS Publication 915 at <http://www.irs.gov/pub/irs-pdf/p915.pdf>.

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