

# JOURNAL OF ACCOUNTANCY

PERSONAL FINANCIAL PLANNING

## Social Security for Two

### **CPA personal financial advisers should run the numbers on Social Security, and for their married clients, that goes double.**

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CPA financial planners are often confronted with the question, "When should I start collecting Social Security benefits?" For married couples, the question should be asked in the plural.

Current financial needs and expected life span may be paramount considerations for a single person. However, the implications of when to begin receiving benefits (and on which spouse's work record) for spousal and survivor's benefits not only introduce key points for every married couple to ponder but also create additional strategic opportunities for financial security in their golden years together.

Many couples don't seem to be approaching the question in the most prudent way. It has been noted, for example, that many married individuals who earned higher wages than their spouses begin claiming Social Security benefits at age 62 or 63, prior to full retirement age (FRA). The Senior Citizens' Freedom to Work Act of 2000 has made it more advantageous than under prior law for married individuals who earn more than their spouses to postpone claiming benefits. A significant provision of the Act is "file and suspend," which permits spouses to collect spousal benefits when the primary worker is postponing the collection of benefits. Married retirees are often unfamiliar with this provision, and the strategy is underutilized by financial planners.

Furthermore, higher-income spouses often claim Social Security at an age that significantly decreases the couple's combined benefits, as well as their spouse's prospective survivor benefits. A 2007 study, "Why Do Married Men Claim Social Security Benefits So Early? Ignorance or Caddishness?" by Steven A. Sass, Wei Sun and Anthony Webb for the Center for Retirement Research at Boston College, concluded the reason was a lack of financial awareness. By educating clients about the full range of Social Security benefits considerations, including marital ones, financial planners can help them make the wisest use of this valuable retirement resource.

#### EARLY OR LATE?

Individuals may start collecting Social Security retirement benefits at age 62, but their benefits are reduced by a fraction of a percent for each month remaining before their FRA. Individuals can collect 100% at their FRA (age 66 for those born between 1943 and 1954). If benefits are delayed beyond FRA, the benefits increase until age 70. The Social Security Administration (SSA) Web site, [www.ssa.gov](http://www.ssa.gov), provides excellent resources to determine and explain early retirement penalties, FRAs and delayed retirement credits (DRCs), as well as online calculators and other helpful facts. See also "Social Security: What's the Magic Age?" *JofA*, July 06, page 28

A summary of a 58-year-old worker's benefits in both today's dollars and what it will take in future dollars to provide benefits at various retirement ages is shown in Exhibit 1. The monthly data—both current and future dollar amounts—were obtained from the Social Security "Quick Calculator" unveiled in July 2008 at the SSA Web site ([www.ssa.gov/OACT/quickcalc/index.html](http://www.ssa.gov/OACT/quickcalc/index.html)). The calculator allows users to input their date of birth and current earnings.

The projected benefits at age 70 from an earlier retirement and at age 85 are extrapolated from the Quick Calculator's results, using an annual cost of living adjustment (COLA) of 3%. Legislation enacted in 1973 provides for automatic COLAs so that benefits will keep pace with inflation. COLAs have averaged 4.4% since 1975. For a more precise estimate, the planner can modify the assumptions the Quick Calculator makes about earnings history by entering data from the client's annual SSA report, *Your Social Security Statement*. But even with its default settings, the Quick Calculator can be an effective aid to stimulate client discussion about collection alternatives. The SSA also offers several more finely tuned calculators at [www.ssa.gov/planners/benefitcalculators.htm](http://www.ssa.gov/planners/benefitcalculators.htm).

Clients who start collecting benefits early receive a smaller amount each month and may provide their spouses lower survivor benefits, but they usually collect for a greater number of months. If they delay, they collect larger monthly checks but fewer payments over their lifetime. Using a side-by-side spreadsheet comparison of cumulative monthly benefits (reflecting the 11 months for the first year in which benefits accrue after reaching age 62 and assuming a 3% COLA) planners can show clients how the 58-year-old worker without consideration of a spouse illustrated in Exhibit 1 needs to live to approximately age 75 years, 3 months to compensate for waiting until age 66 versus starting benefits at age 62. If the worker waited until age 70 to start collecting, it would take until age 77 years, 7 months to break even. This analysis does not take into consideration the time value of money. (For a demonstration, [click here](#).)

The differences between the projected benefits at ages 70 and 85, if the client starts collecting at 62 versus a later age, are significant. The benefit, if started at age 70, is 185% of the amount collected at the same age if benefits started at age 62, a difference of \$23,314 for the year (see Exhibit 1, second column from right, \$50,676 – \$27,362), or more than \$1,900 per month. The reasons are not only the early retirement penalty and the delayed retirement credit but also the impact of COLAs on the higher delayed benefit. By delaying benefits, the retiree has at least partially transferred inflation risk.

#### SPOUSAL AND SURVIVOR BENEFITS

Spousal benefits and survivor benefits are two important features that married clients must understand and should be incorporated into the planner's analysis. A spouse can collect the greater of (1) the amount credited for his or her income, or (2) a spousal benefit based upon the higher-income spouse's benefits. Since 2000, a provision permits a married individual to file at FRA and suspend the collection of benefits. This "file and suspend" strategy permits a lower-income spouse to collect spousal benefits once his or her higher-income spouse reaches FRA while the higher-income worker's benefits accrue DRCs through age 70.

Spousal benefits do not receive DRCs. Therefore, the lower-income spouse should begin to collect these benefits at his or her FRA. If a lower-income spouse starts collecting benefits at or after his or her FRA, the spouse can collect up to 50% of the higher-earning spouse's FRA benefits. If a spouse starts to collect spousal benefits before his or her FRA, the benefits will be reduced. For a worker with an FRA of 66, the spousal benefit at age 62 is 35% of the higher-earning spouse's FRA benefit.

When one spouse of a married couple dies, the surviving spouse is entitled to the greater of (1) 100% of the amount the surviving spouse was collecting or (2) 100% of the amount the deceased spouse was collecting. If the higher-income spouse starts collecting at an earlier age, the spouse inherits reduced

benefits.

Take, for example, a higher-income husband with a lower-income wife. If the husband has no reason to expect longevity, he may be inclined to begin collecting at age 62 and accordingly collect approximately 75% of FRA benefits. This means that his wife will collect reduced survivor benefits when he dies.

The husband's decision may change, however, when he considers that his wife is statistically likely to live beyond him. According to the Social Security Period Life Table, a woman at age 65 has a remaining life expectancy nearly three years longer (19.5) than a 65-year-old man (16.7), and the man is 56% more likely than the woman to die before age 66 (probability 0.017976 male, 0.011511 female).

In a 2007 article, "Rethinking Social Security Claiming in a 401(k) World" ([www.pensionresearchcouncil.org](http://www.pensionresearchcouncil.org)—requires free registration), James I. Mahaney and Peter C. Carlson assert that the most effective solution for married couples to maximize their expected benefits is a 62/70 split. The 62/70 split calls for the lower-income spouse to collect his or her benefits at age 62 and for the higher-income spouse to delay collection until age 70. A key point is that the lower-income spouse should consider collecting as early as possible, because the penalty for a lower-income spouse commencing benefits collection early is eliminated when the higher-income spouse dies. Upon the higher-income spouse's death, the lower-income spouse can start collecting survivor benefits.

The article also describes an effective method for analyzing the Social Security question, the expected present value of benefits approach. The 62/70 split solution is supported by many other practitioners and academics who write on this subject. Of course, many factors need to be considered, including income levels, resources, life expectancies, survivor benefits and income taxes.

#### FILING STRATEGIES FOR COUPLES

For the higher-income spouse to delay to age 70 may be easier said than done. Many factors need to be considered, including, in addition to those just mentioned, the opportunity costs for assets used during the bridge period—the time between stopping work and collecting Social Security benefits. An intriguing strategy using spousal benefits may mitigate the dilemma and provide significant benefits.

To initiate the plan, the lower-income spouse files early, at age 62 or 63, using the lower-income spouse's earnings record, and collects reduced benefits. The higher-income spouse waits until FRA, age 66 for this example, and files to collect 50% of the lower-income spouse's FRA benefits. Then, at age 70, the higher-income spouse applies to collect based upon his or her own earnings history. By waiting until age 70, the higher-income spouse will receive both DRCs and COLAs on his or her benefits, which could result in a significant benefits enhancement. Based on the future dollars data for ages 66 versus 70 from Exhibit 1, the benefit increase is \$17,580 per year (\$50,676 – \$33,096), or \$1,465 per month. Additionally, the higher-income spouse collected spousal benefits for the four-year period.

#### A BEST-KEPT SECRET: THE "DO-OVER"

Another little-known and rarely used strategy could be called the "SSA Do-Over." If a client commences collecting benefits early and subsequently re-evaluates the situation, there is an option to pay back the benefits received and then file a new application, allowing the client to receive larger monthly checks. The client must file Form SSA-521, *Request for Withdrawal of Application*. All benefits including spousal benefits collected must be returned to the SSA. There is no adjustment for inflation or accrued interest charges. The client is entitled to either a tax credit or deduction for the income taxes paid on the benefits previously collected. IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*, provides the instructions and worksheets to calculate the tax benefits. The client can later reapply for the larger eligible benefits.

This strategy almost sounds too good to be true. It provides the CPA/financial planner with another option to the benefits question. The strategy requires the client to have the resources to repay the past benefits, to consider longevity, and to conduct a new break-even analysis. If the client collects early, invests the Social Security proceeds, earns a return on the proceeds, and realizes the tax benefit, he or she should be able to accumulate the funds to repay the Social Security collected. This strategy provides an inflation hedge and can generate higher future benefits for the worker and the spouse.

#### LONGEVITY

A key factor in the decision of when to commence collecting benefits is life expectancy. A 62-year-old male has a 50% probability of living until 84, a 25% chance of living until 90, and a 10% chance of living to 95. The data for women is two to three years greater across the percentiles. The 50th percentile is well past the SSA's breakeven point. Actual life expectancy is impossible to predict precisely, but by using a break-even analysis and the client's individual circumstances, a good approximation can be made. Of course, individuals with insufficient retirement savings may have no option but to begin collecting benefits at age 62.

#### THE KEY TO WEALTH

Financial planners can help clients make better decisions about claiming Social Security benefits. A discussion of the collection options, impact of COLAs, and importance of survivor benefits for married clients is a good beginning. Social Security is an asset free of investment risk, inflation risk, longevity risk and investment income management fees. The income tax implications of collecting Social Security benefits always need to be considered (see sidebar, "The Bridge Period: Taxes and Investment Income," below). Planners should outline all of the relevant facts, both quantitative and qualitative, as part of the benefits discussion. Education is the key to wealth and will enable clients to maximize the value of their Social Security benefits. ♦

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#### The Bridge Period: Taxes and Investment Income

If a client stops working at age 62 and wants to delay collecting Social Security retirement benefits, he or she needs a source of discretionary cash flow, such as drawing from a qualified retirement account and/or other assets. The period between the discontinuance of a paycheck and the commencement of Social Security is the "bridge period." Analyzing the bridge period and post-bridge period requires consideration of taxes, investment income and inflation.

One approach is to run a side-by-side comparison under two scenarios, with and without the early collection of benefits. The worksheets should depict year by year your client's retirement assets, retirement income draw, estimated taxes and after-tax cash flow. To maintain the same after-tax cash flow under both scenarios, the client will need to withdraw more from a traditional IRA than the forgone benefits. The maximum amount of Social Security that is taxable for federal purposes is 85%, while withdrawals from traditional retirement accounts are often fully taxable. Only 14 states tax Social Security to some extent. Only three states that impose income taxes exempt withdrawals from retirement plan distributions. Therefore, the client's average total tax rate would be higher when more cash flow comes from taxable retirement asset sources and lower when more income is derived from Social Security. The type of income also affects the level of taxation. Most CPAs have access to tax planning software to analyze the Social Security collection decision.

Another factor that needs to be considered is the estimated investment income. As clients age, they generally take on a more conservative investment strategy. In conducting a side-by-side comparison, as

the level of estimated investment income declines, the option of delaying the collection of benefits is more favorable. Aggressive investors may choose to collect sooner rather than later so that their retirement investments can grow.

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## AICPA RESOURCES

### *JofA* article

"Social Security: What's the Magic Age?" July 06, page 28

### Publication

*Adviser's Guide to Counseling Aging Clients and Their Families* (#091024)

For more information or to place an order, go to [www.cpa2biz.com](http://www.cpa2biz.com) or call the Institute at 888-777-7077.

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## OTHER RESOURCES

### Web sites

- Social Security Administration, [www.ssa.gov](http://www.ssa.gov)
  - Center for Retirement Research at Boston College, <http://crr.bc.edu>
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## EXECUTIVE SUMMARY

- **Part of the consideration of whether to claim early Social Security** retirement benefits, for married couples, should be the effect on a lower-income surviving spouse later, after the primary wage earner's death.
- **Early benefits also are smaller** than at full retirement age (FRA), and significantly lower than delayed retirement at 70, when maximum benefits are reached, to compensate for the likely longer benefit period.
- **Spouses can collect the greater of the amount** credited for their own earnings or that of their spouse. The "file and suspend" strategy permits a lower-income spouse to collect spousal benefits when the higher-income spouse is postponing benefit collection. The postponement permits the higher-income spouse's benefits to grow while accruing delayed retirement credits and cost-of-living adjustments.
- **An effective strategy for many couples** is for the higher-income spouse to delay benefits until age 70, and for the lower-income spouse to file early for his or her reduced benefits, of which the higher-

income spouse can also collect 50% beginning at FRA.

■ **A little-known strategy** permits a worker who commenced collecting benefits early to re-evaluate and file a new application to collect higher benefits based on his or her older age. Benefits collected are repaid without interest. A tax benefit can be realized for any income taxes paid on the previously collected benefits.

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