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When to Cash in on Social Security

Dear Client,

Clients approaching retirement age must decide whether to begin taking reduced social security benefits early, wait until full retirement age, or delay benefits to earn a higher monthly payment.

Social security retirement benefits are calculated by reference to the Primary Insurance Amount (PIA), which is based on an individual's taxable earnings averaged over the worker's lifetime. Although a fully insured individual is eligible for retirement benefits beginning at age 62, they must reach Full Retirement Age (FRA) to receive their full PIA. Individuals taking social security benefits before their FRA will receive a reduced percentage of the PIA. On the other hand, an individual will earn an increased percentage of the PIA by delaying the start of benefits to as late as age 70.

Since the calculation is complicated and many of the factors change each year, the most practical way to estimate your PIA may be to use the SSA's projection. You can obtain an estimate of your future benefits by creating and logging into your personal my Social Security account on the Social Security Administration website here: https://www.ssa.gov/prepare/get-benefits-estimate.

A fully insured individual can start receiving social security retirement benefits at any time between age 62 and full retirement age. However, if benefits start at an early age, they are permanently reduced a fraction of 1% for each month before the individual's full retirement age. Individuals who start receiving benefits early have one year to reverse their decision by completing Form SSA-521 and sending it to the local Social Security office. This allows them to qualify for the higher benefit at full retirement age, but the worker must repay any funds already received, including any Medicare premiums that were withheld from the social security benefits.

Workers who reach their full retirement age but choose to postpone receiving their benefits, earn a delayed retirement credit of 8% per year or 2/3 of 1% per month, until age 70. After beginning to receive social security retirement benefits, a worker who has reached full retirement age can earn the delayed retirement credit for any month that suspension of benefits is requested, until age 70.

The client's life expectancy, as well as the spouse's (if applicable), may be the biggest factor in determining the starting date for social security benefits Those with a shorter life expectancy might be wise to start receiving benefits as soon as they can because they may not receive them for very long. On the other hand, a client with a longer life expectancy may want to postpone taking benefits to shorten the length of their retirement or increase their monthly benefit. Northwestern Mutual Life Insurance Co. has a helpful online lifespan calculator, available at https://media.nmfn.com/tnetwork/lifespan/index.html#0, that considers such factors as weight, exercise, diet, family history, current age, etc.

The break-even point for receiving benefit varies. Example: Age 62 versus full retirement age. Ken is single and plans to begin receiving social security benefits on his 62nd birthday in 2025 when his PIA is $2,000. Therefore, he will receive monthly social security retirement benefits of 70% of his PIA, or $1,400. When he reaches age 67 (his full retirement age), he will have received 60 benefit checks of $1,400 each (not considering annual inflation adjustments), a total of $84,000. If he waited until age 67 to begin receiving benefits, his monthly benefit would be $2,000, so it would take nearly 12 years before the additional $600 per month ($2,000 - $1,400) benefit equaled the $84,000 he would have

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received between ages 62 and 67 ($84,000 / 600 = 140 months or 11 years and eight months). If Ken waits until age 67 to start taking his benefits, he will break even at around age 79 (age 67 + 12 years).

On the other hand, clients in a better financial situation may have the luxury of choosing whether to retire and take benefits early or to wait and allow their benefits to increase. If the present value of future social security benefits is considered, it is generally more favorable to start the benefits as soon as possible (if the money will be invested). However, if the client is simply using early social security benefits to replace a similar amount of earned income, waiting may be the better option.

Another factor to consider is the potential tax cost. For instance, a retiree taking the smaller early social security retirement benefit may need to draw on other resources to meet expenses. If the additional income exceeds the provisional income thresholds, 50% or even 85% of the social security benefits will be taxable. Over time, the percentages of retirees who pay tax on their social security benefits has been steadily increasing because the income thresholds aren't indexed for inflation.

Because the PIA is calculated using an individual's highest 35 years of indexed earnings, a client can increase their PIA by working longer to replace lower-wage years early in their career with higher-wage years after age 62. This generates a greater retirement benefit for the retiree as well as a larger spousal and survivor benefit. (Keep in mind that social security wages are capped at $176,100 in 2025.)

The full retirement benefit for a spouse generally is 50% of the retired worker's PIA, and spousal benefits can't be claimed unless the worker is already drawing their own benefits. A retiree spouse who qualifies for social security benefits based on their own earnings record is entitled to receive their own retirement benefits, if greater.

Because spousal benefits are 50% of the worker's PIA, even if the worker retires early and receives a reduced benefit, the spouse's benefit is 50% of the worker's full PIA, rather than 50% of the worker's reduced benefit. However, if the spouse claims benefits before reaching their own full retirement age, the amount of the spouse's benefit is reduced based on their birthdate.

The SSA has a number of free calculators to assist in determining estimated benefits, which can be found on the SSA website here: https://www.ssa.gov/OACT/anypia/index.html . The tools can provide results for different retirement ages, and you can also enter expected future earnings to estimate the increased benefit.

If you have questions or want help deciding the best strategy for your situation, don’t hesitate to reach out and give us a call.

Yours truly,

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