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Social Security’s Role in the Advice You Provide

How does Social Security fit into your client’s financial plan?

By C.W. Copeland, Ph.D.

If Social Security is going to be a part of your client’s income stream in retirement, shouldn’t you understand how it works? Although we casually know it as Social Security benefits, it is formally called the Old-age, Survivors and Disability Insurance (OASDI) program. Since its inception in 1935, OASDI has focused on providing a basic level of monthly income to workers (and their families) as a result of achieving a certain level of credits. Many naysayers question the viability of the program, suggesting it will run out of money in 2035. There may be some cause for this level of concern. Statistics show...
us that, while in 1945 there were 50 workers contributing for every one person receiving benefits, today only three workers contribute for every one person receiving benefits—and projections suggest that in 2030 only two workers will be contributing for every one person who receives benefits. According to the Social Security Administration (Social Security Bulletin, Vol. 70, No. 3, 2010), over 50 million people currently receive benefits through the payroll taxes paid by 150 million workers and their employers.

In general, money is allocated in the form of payroll taxes from a worker’s salary to meet Federal Insurance Contributions Act (FICA) mandates. There is a 6.2-percent Social Security payroll tax up to the taxable wage base; both the employer and employee pay this tax. In fact, for those fortunate enough, the first $118,500 of income — known as the taxable wage base — is subject to taxes specifically toward Social Security. There is also a 1.45-percent FICA tax specifically toward Medicare on all income. (Note: There is no taxable-earnings limit for monies allocated toward Medicare.) There is a 12.4-percent Social Security self-employment tax (also known as SECA tax) up to the taxable wage base; half of the tax is deductible from income.

**BENEFITS**

Social Security benefits can be lumped into three main categories: retiree, survivor and disability. As an advisor, you should understand that all three are relevant because your clients have entrusted you to assist them in reaching their goals.

1. **Retiree.** Benefits are paid to retirees as early as age 62; however, there is a cost to receiving benefits “early” in the form of a reduction in benefits (e.g., 25 percent less). Assuming one meets the minimum criterion of quarters worked, full benefits are payable at the full-retirement age (i.e., 66, 67, …, 70). Deferring benefits has its advantages. Waiting to age 70 to receive benefits could create a payment increase of as much as 8 percent per year.

2. **Survivor.** Benefits are also paid to the survivors of workers who have qualified for Social Security benefits. The widow(er) of a retired worker can receive as much as 100 percent of his or her deceased spouse’s benefit amount if the widow(er) has reached his or her full retirement age. Payments are a little less if he or she is under his or her full retirement age. A widow(er) can receive 75 percent of his or her deceased spouse’s benefit, no matter the widow(er)’s age, if he or she is caring for a child under age 16; and children under age 18 also are eligible for 75 percent of their deceased parent’s benefit. It is critical to the widow(er) that he or she communicate with the Social Security Administration to confirm whether his or her benefit or that of his or her deceased spouse is higher.

3. **Disability.** Disabled workers are eligible for Social Security benefits; however, it shouldn’t be their first choice of recourse due to a number of restrictions, including a five-month waiting period. Benefits typically would not be available if the worker could do any type of work. Benefits could be available, though, if the prognosis for the disability is 12 months or resulting in death.
WHAT STRATEGIES CAN YOU SUGGEST TO YOUR CLIENTS?

While strategies such as working longer (either full time or part time), spending less and downsizing are ways to increase your clients’ resources in retirement, one of the most effective is deferring Social Security benefits. Because Social Security comprises a considerable amount of the average American’s retirement income, it is important to understand its impact on their budget over time. Consider the following replacement rate example using the Social Security Administration’s Quick Calculator:

A couple, both earning $60,000 per year, decide to defer their benefits while continuing to work full time:

- At age 62, Social Security replaces 23 percent of pre-retirement earnings.
- At age 66, Social Security replaces 32 percent of pre-retirement earnings.
- At age 70, Social Security replaces 45 percent of pre-retirement earnings.

One of the most important strategies to consider for a married couple is the timing of receipt of the retiree benefits. This is important whether both are eligible to receive Social Security benefits or if only one is eligible. If only one person is eligible to receive benefits, we would consider the “spousal” benefit approach. It must be noted that the spousal benefit cannot begin until the worker claims benefits. At full retirement age, a worker can claim benefits to start the spousal benefit and then suspend his or her own benefit until age 70 to maximize the benefit (as shown above). If both the spouses are entitled to a worker’s benefit, the worker with the lower benefit claims worker’s benefits. At full retirement age, the worker with the higher benefit elects the spousal benefit. Then, at age 70, he or she switches to the higher worker’s benefit. As an example, John and Nina are 66 and 64, respectively. Assuming that Nina makes less money, she chooses to begin her worker’s benefit while John chooses to suspend his benefit and claim the spousal benefit. When John turns 70, he can then claim his own benefit, which happens to be higher, and receive more income per month.

In the event your client has gone through a divorce (and had been married for 10 years), he or she can also employ the spousal benefit strategy by electing his or her benefits at full retirement age (assuming the client’s benefit was less) and, at age 70, switch to the maximum worker’s benefit (i.e., that of the client’s former spouse).

In the event your client is left a widow(er), note that the advice you provided prior to the death of his or her spouse can also have a significant impact on his or her ongoing benefits. A simple way to look at this is that the surviving spouse receives the higher of the couple’s two Social Security retirement benefits. When the spouse with the higher Social Security lifetime benefit has a short life expectancy, the surviving spouse will inherit the benefit. So, if benefits were claimed early, the surviving spouse is saddled with the lower benefit for the rest of his or her lifetime.

WHY SHOULD YOU CARE?

Advisors should become very knowledgeable about the requirements for Social Security benefits because the advice they provide can hinge heavily on whether the client’s resources are sufficient without Social Security benefits. If those resources are inadequate, careful consideration must be given to how Social Security benefits can supplement existing resources or, in some cases, be the main benefit available. The conscientious advisor should also focus on some of the risk his or her clients are bound to face. One mitigating risk is longevity. It is a simple fact that people are living longer, and a solid plan consists of advice to combat this risk — such as an annuitized income stream like Social Security. Another risk worth focusing on is inflationary risk. Because clients are living longer, it is highly likely their buying power will be eroded over time. One of the positive features of the Social Security program is that it has a cost of living adjustment (COLA). As a matter of fact, the Social Security Administration has stated that recipients will receive a 1.7-percent COLA for 2015.