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4 Ways to Leverage the Social Security Conversation

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In late 2015, two of the most touted Social Security claiming strategies for improving lifetime benefits came to what appeared to be a screeching halt. In fact, many thought the legislation to gradually eliminate both file and suspend and the restricted application strategies was inconspicuously added to the pages of the Bipartisan Budget Act to avoid descension, particularly among those financial professionals and consumers who understood the potential magnitude of incorporating the strategies on overall Social Security income. After a short grandfather period, permitting last minute eligible opportunists to affirmatively elect the file and suspend strategy by April 29, 2016, many financial professionals adopted the belief that leveraging Social Security to enhance retirement income was essentially a thing of the past[1]. Time and again, the same conversations happen: "With the elimination of these strategies, it's just a matter of filing for the benefit when it makes most sense to the client" or "There's no magic formula anymore. It is pretty straight forward." Sounds familiar, right?

The problem is those statements may not be true. In fact, if you aren't leveraging the conversation about Social Security when helping your clients and prospects navigate their retirement income strategy, you may be missing an opportunity.

By asking the right questions and recognizing potential pitfalls, you are building your credibility with your clients. Credibility, as we all know, leads to greater transparency and willingness to let the proverbial walls down. Let's face it; a conversation about when to file for Social Security by itself isn't a sales opportunity for you. However, if you can begin to think about the Social Security conversation as a means to provide even greater value to your clients, while recognizing the intricate dance it plays with other sources of retirement income, you will begin to see how identifying certain factors may change the conversation into one that demands a holistic approach to the claiming decision. This, in turn, requires the client to be open with you about other facets of their overall retirement strategy.

Before we dive further into ways to leverage the Social Security discussion, let's start by talking about what hasn't changed. Almost 90 percent of retirees, age 65 or older, receive Social Security benefits. In 2018 alone, 63 million Americans will receive one trillion dollars in Social Security benefits. Further, among married couples, 50 percent of them rely on Social Security for 50 percent of their income and, for unmarried persons, that number rises to 71 percent relying on it for at least half of their income[2]. This is not new information.

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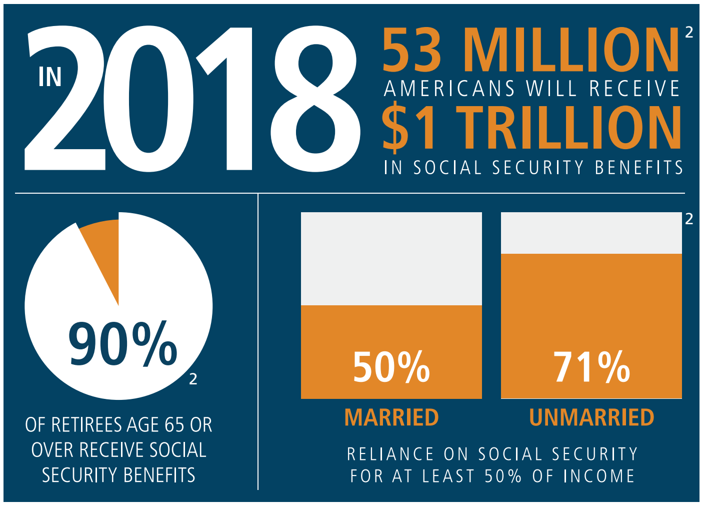

These statistics have remained relatively stable for years. However, these statistics lend credence to the idea that the claiming age decision is an important one.

In addition to a large percentage of the population relying on Social Security for retirement income, Americans are living longer. As longevity increases, so does the number of years some retirees may need to rely on Social Security for income.

Understanding the importance of longevity and how it relates to the claiming age is key to helping your clients know when to start taking their Social Security benefits—especially since for some, this is the only source of income that they might expect to receive for as long as they live.

Or is it? Yes, you know that there are other options to provide a pension-like source of income and therein lies a value that you can provide, but often your challenge is to make those other retirement assets last for the duration and at a level that supports the income need. Social Security should be viewed much like the decision surrounding which payout option to take from a pension. This typically requires thought and consideration of the pros and cons of the various distribution options, doesn't it? Deciding when to file for Social Security is no different! The greater care that is taken to get the most out of Social Security in the most tax efficient way possible, means less strain on the other assets earmarked for retirement. With this, the marriage between when to file for Social Security benefits within the greater scheme of building a retirement income strategy begins.

Now, let's get to the heart of the matter. The intention of the next few pages isn't to throw Social Security rules at you like water out of a fire hose. Yes, you can breathe a sigh of a relief. Let's uncover some nuggets of Social Security wisdom that will bring even greater value to your clients.

#1 The Restricted Application Strategy

As previously mentioned, there is a belief among many that the elimination of file and suspend and restricted application vanished simultaneously. In other words, if you didn't put your ticket in the hat by April 29, 2016, you had no "strategies" left to employ. Considering this common misconception, let's clarify what actually did happen. Yes, file and suspend, a strategy widely used before its expiration, to allow a higher wage earner to file and immediately suspend benefits so that a spouse or other dependent could file for benefits under the suspended record, was eliminated as of April 30, 2016. The benefit was twofold: the higher wage earner could continue to accrue delayed retirement credits during the suspension period, while also allowing a spouse or dependent to collect benefits under the record of the suspender. Now, in order for a spouse or other dependent to collect benefits from the higher wage earner's record, that person must file for their benefit.

Let's switch gears and talk about the restricted application strategy. This strategy is still alive and well for those who were born before January 2, 1954[3]. Write this date down and immediately start sorting your client list into those born before it! Here's a quick tutorial on what the strategy even entails, because the two strategies are often confused. A restricted application allows an individual, who is dually entitled to both their own retirement benefit and a spousal benefit (or ex-spousal), to file for the spousal benefit first, while deferring their own benefit until later, thus allowing their own benefit to earn delayed retirement credits of up to 8 percent per year up to age 70. There are two requirements, other than age, that must be met for this strategy to work. First, the restricted filer must wait until their full retirement age (FRA) before filing restricted. Second, the person on whose record they wish to file, must have already filed for benefits (or suspended by the April 29, 2016 deadline).

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Here's a hypthetical example:

Jack and Emily Jones are both 65 (born in 1953) and are considering filing for benefits when they reach their full retirement age of 66. Jack's benefit is $2,600 per month and Emily's is $2,000. They both are healthy and expect to live to at least age 85. Assuming zero percent COLA, the cumulative lifetime benefits, if they both file at age 66, would be $1,067,520. However, if Emily files for her benefit at age 66 and Jack instead files restricted for 50 percent of Emily's Primary Insurance Amount, or $1,000, their cumulative lifetime benefits would increase by $73,920! By having Emily file for her benefit, so that Jack could file restricted, Jack is able to switch over to his maximum benefit of $3,432 at age 70. So, why wouldn't we have Jack file so that Emily could file restricted and get a greater spousal benefit of $1,300 you ask? Remember, this is a carefully crafted dance. By having Jack file restricted for the smaller spousal benefit of $1,000, Jack's own retirement benefit, which is greater than Emily's, will reach its maximum at age 70. By allowing Jack's higher benefit to earn delayed retirement credits, they have secured a higher benefit to the survivor.

The point is not to forget about or discount the income enhancing benefits of this strategy. Seek out clients and prospects that could potentially take advantage of this strategy. There is a good chance they don't even know the opportunity exists. It may just be the solution to solving for a smaller income gap over time for those able to employ it.

#2 The Disparity in Income Conversation

How often do you encounter married clients that have a disparity in their estimated Social Security benefits? It happens quite often, right? The estimated income benefits, besides the age of the client(s), is virtually the first thing to hone in on when determining which direction the conversation should go. Why? Because most consumers have little to no knowledge of how their own claiming age decision can have long-lasting effects on the income of the surviving spouse. Worse yet, when they think about the "breakeven," many times they are only thinking about the breakeven from a single life point of view.

Let's pick up with our hypothetical example of Jack and Emily Jones for a moment. Suppose Jack has the same $2,600 FRA benefit that we mentioned earlier, but that Emily's benefit is $1,250. Let's also assume that Jack is concerned about not living much past 75, so he thinks his best bet is to file now to get the most of his Social Security benefits while he is alive. Seems reasonable, right? Obviously, none of us have a crystal ball. Even if we assume that Jack dies at 75, his decision to file early would be a winner if he were single and, therefore, didn't have to worry about survivor benefits for Emily. Now is the opportunity to point out what may seem obvious to you, but often isn't with consumers trying to navigate the best claiming decision. The higher of the two earners in a married couple situation needs to understand that his/her claiming age decision impacts the income left to the survivor.

Fast-forward to when Jack passes away. Emily effectively loses her own benefit and it is replaced with Jack's, since it is the higher of the two. Yes, it is higher than what she was collecting before, but her Social Security survivor income is far less than what they received collectively. In fact, the breakeven, assuming Jack only lives to age 75, would only require Emily to live to age 80 for it to make far greater sense for Jack to file restricted on Emily's benefit and switch to his own at age 70.

The point of this example is to encourage you to expand the conversation surrounding the claiming age decision. If the clients already have a claiming age in mind, it's even better. Why? Because this leads to a dialogue, which leads to an opportunity! Always remember, your clients don't know what they don't know. The whole "when should I file for Social Security?" question is complicated enough without thinking about the "what ifs" down the road. Don't tell the clients that their thinking is wrong, but use it as an opportunity to compare strategies. Engage them by discussing the risks and the rewards of each. Empower them to make an informed decision! And, perhaps, suggest an alternative to fill the income gap, so that Jack feels more comfortable with holding out for a larger Social Security benefit to ensure that Emily is taken care of upon his death.

Inevitably, you are going to have clients who want to file for benefits the moment they retire even if, given their unique circumstances, it doesn't make

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mathematical sense. Obviously, there's more than just a hint of emotion that charges this decision for many. So, encourage the couple to consider having the person with the smaller benefit file first. Perhaps just getting some income will soothe the need for collecting both benefits, particularly if you can offer a solution to fill the income gap with another source of funds. Holding out on collecting the higher wage earner's benefit for as long as possible will at least allow for greater survivor income later.

#3 The Effect of Income Taxes on the Benefit

Informing your prospects and clients about the potential role that taxes can play on the net income received from Social Security is one that some of you may have been met with complete surprise (maybe even bordering on shock) from clients. Many retirees, or near retirees, have a hard time understanding, and rightfully so perhaps, that a benefit they earned by paying into the system for many years shouldn't be taxed on the way out. Many of your clients who may have saved in preparation for retirement might encounter this tax, merely because they were planners and want to live on more than Social Security in their golden years.

Let's review briefly the rules surrounding taxation of benefits. The first component in figuring out the impact taxes might play on the benefit is something called "combined income."

Adjusted Gross Income
+ Nontaxable Interest
+ 1/2 of Social Security Benefits Received

= Combined Income

Once the combined income is determined (note that this is based upon the household's income, not just the benefit recipient's), then it is compared to the income thresholds displayed here[4].

Single Filers:
Combined Income < $25,000
Benefit not subject to taxes

Combined Income $25,000 – $34,000
As much as 50% of benefit subject to taxes

Combined Income > $34,000
As much as 85% of benefit subject to taxes

Married Filers:
Combined Income < $32,000
Benefit not subject to taxes

Combined Income $32,000 – $44,000
As much as 50% of benefit subject to taxes

Combined Income > $44,000
As much as 85% of benefit subject to taxes

Married Filing Separately Filers
Will likely pay taxes on benefits received

Notice that it doesn't take an amount of income to push someone into the taxable category, particularly since part of the combined income calculation includes ½ of the Social Security benefits received! Your average client may have the bulk of their savings in their employer-sponsored retirement plan or IRA, or may have retired and wants to begin collecting their Social Security benefit while their spouse is still working. Do you see a potential problem yet? Oftentimes, consumers just think of the gross benefit that they may receive, based upon their Social Security estimates (minus Medicare premiums, which they usually anticipate), but never even consider that their other income sources could substantially reduce the net income benefit.

Here's another hypothetical example: Suppose you meet with a married couple. He is 65 and earning

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$80,000 per year and she has recently retired at 62 and is ready to run (not walk) down to the local SSA office to file for her benefit. Suppose her estimated benefit is $1,950 at age 66. For starters, her benefit at 62 will be 25 percent less or $1,462.50, since she is collecting it four years prior to her FRA. Let's consider the impact of taxes on the benefit. The couple's combined income is:

$80,000	**His Earnings**
$0	**Nontaxable Interest**
$8,775	**1/2 of Her Annual Social Security Benefit**
$88,775	

This figure far exceeds the highest threshold of $44,000, so now as much as 85 percent of her benefit, or $15,087.50, is subject to ordinary income tax. Is this the best solution? Maybe not. Opening the dialogue and informing the client on the very real impact of taxes on an already reduced benefit, since she plans to collect it early, might lend itself to a better solution. This kind of knowledge helps take the conversation to an entirely different level.

When you're working on a retirement income planning strategy for someone who is in their mid-to-late 50s, you should be excited. Why? Because there's still TIME! Perhaps by looking at the makeup and tax class of their retirement assets, you can devise a plan that not only meets the needs and wants of the client, but also does it in a more tax efficient way.

Roth conversions are one of the best ways to tax diversify qualified plans and IRAs. Serial conversions (smaller conversions over several years, if possible) help mitigate the tax risk in retirement, and the fact that Roth IRAs are not subject to lifetime RMDs, like their Traditional IRA counterparts, is a bonus! Having a conversation as a precursor to the Social Security discussion that highlights the benefits of Roth IRAs and life insurance as sources of tax-free income during retirement can be a game changer on how the Social Security benefit itself is impacted by taxes down the road. Keep in mind that the ability to recharacterize a conversion was eliminated as of January 1, 2018, so making certain that the client has first consulted with their tax advisor is important before moving forward with the conversion[5].

#4 Ancillary Benefits

Imagine the delight your client or prospect would have if your fact-finding conversation uncovered an untapped benefit to which your client never knew that he/she was entitled. There could be any number of benefits that fall into this category, whether it be spousal, ex-spousal, dependent, caregiver, survivor and even survivor benefits from an ex-spouse. Yes, an ex-spouse. That is why knowing which questions to ask is important to ensuring that you are helping your client navigate the claiming decision in an informed way. To see the eligibility requirements for each of these benefits, print out and use the new consumer facing Social Security and Retirement Income Questionnaire. The questionnaire helps guide the consumer through the questions that uncover any potential benefits to which he/she may be entitled, other than the client's own retirement benefit. If you discover that the responses warrant a closer look to make sure that no stone is left uncovered, reach out to your marketer to get the conversation started.

Here are a couple of hypothetical examples of benefits and/or strategies that sometimes get overlooked when it comes to ancillary benefits:

1. Susan was married twice and is now unmarried and has a marginal retirement benefit of $1,000 at her FRA after staying home to care for her family for many years. She met the requisite 10 years of marriage requirement for both marriages. Both of her ex-husbands are over the age of 62. The second husband was a bongo player on the beach, so his retirement benefit is nothing to write home about, at a mere $750. But the first husband had a long career and his benefit is estimated to be $2,700 at his FRA. Susan can cherry pick the benefit that will reap the greater reward for her. Since 50 percent of husband #1's benefit is greater than her own $1,000, she can collect the higher benefit, even if he is re-married and his new wife is also collecting a benefit!

2. Tom passed away at the age of 68. At the time, his benefit was $2,450 per month. His widow, Mary, is 65 at the time of his passing. Her retirement benefit, which she hasn't yet collected,

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is estimated to be $2,100 at her FRA of 66. To leverage the most income from both benefits, Mary could restrict her filing to Tom's survivor benefit first and then switch over to her own greater benefit at age 70. At that point, her benefit would be worth $2,772. Incidentally, the ability to coordinate survivor benefits with one's own, by taking the smaller benefit first and waiting to take the other when it reaches its maximum, was left unchanged by the legislation back in 2015 that put grandfathering requirements on file and suspend and restricted application. When you encounter these situations, speak with someone who is well-versed on Social Security planning to make certain that your client or prospect is optimizing the benefits to which he/she is entitled.

In Conclusion

The point of this exercise is not to leave you with the notion that you need to know everyting about Social Security. That couldn't be further from the truth. Your clients lean on you to provide perspective that they sometimes don't have the tools to provide themselves. The mere fact that you can recognize potential pitfalls with a plan that they have in place (or are considering) allows you to help them make informed decisions. It also naturally progresses into providing your clients with a better appreciation for the fact that Social Security planning shouldn't be done in a vacuum. As we've just seen, there are unique factors and circumstances that near-retirees face as they approach retirement. No one answer fits every situation. If they ever encounter someone who gives them a pat answer on when to file for Social Security, there may be cause for concern. Having you in their corner to help them navigate the road to retirement is one that will be well worth the travel not only your client, but for you as well.

If you have questions, or need help talking through a case that you are currently working on, reach out to your marketer and we can walk through the details together.

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Sources:
[1]*Social Security Administration – Benefits Planner: Voluntary Suspension FAQs, 2018.*
[2]*Social Security Administration- 2018 Fact Sheet.*
[3]*Social Security Administration – Benefits Planner: Deemed Filing FAQs, 2018.*
[4]*Social Security Administration – Benefits Planner: Income Taxes on Your Social Security Benefit, 2018.*
[5]*H.R. 1 Tax Cuts and Jobs Act, Title I, Subpart B Section 13611, December 22, 2017.*

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