To Defer or Not to Defer: Considering Your Spouse in Planning Social Security Benefits

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An arduous decision facing persons considering retirement is when to start collecting Social Security benefits. In planning to maximize Social Security benefits, oftentimes the right decision comes down to whether you will outlive your life expectancy. People can elect to start collecting Social Security benefits as early as age 62, wait until full retirement at age 66, or defer the election until age 70. The longer one waits to start collecting Social Security benefits, the greater the monthly benefits. Those who start collecting benefits at age 62 will receive a 25 percent reduction in benefits, while those who wait until after age 66 will receive 100 percent of their benefits. Those who wait an additional four years will receive 132 percent of their benefits (an 8 percent increase of benefits each year they defer the election up to age 70).

Most tax planning software, including the Social Security online calculator, is based on a recipient's own benefits. However, the impact of one's spousal benefits, which is often overlooked, can be an integral component of this decision. Consider the following cases, one that includes just the Social Security benefit recipient, one that includes the Social Security benefit recipient and spouse, and another that includes claiming spousal benefits under the file-and-suspend strategy.

Case 1 – Individual Analysis

Assume the Social Security beneficiary is a male, approaching age 66, who has earned the current maximum Social Security benefit at full retirement age (66) of $2,533 per month. He is considering whether he should wait until age 70 to begin receiving benefits to receive the maximum benefits of $3,350 per month. The breakeven analysis in Exhibit I[1] reports that one would need to live 12.4 years beyond the election age of 70. Therefore, to benefit from deferring benefits until age 70, the beneficiary would have to live longer than 82 years and 5 months.

Exhibit I – Individual Analysis (without Spouse)

Male, age 66 (full retirement age)

Monthly benefit at age 66 = $2,533
Monthly benefit at age 70 = $3,350
Annual benefit at age 66 = $2,533 x 12 months = $30,396
Annual benefit at age 70 = $3,350 x 12 months = $40,200

Benefits of beginning at age 66 = Benefits of beginning at age 70

Let Y equal breakeven in years from age 70:
$30,396 (Y + 4 years) = $40,200Y
Solving for Y:
Y = 12.4 years

According to the online Social Security calculator, a male has a life expectancy of 84.4 years or 18.4 years beyond the full retirement age of age 66. On average, it would appear that deferring benefits until age 70 would be the recommended course of action. However, factors such as one's health, economic circumstances, desire to retire early or opinion of the financial soundness of the Social Security system may favor electing benefits at the full retirement age of 66. Either way, life expectancy plays a major role in making the decision.

Case 2 – Analysis with Spouse

The age of a spouse is another important factor that should be considered when an individual is deciding whether to elect Social Security benefits. Couples can increase their Social Security income by coordinating their benefits. A spouse can receive up to half of the electing spouse's Social Security benefits if the spouse is age 66 (full retirement age) or a reduced benefit if between age 62 and 66. A couple's combined Social Security benefits can be greater if the electing spouse defers benefits until age 70 and the spouse is at least age 66 (full retirement age). Accordingly, if a couple is aiming to maximize Social Security income, the age of the spouse can influence the age at which an individual elects Social Security benefits.

Assume that the individual in our above example is married and his female spouse is exactly four years younger, age 62 (to eliminate the need for monthly adjustments to the calculations). Furthermore, assume that the spouse has earned no Social Security benefits of her own. If the husband opted to receive Social Security benefits at age 66, he would again receive $2,533 per month. The female spouse could begin to collect at the same time, normally one half of the spouse's monthly benefit. However, because she would start collecting benefits early at age 62, she would only receive approximately 35 percent of the spouse's benefit or $887 per month; i.e., 35 percent times $2,533. If both spouses would wait four more years to begin receiving benefits at ages 70 and 66 respectively, they could increase their combined monthly income approximately 35 percent. The husband would receive $3,350 per month and the spouse, now having reached full retirement age of 66, would experience no reduction. However, the amount of the spousal benefit would be based on the full retirement age benefit of the electing spouse; i.e., one-half of $2,533 or $1,267 per month.

The breakeven analysis in Exhibit II reports that one would need to live 11.43 years beyond the election age of 70. In other words, to

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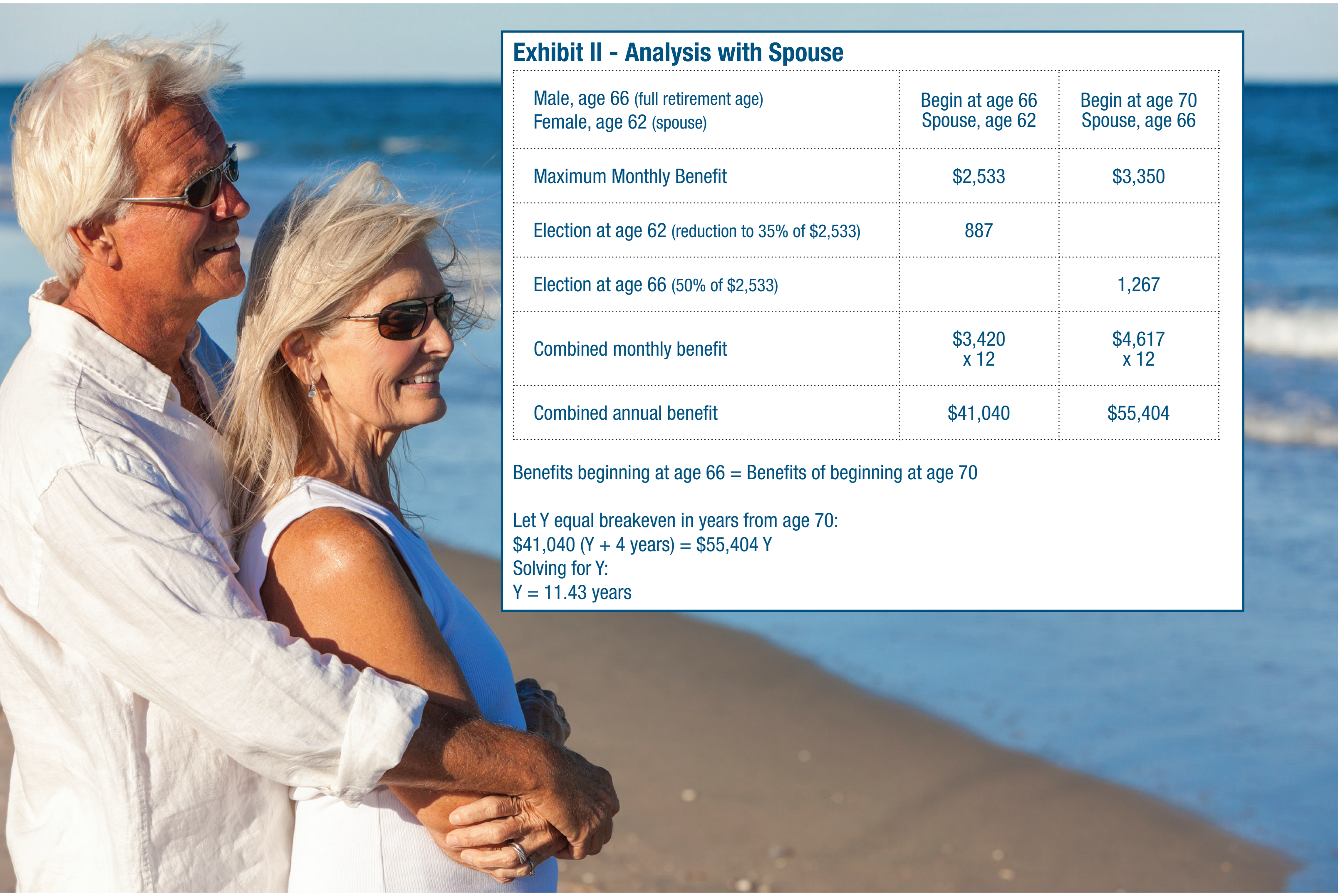

Exhibit II - Analysis with Spouse

Male, age 66 (full retirement age) Female, age 62 (spouse)	Begin at age 66 Spouse, age 62	Begin at age 70 Spouse, age 66
Maximum Monthly Benefit	$2,533	$3,350
Election at age 62 (reduction to 35% of $2,533)	887	
Election at age 66 (50% of $2,533)		1,267
Combined monthly benefit	$3,420 x 12	$4,617 x 12
Combined annual benefit	$41,040	$55,404

Benefits beginning at age 66 = Benefits of beginning at age 70

Let Y equal breakeven in years from age 70:
$41,040 (Y + 4 years) = $55,404 Y
Solving for Y:
Y = 11.43 years

benefit from deferring benefits until age 70, the beneficiary would have to live longer than 81 years and five months.[2] Including the spouse in the calculation will result in approximately a one-year decrease in the breakeven point. Furthermore, the deferral to age 70 can result in an increase of almost $1,200 monthly and over $14,000 per year. Given that a male age 66 has a life expectancy of 84.4 years (or 18.4 years of additional life expectancy from age 66), it would appear that deferring benefits until age 70 would be the recommended course of action. Most importantly, since the life expectancy of women is greater than men, should the wife outlive her husband, his deferring benefits until age 70 allows her monthly benefit to be stepped up to his monthly benefit of $3,350 (rather than $2,533 per month) for the rest of her life. Again, the health of both spouses, the benefit of having the money earlier when one is younger, the time value of money, and one's opinion as to the financial soundness of the Social Security system may favor taking the benefits at age 66, full retirement age.

When deciding whether to elect Social Security benefits at an earlier age or defer until full retirement age, couples also should consider factors such as their health, economic circumstances, other sources of income, etc.

Case 3 – Analysis with File-and-Suspend Strategy

Spousal benefits can start when both spouses are at least age 66. However, couples may be able to maximize their Social Security benefits by using the file-and-suspend strategy. Following this strategy, one spouse elects to receive benefits at age 66 and the other spouse files and immediately suspends their benefits until age 70. By the younger spouse waiting until age 66 to collect spousal benefits, they can collect the maximum 50 percent of their spouse's age 66 benefit. At age 70, the younger spouse would switch to their own benefit. This strategy allows the younger spouse to collect 50 percent of their spouse's age 66 benefit while both spouses' benefits continue to increase 8 percent each year (until the maximum benefit at age 70). Upon reaching age 70, they would both collect their own maximum benefit (132 percent). Therefore, to maximize lifetime Social Security benefits, couples should also consider coordinating their benefits under the file-and-suspend strategy.[3]

Assume that both individuals have earned Social Security benefits of their own and they live to age 90. Further, assume that the husband was born on Jan. 1, 1949, and his wife was born on Jan. 1, 1950. Accordingly, the husband's benefit would be $2,500 at age 66 and $3,300 at age 70. The spouse's benefits would be $1,750 at age 66

Exhibit III – Comparison of Lifetime Benefits

Strategy	Cumulative Benefits to Age 90
File-and-Suspend Strategy	$ 1,423,890
Both Spouses Begin Collecting at Age 70	$ 1,363,890
Both Spouses Begin Collecting at Age 66	$ 1,237,250
Both Spouses Begin Collecting Immediately (next month at ages 65 and 7 months, and 64 and 7 months)	$ 1,209,634

and $2,310 at age 70. The application process would consist of the following:[4]

- The husband files and suspends benefits based on his earnings record in December 2015 at age 67, which makes his spouse eligible for spousal benefits at age 66.
- The wife files a restricted application for spousal benefits only in the estimated amount of $1,250 in December 2015 at age 66.
- The husband begins benefits based on his earnings record in the estimated amount of $3,300 in December 2018 at age 70.
- The wife switches to benefits based on her earnings record in the estimated amount of $2,310 in December 2019 at age 70.
- In January 2039, the wife switches to survivor benefits, after the husband passes at age 90, in the estimated amount of $3,300.

Based on the above process, by the seventh year, annual benefits will be higher than if they both started collecting benefits immediately. By year seven, they will collect $67,320 per year as compared to benefits received if filing immediately, which would be $48,182.

The breakeven point would be 13 years from when they start collecting benefits (i.e., 65 years and seven months and 64 years and seven months). The maximum cumulative shortfall is in Year 4 and totals $167,271. In Year 5, the shortfall begins to decline until the breakeven point is reached. Starting in Year 14, the cumulative excess benefits begin to accumulate. Using the file-and-suspend strategy, if both spouses die at age 90, they will have collected $214,256 more than if they started collecting immediately. Exhibit III compares the cumulative benefits collected based on the file-and-suspend strategy and typical Social Security election ages.

The area of Social Security benefits, like any other area of financial planning, requires financial planners to take into account both spouses when giving advice to married couples. In fact, due to a system of interdependent benefits for married couples under the Social Security system, it is even more important to include both spouses when providing financial advice.

This planning also should be considered for same-sex couples. While laws have not been finalized regarding Social Security benefits for same-sex couples, those who believe they are eligible are encouraged to file claims right away to preserve their filing date. Once laws are finalized, eligible Social Security benefits will be retroactive to the filing date.

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Footnotes

1. The time value of money and possible higher income taxes in later years have been ignored to prevent overly complicating this article. It is unlikely that the time value of money on a short period of time will have a significant impact on the above outcome.
2. It is assumed that the primary beneficiary's spouse also lives longer than the same 11.43 years.
3. Individuals and practitioners should be aware that this strategy is under review. The Budget of the United States Government, Fiscal Year 2015 "proposes to eliminate aggressive Social Security claiming strategies, which allow upper-income beneficiaries to manipulate the timing of collection of Social Security benefits in order to maximize delayed retirement credits" (page 150).
4. Individuals should be sure to apply for benefits approximately three months before they expect to receive their first payment.