Social Security Rules for Retirement Benefits

The Social Security system has a large number of rules to deal with different types of benefits programs it administers. The rules and exceptions are so many that a number of books have been written up on Social Security. The purpose of this article is to cover some key rules that are commonly used in calculation and planning of your retirement benefits. As a start, you should have paid Social Security taxes in order to be eligible for benefits on your own record. You can earn a maximum of four credits for any year you paid Social Security taxes. The amount needed to earn one credit increases automatically each year when average wages increase. You must earn a certain number of credits to qualify for Social Security benefits. Let's cover some basic rules first and then we will take a quick dive into some of the strategies to maximize benefits.

Full Retirement Age (FRA)

The Social Security Administration uses this age to determine your retirement benefits. This age varies based on the year you were born in. For example, the FRA for people born in the year 1942 is 65 and 10 months whereas for those born in 1943 - 1954 range it's 66, and 66 and 2 months for those born in 1955. This is the baseline for benefits calculations. The benefits statement that you get from Social Security shows your benefits at full retirement age as well as reduced benefits for taking them sooner and increased benefits if you waited past your FRA. GoWealthpro's Social Security Maximizer™ software automatically determines a client's FRA based on client's date of birth.

Delayed Retirement Credit for Increased Benefits

Don't forget this 8% risk free gain to your benefits.
In a nutshell what it means is that for each year you delay your retirement benefits past your full retirement age, you get 8% more in benefits. Conversely, if you start them sooner (earliest is generally age 62), the benefits are reduced based on your full retirement age. For example, if your full retirement age is 66, the reduction of your benefits at age 62 is 25 percent; at age 63, it is about 20 percent; at age 64, it is about 13.3 percent; and at age 65, it is about 6.7 percent. For people in good health with a family history of living longer, delaying benefits may be very useful.
It's also important to note that Social Security also adjusts your benefits for inflation. This adjustment is called Cost of Living Adjustment or COLA and is applied periodically (generally every year, or every other year).

Spousal Benefits

You are not required to pay Social Security taxes to claim spousal benefits.
If your spouse is eligible for Social Security benefits on his/her own work record, then you qualify for half of those benefits

irrespective of whether you have paid Social Security taxes or not. Spousal benefits can be claimed by only one spouse at a time even if both spouses are eligible for spousal benefits on each other's earning record. You can claim a spousal benefit as early as age 62, provided the principal beneficiary is currently receiving benefits. However, you maximize your spousal benefit by taking them at your full retirement age. There is no benefit in delaying spousal benefits past your full retirement age since spousal benefits don't get delayed retirement credit. Social Security Maximizer™ software automatically adjusts spousal benefits depending upon the benefits start age for the spouse claiming spousal benefits and the full retirement age of the other spouse. If the spouse claiming spousal benefits starts taking benefits prior to his own full retirement age, then he is deemed to have taken his own retirement benefits first and he's paid the higher of (own benefits and spousal benefits).

Ex-spousal and Survivor Benefits

If you've been divorced, ex-spousal benefits could be worth exploring.
If you're divorced and your marriage lasted 10 years or more, you may qualify for spousal benefits on the record of your ex-spouse (50% of ex-spouse). However, when a divorced spouse remarries, he or she generally cannot collect ex-spousal benefits unless the latter marriage ends (whether by death, divorce or annulment). To be eligible for ex-spousal benefits your ex must be receiving Social Security (even if it is before FRA). If s/he hasn't filed yet, then you must be divorced for at least two years. Your ex-spouse does not have to file for his/her own social security benefits for you to be eligible to receive ex-spousal benefit, but he/she has to be eligible for those benefits.
A surviving spouse is eligible for the full benefits that the deceased spouse was receiving prior to death. The surviving spouse must have been married to the deceased spouse for at least 9 months before death. If the surviving spouse hasn't attained the full retirement age, reduced benefits may be available as early as age 60. A disabled widow(er) can get reduced benefits as early as age 50. An ex-spouse may also be eligible for survivor benefits.

Dependent Children's Benefits

An effective tool for older parents with young or disabled children.

Subject to certain family maximum, dependent minor children and parents also qualify for Social Security benefits on a worker's record. A child must be unmarried and younger than 18 (18-19 if in school and no higher than 12th grade) or disabled with disability starting before age 22. Social Security Maximizer™ automatically handles these rules and family maximum constraints to calculate your benefits.

Effect of Government Pensions on Social Security Benefits

If you're eligible for a government pension and Social Security benefits, your own Social Security benefits may be impacted by Windfall Elimination Provision or WEP. The spousal benefits you are entitled to can be reduced by another rule called Government Pension Offset or GPO.

Windfall Elimination Provision (WEP)
If you work for an employer who does not withhold Social Security taxes from your salary (such as a government agency or an employer in another country), any pension you receive from that employer may reduce your Social Security benefits. WEP only applies if you paid Social Security taxes for less than 30 years.

Government Pension Offset (GPO)
If you're eligible for government pension and spousal Social Security benefits based on your spouse's work record, your spousal benefits may be reduced. Under the Government Pension Offset (GPO) law, your spousal benefits may be reduced by 2/3rd of the pension amount. The Social Security Maximizer™ takes into account any GPO related adjustments to Social Security benefits.

Working While Taking Social Security Benefits

If you work and take Social Security benefits at the same time before your full retirement age, the income you earn from work may impact your benefits. It is important to note that the income here is W2 income (for IRS purposes). This is how it works: for years prior to the year of your full retirement age, if your W2 income is more than $15,720 (for 2016), your Social Security benefits will be reduced $1 for each $2 earned **above** this amount. When you reach full retirement age, the reduction will be $1 for every $3 you earn **above** $41,880 (for 2016). Again, this reduction only considers the income for the year until the date of your full retirement age.

While this reduction may scare some people, The Social Security Administration actually recalculates your benefits at your full retirement age. This recalculation uses your earnings history until that point. As a result your benefits may actually go up after that. In Social Security Maximizer™, you don't have to worry about these arcane calculations involving different dates and formulas. Just indicate approximate dates of your client's work and estimated income and the software automatically figures out if that income will have any impact to benefits.

Social Security Planning Strategies for Married Couples

Beside delaying your retirement, there are two strategies for couples that are commonly used to maximize combined Social Security benefits. One of them is file and suspend and the other one is called restricted option. The rules governing the eligibility for these strategies have recently changed (see below). Here is how they work.

In case of **file and suspend**, one spouse files for Social Security at his/her full retirement age and immediately suspends taking benefits until a future date. This allows the filer to delay his retirement benefits until a later age (up to age 70) while simultaneously allowing an eligible spouse to claim spousal benefits on his record. In this case both spouses can increase benefits on their respective income record while also claiming half of one spouse's benefits. This strategy can add tens of thousands of additional dollars to a couple's lifetime benefits. Going forward, this strategy will only be available to individuals born before 12/31/1949.

The other strategy for couples is **restricted option**. Under this strategy, while one spouse is collecting retirement benefits the other spouse (if eligible) could restrict his benefits just spousal benefits and allowing benefits on own record to grow via delayed retirement credit. Going forward, this strategy will also be available to individuals born before certain dates.

Social Security Planning Strategies for Individuals with Dependent Children

If you have young or disabled children, biological or adopted, it may be worth examining taking benefits sooner. Taking benefits sooner than your full retirement age will ultimately reduce your own benefits but as long as your dependent children are eligible (see eligibility above), you will also receive benefits on their behalf. However, it's difficult mathematically to decide which way to go. Social Securty Maximizer™ automatically tests to see which strategy results in the greatest benefits.

Social Security Planning Strategies for Singles

There are several strategies singles can implement. For starters, if you're single because you are divorced, you can explore ex-spousal benefits. You can initially take ex-spousal benefits (your full retirement age through age 70) if you're eligible. This will allow benefits on your own record to grow. Remember, you may qualify for spousal benefits even if you have never worked. If you never married, you should still consider the 8% annual increase to your benefits for delaying them past your full retirement age. Your life expectancy plays an important role in making this decision. In general if you believe you're unlikely to live past age 80, it might make sense to start benefits at age 62. But if you believe you have a life expectancy past age 80, and can afford to wait then you should. The Social Security Maximizer™ automatically analyzes the break-even point where the earlier (and smaller) benefit offsets a later (and larger) benefit.

Latest Changes to the Social Security Law

New rules governing spousal benefits took effect on 11/02/2015.

In a bitterly divided Congress, the lightening speed of the repeal of some Social Security strtegies came as a shocking surprise to most people. In general, the new law impacts spousal and dependent benefits. At a high level, the new legislation states that a spouse or other dependents should get Social Security benefits on a worker's record **only when** the worker himself is taking benefits. Like all government rules, the devil is in the details. Here are some salient features of the new law.

File & Suspend Provision

A person can still file and suspend (and allow his eligible spouse take spousal benefits on his record while waiting his own benefits to grow) if he has attained full retirement age on or before 05/01/2016. What's the logic behind this date? For one, it's 6 months from the date this legislation was signed into law by the President. Keep in mind that the full retirement age is based on a person's date of birth. For those who made it to this date, congratulations for winning the lottery. And for those of us who are younger by a day or more, tough luck my friends. One very important point to remember here is that all file and suspend elections need to be made by 05/01/2016 as well. And since 05/01/2016 falls on a Sunday, the deadline is really Friday **4/29/2016**. Again, no file & suspend after 4/29/2016.

Restricted Option

The restricted option (whereby the spouse of a person taking benefits can opt for only spousal benefits while waiting for own benefits to grow) also went through changes. According to new rules if you're 62 or over as of 12/31/2015, the restricted option is available to you. What's the logic behind this date? Make up one of your own. I guess some of those who will miss out on file and suspend can possibly go for restricted option. Unlike file and suspend, there is no deadline for applying for restricted application.

Ex-spousal Benefits

Under certain conditions an individual could claim half of the Social Security benefit on an ex-spouse's record while letting his own benefits grow till age 70. Similar to restricted option, one can benefit from this approach if he/she is 62 or over as of 12/31/2015.

Dependent Children Benefits

As you may know, subject to family benefits limit, each eligible dependent of a Social Security recipient is eligible for half the benefits of the recpient (higher of the two if both parents are eligible). Going forward dependent benefits will only be available when the eligible parent is collecting benefits except if the parent filed and suspended on or before 05/01/2016. This is probably the most important date in my view.

Rules That Didn't Change

No changes to survivor benefit rules. Thank god.

No changes to delayed retirement credit. The supposedly risk free 8% annual increase to delayed benefits is still available. Coupled with the compounding effect of COLA (Cost of Living Adjustment), it's a very useful option for people who're likely to live longer.

The Social Security Maximizer™ software has been upgraded to handle these changes.

Take Aways

Prepare a Social Security Plan and Review It Periodically

The Social Security remains a complex system and will remain a complex system because it has to cater to people with varying needs and circumstances. The unfortunate reality is that with so many complexities, it is difficult to adequately train the entire staff of The Social Security Administration. A question that often comes up is if someone hasn't started taking Social Security benefits, how frequently should he review this plan. The answer is at least once a year. There are several reasons for that. One, for each year live, your life expectancy changes according to IRS tables. This plays an important role. The Social Security Administration calculates your Social Security benefits on an annual basis. That changes your benefits projection. Certain Social Security rules may also change from year to year. Additionally, your personal and financial situation may also change over the course of a year.

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A 20-year veteran of the financial services, Dinesh has broad and deep experience in financial planning and investment management technologies.

He founded GoWealthPro to help financial advisers efficiently produce meaningful and actionable financial plans. He has pioneereed several ground breaking concepts e.g. Personal Financial Index® for wealth neutral financial health benchmark, lifetime healthcare cost estimation, Social Security maximization, and life-stage based financial planning. He is also a Certfied Financial Planner® and has helped thousands of financial advisers and corporate employers to effectively educate and empower a large number of people. He also worked at Fidelity Investments for 13 years. He has spoken at numerous financial services conferences and authored/co-authored a number of articles on personal finance, retirement planning, Social Security, investments, and the role of technology in financial services. He can be reached at dinesh.sharma@gowealthpro.com.