

The Magic Number

By Tammy Flanagan *National Institute of Transition Planning* August 27, 2010

This week I received what appeared to be a simple question: At what age should I apply for Social Security to get the maximum benefit?

Actually, this is a loaded question. Before I can begin to answer, I have to ask more questions such as:

- Are you still working?
- If you are, how much do you earn?
- What other sources of income do you have?
- Are those sources of income enough to live on?
- Are you married, widowed, or divorced?
- Do you have a Civil Service Retirement System benefit or any retirement from work not covered by Social Security?
- How old are you now?
- Most important: How long are you going to live? I know we can't answer this last question, but if we knew, then it would be easy to determine when would be the best time to apply for Social Security.

Let's understand some basics.

If you are retired, where will your income come from? Social Security, pension (a federal retirement benefit, military retirement or private sector pension), savings (Thrift Savings Plan or other investment income)?

The portion of your income that will come from Social Security will be the main factor in determining whether you can afford to delay your Social Security application. If Social Security benefits are going to represent 50 percent of your retirement income, then waiting a few years to collect the benefit is probably not an option.

If you are fortunate enough that Social Security benefits are not the primary source of your retirement income, then you will have to decide when to apply for your benefit to maximize your retirement income. Social Security benefits are computed on a tilted formula. This means if you work at lower wages, you will receive a proportionately higher benefit compared to what your earnings were.

On the other hand, if you have worked at higher earnings, then your Social Security benefit will represent a smaller portion of your pre-retirement earnings. The theory being if you have earned higher wages, you should have been able to save more for your retirement and would be less dependent on social "insurance" -- at least in theory.

For those of you who have spent your federal career exempt from Social Security taxes (FICA tax), then you might not even qualify for Social Security retirement benefits unless you have worked long enough in Social Security-covered jobs to earn 40 credits of coverage. In addition, your benefit will be affected by the Windfall Elimination Provision triggering a modified formula for computing payments that would reduce your benefit.

Earnings Test

If you are still employed and are younger than the full Social Security age, then there is an earnings limit. If your annual earnings are above a certain amount -- \$14,160 for 2010 -- then your Social Security benefit will be reduced by \$1 for every \$2 you earn over that limit. If you still earn substantially more than the annual earnings limit, then you should consider applying for Social Security when your earnings fall below the annual limit, or after you reach full retirement age, when there is no longer an earnings limit.

Back to the question: When should I apply?

It is difficult to know when to apply for Social Security retirement benefits, because if you apply early, then payments are reduced by as much as 30 percent. If you postpone the benefit beyond your full retirement age, then payments increase by as much as 32 percent just for waiting. If we knew how long we would be receiving those benefits, then it would be easy to decide whether to take them earlier or later, based on our life expectancy.

Many people apply for their Social Security benefit as soon as they stop working. As the old adage goes: "A bird in hand is worth more than two in the bush." In other words, if you are not working, or if you are making less than the Social Security earnings limit of \$14,160 for 2010, and you are at least age 62 -- or if widowed, age 60 -- then the best time to apply for Social Security is now.

It's important to keep in mind, by applying early for the benefit, it will be permanently reduced, but you will receive the benefit longer.

Let's look at an example: If your full benefit was computed as \$1,600 per month at age 66, but you elected to receive the benefit at age 62, it would be reduced to \$1,200, a 25 percent reduction if your full retirement age was 66.

If the \$1,200 was received from age 62 through 65, a benefit of \$57,600 (\$1,200 times 48 months) already would have been received before the first \$1,600 payment would have been made. The difference between \$1,200 and \$1,600 is \$400 per month. The question is how long would you have to receive the larger payment to make up for not taking the benefit at age 62? The answer: 144 months or 12 years (\$57,600 divided by \$400 equals 144). The break-even age would be 78 in this example (age 66 plus 12 years). This calculation does not include an annual cost-of-living adjustment, but considering the current economy, it didn't seem important to include the COLA (there was no Social Security COLA in 2009 and it is unlikely that there will be one this year).

Starting at age 62			Starting at age 66		
Age	Annual Benefit	Cumulative Benefit	Age	Annual Benefit	Cumulative Benefit
62	\$14,400	\$14,400	62	\$0	\$0
63	\$14,400	\$28,800	63	\$0	\$0
64	\$14,400	\$43,200	64	\$0	\$0
65	\$14,400	\$57,600	65	\$0	\$0
66	\$14,400	\$72,000	66	\$19,200	\$19,200
67	\$14,400	\$86,400	67	\$19,200	\$38,400
68	\$14,400	\$100,800	68	\$19,200	\$57,600
69	\$14,400	\$115,200	69	\$19,200	\$76,800
70	\$14,400	\$129,600	70	\$19,200	\$96,000
71	\$14,400	\$144,000	71	\$19,200	\$115,200
72	\$14,400	\$158,400	72	\$19,200	\$134,400
73	\$14,400	\$172,800	73	\$19,200	\$153,600
74	\$14,400	\$187,200	74	\$19,200	\$172,800
75	\$14,400	\$201,600	75	\$19,200	\$192,000
76	\$14,400	\$216,000	76	\$19,200	\$211,200
77	\$14,400	\$230,400	77	\$19,200	\$230,400
78	\$14,400	\$244,800	78	\$19,200	\$249,600

Here are some additional reasons that justify applying at your first opportunity.

If not taking your Social Security benefit means the difference between withdrawing money from the TSP or other tax-sheltered account rather than taking Social Security retirement, it might be best to let those tax-sheltered benefits continue to grow and stay tax-deferred awhile longer. The extra income from Social Security is at least partially tax-free. You will have to pay taxes on some of your benefits if you file a federal tax return as an "individual" and your total income is more than \$25,000.

If you file a joint return, then you will have to pay taxes if you and your spouse have a total income of more than \$32,000. You will pay tax on 85 percent of your Social Security benefit, but 15 percent is still tax-free. Believe it or not, less than one-third of Social Security beneficiaries pay taxes on their benefits because their income is below the taxable threshold.

If you start taking benefits at age 62 and invest the monthly payment, then the interest you will earn will offset the smaller amount you're receiving by not having waited. If you were able to invest \$14,400 per year and earn 5 percent interest, you would have \$63,689 in four years, which is more than \$57,600. Don't forget, however, that you won't have all of the \$14,400 to invest, since most likely 85 percent of it will be taxable. So you might be able to invest about \$11,000 after taxes, bringing the investment down to \$48,651. To earn 5 percent interest, the money would not be invested in a passbook savings account, and so there would be some risk involved where the money could earn less than 5 percent and possibly even decline in value. But then again, the money could earn more than 5 percent.

The reality is some of us will not live long enough to make it worth waiting. But that is not true for millions of people, it seems.

One argument for waiting until your full retirement age or beyond to start receiving benefits: People are living longer. Here are some projections, according to MetLife's [Mature Market Institute](#).

The [Census Bureau](#) projects that by 2030, the 65+ population will represent about 19 percent of the U.S. population. This is the fastest growing segment of the population, especially among women.

U.S. Population by Age	2009	2030
65-74	20,781,497	38,784,325
75-84	12,932,588	24,562,604
85+	5,914,063	8,744,986
Total	39,628,148	72,091,915

How about those over age 100? Today there are about 99,000 people in the United States who are older than 100. By 2030, that number is expected to more than double to 207,631. By 2050, the Census Bureau projects that more than 600,000 Americans will be at least 100 years old. I wonder how many of them will still be living independently and enjoying their retirement benefits.

Self-Reported Health Status 2006-2008			
Male	Excellent/ Very Good	Good	Fair/Poor
65-74	43.9%	33.7%	22.4%
75-84	35.3%	37.2%	27.5%
85+	30.8%	34.1%	35.1%
Female			
65-74	43.0%	34.6%	22.3%
75-84	35.0%	37.4%	27.6%
85+	31.5%	35.6%	32.9%

One last consideration, women are most likely to be widowed and also most likely to live longer according to these same projections.

Marital Status	Ages 65-74		Ages 75+	
	Male	Female	Male	Female
Married	77.8%	55.0%	67.0%	30.3%
Widowed	5.8%	24.4%	22.5%	59.0%
Divorced	10.2%	14.8%	5.8%	6.3%
Never Married	4.8%	4.2%	3.8%	3.9%

There are almost three times as many widowed women than men who are age 75 and older. So for women who worked at lower wages and/or fewer years than their husbands, it makes sense for the husband to delay his Social Security retirement benefit while both he and his wife are living, so the widow's benefit will be based on the husband's higher Social Security benefit. Many women are entitled to their own Social Security retirement benefit in addition to the spousal benefit their husbands earned. In this case, the logic for determining the best timing for benefits on an individual basis applies.

So here are three simple questions that might help you decide when to apply for Social Security retirement:

- Are you still working full time?
- Do you need the money?
- How's your health?

Here are three things to do, to get help:

- Contact Social Security to find out what you are entitled to receive (www.ssa.gov, or 800-772-1213).
- Contact a financial planner to help you decide whether you should apply immediately or whether it makes sense to wait based on your financial situation.
- Contact your doctor to see how you're doing physically.

CORRECTION: The original version of this column contained incorrect figures for the value of money invested at 5 percent interest over four years. The column has been updated to correct the errors.

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