Top 6 Myths About Social Security Benefits

My Comments: This more or less confirms everything I've been teaching about Social Security for a long time.

By Rich White \ 4 OCT 2018 \ https://tinyurl.com/tw64uw2d

If you are confused by the advice some people offer about Social Security benefits, you're not alone. In perhaps no other area of personal finance is more misinformation consistently provided. As a result, people often make the wrong decision about when to start receiving their Social Security benefits. This article aims to set the record straight.

Sources of Information About Social Security

Let's begin with some general guidance. As you approach age 62, the earliest age at which Social Security retirement benefits can begin, you are entitled to free counseling from your local Social Security office. While the quality of this counseling is generally good, it can vary in depth and clarity, depending on the knowledge and experience of the Social Security employees you encounter.

The definitive place for clear, accurate information is the Social Security Administration's (SSA) comprehensive website (http://www.ssa.gov). Once you are there, most of what you will need is located under the "Retirement" menu. The goal of this article is not to replace information from the Social Security Administration, but merely to summarize key points while focusing on and correcting common misconceptions – hence, the six myths below.

Myth #1: It's Best to Start Getting Benefits at Age 62

There are two schools of thought behind this idea. The first is that even if you do not need the money to cover your living expenses, you should take it so that it can be invested. Assuming you can invest the money successfully, you then may have more money available down the road than if you waited until full retirement age – age 66 or 67, depending on when you were born – to start receiving benefits.

The second school holds that a bird (or benefit, in this case) in the hand is worth more than two in the bush. The theory goes that you should take every dollar as soon as you can because Social Security retirement benefits (at current levels) may not continue much longer. This concept is based on a fear that Congress will scale back benefits to shore up funding.

As to the first school of thought: When to start Social Security benefits is a complex decision that should be personalized to each individual. It can involve many factors, ranging from the potential to continue working to attitudes about longevity and inflation. Permanent reductions for starting benefits before full retirement age are assessed on a monthly basis, so there is no hurry to make the start-date decision. By waiting to start until three months after age 62, for example, you can avoid three months' worth of permanent benefit reductions. Clearly, individuals have different levels of confidence in their ability to "invest the difference" successfully. Some people don't want the extra pressure of having to invest critical retirement assets in uncertain markets.

"You definitely should wait until your full retirement age and not take Social Security at age 62 if you are still working," says Alexis Hongamen, CRPC, founder of Federal Retirement Investment Advisers, LLC, in Orlando, Fla. "You don't want to claim and have your benefit permanently reduced if you have any significant income from working a job."

As for the fear-based argument, Social Security benefits are not guaranteed, and Congress can make any future changes it wishes. But for both practical and political reasons, it may be more difficult to reduce the benefits of retired people who have already earned them by formula. There are two important ages for this purpose:

- At age 60, your average indexed monthly earnings (AIME) are calculated, including the final year of indexing to the National Average Wage Index.
- At age 62, individuals qualify for a primary insurance amount (PIA), which is their benefit, payable monthly at full retirement age.

The SSA has a significant investment in technology and counseling resources behind these calculations, and individuals aged 60-plus rely on them for retirement-planning security. So, even if Congress should decide to reduce benefits, it could grandfather in anyone who has already reached age 60.

There's also a sad, third point: If you are in poor health, it will likely make sense for you to start getting Social Security as soon as you are eligible. This is a decision to be made in consultation with your physician, family and financial advisor.

Myth #2: You Must Wait X Years to Reach "Breakeven"

You may hear some financial pundits make claims such as: "Your breakeven age for starting Social Security benefits is age 78." By this, they mean: If you were to start benefits at age 62 instead of waiting until full retirement age, you would have more money in hand (on a time-weighted basis) through age 78.

There is no universal breakeven age because the variables behind the calculation can change. They include:

- Discount rate or time value of money,
- Inflation rate, and
- Benefit recipient is a worker or non-working spouse.

The permanent benefit reduction for starting early is greater for non-working spouses than for workers. Therefore, most non-working spouses can expect to outlive their breakeven ages. You can also think of the discount rate or time value of money as the after-tax return you could earn by investing after-tax Social Security benefits from age 62 through full retirement age. However, keep in mind that up to 85% of benefits may be taxable for higher-income seniors.

Finally, the breakeven point usually isn't the most critical issue in making the start-date decision. If you don't need the income to support your lifestyle from age 62 through 66, it's often best to wait.

"It is impossible to determine the best time to take Social Security without looking at your entire situation, particularly taxes, longevity, the current amount of retirement savings and life insurance. If you are married you must examine the benefits, age difference and longevity of your spouse. There is far more to the 'when do I file' question than just a breakeven analysis," says Jason Glisczynski, CFP®, CAS®, investment advisor representative, Glisczynski and Associates, Inc., Plover, Wis. "Everyone is different."

Myth #3: You Could Permanently Lose Part – or All – of Your Benefits

Currently, Social Security reduces benefits by $1 for every $2 of earned income above $16,920. This reduction continues until the start of the year in which you reach full retirement age.

It's true that your benefits are reduced if your earned income exceeds a threshold. Assume, for example, that you work and earn $25,040 ($8,000 over the $17,040 limit) in 2018. Your Social Security benefits would be reduced by $4,000 ($1 for every $2 you earned over the limit), but you would still receive $13,040 of your $17,040 in benefits for 2018 ($17,040 - $4,000 = $13,040).

Some commentators say that it is wasteful to start benefits early and then continue to work and lose benefits for several years. However, this is not so. Any benefit reductions are only deferred, and Social Security will credit those amounts to your benefits record when you reach full retirement age. There are good reasons not to start benefits before full retirement age, but this one isn't high on the list.

Myth #4: After Full Retirement Age, You Won't Earn Any More Social Security Benefit Credits

Most workers and their employers are subject to the Federal Insurance Contributions Act (FICA) withholding on earned income, regardless of the worker's age. Self-employed people pay the same rate in self-employment (SE) tax. The total FICA withholding or SE tax for 2018 is 15.3%, charged on up to $128,400 of earnings.

But every dollar of earned income, up to any age, can result in increases in Social Security benefits. Social Security will automatically recalculate your primary insurance amount (PIA) every year in which you work. If one of your 35 highest indexed-earnings years is attained after you start benefits, then you will be credited with a higher benefit. However, you do not receive any help from annual wage indexing after the calculation made in your 60th year. As long as you keep paying FICA or SE taxes, however, you can potentially keep increasing your benefit. There is no disincentive in the Social Security system to keep working after you start benefits.

"There is, however, a maximum benefit that can be received per worker per year and this amount is declared by the administration annually," says Jillian C Nel, CFP®, CDFA, director of financial planning, Legacy Asset Management, Inc., Houston, Texas. For 2018, the maximum full retirement benefit for a worker is $2,788.

Myth #5: The Tax on Social Security Benefits Isn't Enough to Worry About

Modestly affluent seniors now pay tax on up to 85% of benefits. For example, an affluent senior has 85% of a $20,000 annual benefit taxed at a 25% marginal federal tax rate. The tax on benefits is $4,250 ($20,000 X .85 X .25).

There are two problems with discounting the tax impact on benefits. First, it is possible and perhaps likely that the taxable portion could increase to 100% in the future as a politically attractive way to strengthen the system's fiscal status. Secondly, because benefits are paid monthly, they offer little tax-planning flexibility, unlike many other sources of retirement income such as traditional IRA withdrawals prior to age 70½.

Tax impact is something to be concerned about and should definitely be considered in making Social Security decisions. In the example above, if 100% of benefits were taxable at 28%, instead of 85% at 25%, the tax would increase to $5,600, an increase of $1,350.

Myth #6: Social Security Benefits Don't Really Help Seniors Offset Inflation

This myth arises from a lack of understanding of how Social Security's annual cost of living adjustment (COLA) works. Also, it may involve a belief that retired people have better inflation-hedging tools available to protect their retirement incomes.

In reality, the COLA is perhaps Social Security's most powerful long-term planning benefit. For an 85-year-old person who started benefits 20 years ago, cumulative COLAs now provide more benefit than the starting benefit itself. Each year, all Social Security retirement benefits are adjusted dollar-for-dollar for Consumer Price Index (CPI) inflation, creating a direct offset against inflation (as measured by this index).

For many retired people, the COLA provides the only source of inflation-adjusted retirement income linked directly to the CPI. A similar benefit is available only in some types of immediate annuity and pension payouts. For individuals who don't receive income from immediate annuities or pensions, maximizing Social Security benefits can be one of the best ways to hedge retirement income against high inflation.

For individuals who live a very long time, any decision to start benefits early at permanently reduced levels will reduce the longevity protection of lifetime benefits and the inflation protection of the COLA. Therefore, individuals who are in good health and have "longevity genes" in their families should carefully consider the long-term cost of starting benefits early. Keep in mind that the current COLA is not guaranteed and could be changed by Congress in the future.

Bottom Line

Don't let myths about Social Security stop you from making the most sensible decision for you about when to begin taking your benefits. Work through each of these questions carefully. Meeting with your local Social Security office and talking over the options with a financial advisor can also help.