The Kitces Report
Advancing knowledge in financial planning . . . September 2011

The Complex Rules of Social Security For Couples

Executive Summary

- Social Security benefits are calculated based on an individual's Average Indexed Monthly Earnings (AIME), which are used to calculate the amount of income replacement the individual will receive in retirement as his/her Primary Insurance Amount (PIA). An individual's PIA represents the retirement benefits that will be paid at full retirement age.

- Retirement benefits can be applied for as early as age 62; however, benefits claimed before full retirement age will be reduced. Retirement benefits can also be deferred past full retirement age, as late as age 70, earning "delayed retirement credits" that increase the benefits payable. In both cases, the exact impact varies depending on the individual's year of birth.

- The decision to delay Social Security retirement benefits represents a trade-off between current benefits and incrementally higher future benefit. Depending on assumptions, the breakeven period is typically 15 to 25 years, and increases with higher growth or lower inflation assumptions.

- The risks and rewards of delaying benefits are not symmetrical around the breakeven period. While the risk of delaying benefits and dying early are limited, the upside is potentially far greater, as ever-compounding inflation increases result in an exponentially rising benefit for longevity. For example, giving up a year of $1,000/month payments may put $12,000 at risk with a 15-20 year breakeven period, it only takes another 6 years to come out with an extra $12,000 profit ("doubling" your money), and after 12 years the value has almost tripled.

- A married individual is eligible for a spousal benefit equal to 50% of the spouse's PIA, and after the spouse's death is entitled to a survivor's benefit equal to the deceased spouse's retirement benefit (adjusted for early/late retirement, if applicable).

- The fact that an individual can receive benefits over his/her lifetime, and effectively continue those benefits for his/her spouse's lifetime as a survivor benefit, means the decision to delay benefits can create value until the *last to die* of the couple's joint life expectancy. As a result, it is often highly probable that at least one member of the couple will live long enough to pass the breakeven period, creating an incentive to delay benefits (especially for the higher income spouse).

- Notwithstanding the decision to delay, spousal benefits are restrictive in that the primary earner must apply for benefits to allow a spouse to receive spousal benefits. However, an individual can file for a benefit (at full retirement age or later) and then suspend the payment of that benefit to unlock a spousal payment, while still earning delayed retirement credits. Similarly, a spouse at full retirement age can choose to file a restricted application to receive a spousal benefit, but not start his/her individual benefit. Using these strategies, a couple can receive at least partial benefit payments, yet still earn delayed retirement credits.

- Unlike with spousal benefits, there is significantly more flexibility about the timing of applying for survivor benefits. A surviving spouse has the opportunity to begin survivor benefits as early as age 60 (or earlier in certain circumstances), and/or individual benefits as early as age 62, and can choose to time either whenever he/she wishes without affecting the eligibility or payments for the other, in whatever manner maximizes the total payments received.

- In practice, the exact optimal combination of benefits for a husband and wife will vary, depending on the difference in their benefits, and how far apart they are in age. Strategies that are effective for some couples may prove ineffective for others; however, tools are available to help analyze all the combinations.

About the Author

Michael E. Kitces, MSFS, MTAX, CFP®, CLU, ChFC, RHU, REBC, CASL, CWPP™, is the Director of Research for Pinnacle Advisory Group (www.pinnacleadvisory.com), a private wealth management firm located in Columbia, Maryland. In addition, he is an active writer and speaker, and publishes The Kitces Report and his blog "Nerd's Eye View" through his website www.kitces.com.

Introduction

As one of the supports of the proverbial three-legged stool of retirement, and a social insurance program that virtually all clients have paid into over the years and are eager to get something back, Social Security occupies a special place in the minds of most. And with one key decision left available to clients - when to start Social Security payments - many strategies have emerged over the years to try to maximize the benefits received.

However, while the principle of Social Security timing strategies is fairly straightforward for individuals, the situation is more complex for married couples, due to the presence of spousal benefits, and survivor's benefits for widows/widowers after the death of the first spouse. Accordingly, in this month's newsletter, we take a deeper look at Social Security claiming strategies for married couples, and the factors that are relevant in determining an optimal approach for any particular client situation.

Background

Determining Benefits

Social Security benefits for an individual at retirement are calculated based on his/her "Average Indexed Monthly Earnings", or AIME. The AIME is calculated by first adjusting an individual's lifetime earnings (up to the Social Security wage base in effect at the time) for inflation. The highest 35 years (not necessarily consecutive years) are then added up, and the total is divided by 420 months (35 years x 12 months/year), to arrive at a lifetime Average Indexed (i.e., inflation-adjusted) Monthly Earnings.

Once an individual's lifetime monthly earnings have been determined (via the AIME calculation), those earnings are used to determine his/her "Primary Insurance Amount", or PIA. The PIA represents the Social Security retirement benefits that the individual would receive at his/her full retirement age. The calculation of an individual's PIA using their AIME is performed as follows:

90% of the first $749 of AIME
+ 32% of AIME over $749, and under $4,517
+ 15% of the AIME over $4,517
= PIA

In essence, this means the PIA formula is used to calculate what portion of the individual's lifetime earnings (AIME) will be replaced in retirement (a special calculation applies for the family of a worker that dies prior to age 62, or for the family of a disabled worker). The formula results in a large portion of income replacement for lower income individuals, and a progressively smaller income replacement factor as each "bend point" threshold is crossed, until the top tier where only 15% of upper earnings are replaced in retirement.

> *Example 1a*. Mary's lifetime average indexed monthly earnings are $9,000/year, or $750/month. As a result, her PIA will be $674/month - a 90% income replacement ratio.
>
> *Example 1b*. Continuing the prior example, if Mary's lifetime average indexed monthly earnings were double that amount - $18,000/year, or $1,500/month - her resulting PIA would be 90% x $749 + 32% x $751 = $914/month, or a 61% total income replacement ratio (90% of the first half, 32% of the second half). As Mary's income climbs even higher, her Social Security benefits will rise, too, but the effective income replacement ratio will continue to decline as additional income is only replaced in retirement at 32 cents on the dollar (and then only 15 cents on the dollar, and eventually at 0 cents on the dollar once the Social Security wage base cap is reached).

Because the calculation of an individual's AIME itself is capped at the maximum Social Security wage base for that particular year ($106,800 in 2011), the AIME (and therefore PIA and the maximum possible retirement benefit) is capped. For a worker who was born in 1945 (full retirement age of 66 in the year 2011), and earned at least the maximum amount for 35+ years of employment, the maximum PIA would be $2,366/month (monthly benefit at full retirement age)

As mentioned earlier, a worker is eligible for 100% of the PIA amount at his/her full retirement age. Full retirement age (FRA) itself varies, though, based on the year of birth (see Figure 1, next page).

Starting Retirement Benefits Early

Notwithstanding that individuals have a full retirement age at which they can take "full" benefits (i.e., the full amount of their PIA), all individuals who are eligible for retirement benefits are permitted to start those benefits as early as age 62.

Figure 1. Social Security Full Retirement Age Based On Year Of Birth.

Year of Birth	Full Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943--1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

For every month prior to his/her full retirement age that an individual starts payments, the monthly benefit is reduced by 5/9 of 1%, for up to the first 36 months. For every month early beyond the first 36, the benefit is reduced by 5/12 of 1%. However, because full retirement age itself varies based on age, the extent to which an age-62 early election reduces benefits (i.e., the number of months "early" it would be) depends on the birth year of the client.

Example 2a. Chris was born in 1949, which means his full retirement age will be 66. If Chris decides to begin taking Social Security benefits this year at age 62, his benefit would be reduced by 25% (5/9% * 36 months + 5/12 * 12 months), which is the maximum reduction he can face.

Example 2b. Harold was born in 1961, which means his full retirement age will be 67. If Harold decides to begin taking Social Security benefits when he reaches age 62 in the future, his benefit would be reduced by 30% (5/9% * 36 months + 5/12 * 24 months); notably, because Harold's full retirement age is later and therefore starting at age 62 is even further before his FRA than Chris (5 years early as opposed to 4 years early), his benefits are reduced further for the maximum early election.

Starting benefits early reduces an individual's benefit below his/her PIA; but viewed another way, the benefit of *not* starting payments early is the opportunity to receive a higher benefit in the future. For every month the client does *not* elect early benefits, the PIA is *not* reduced by 5/9ths (or 5/12ths) of 1%, allowing for higher benefits in the future. Accordingly, while Harold (example 2b) starting benefits at age 62 would result in a 30% reduction, the effective impact for Harold to *wait* on benefits until age 67 (instead of starting at age 62) would be an increase of 43%; e.g., his benefits would rise from $700/month to $1,000/month by avoiding the early-onset-of-benefits adjustment. The marginal benefit of delaying one month (or one year) as an increase from a currently-eligible early benefit is shown in Figure 2, below.

Delaying Retirement Benefits

Just as benefits can be taken early (before full retirement age), they can also be delayed past full retirement age. For each year after full retirement age that a worker delays (up to age 70), he/she receives a delayed retirement credit depending upon the year they

Figure 2. Benefit increase for delaying early Social Security election by 1 month or 1 year, depending on number of months before FRA.

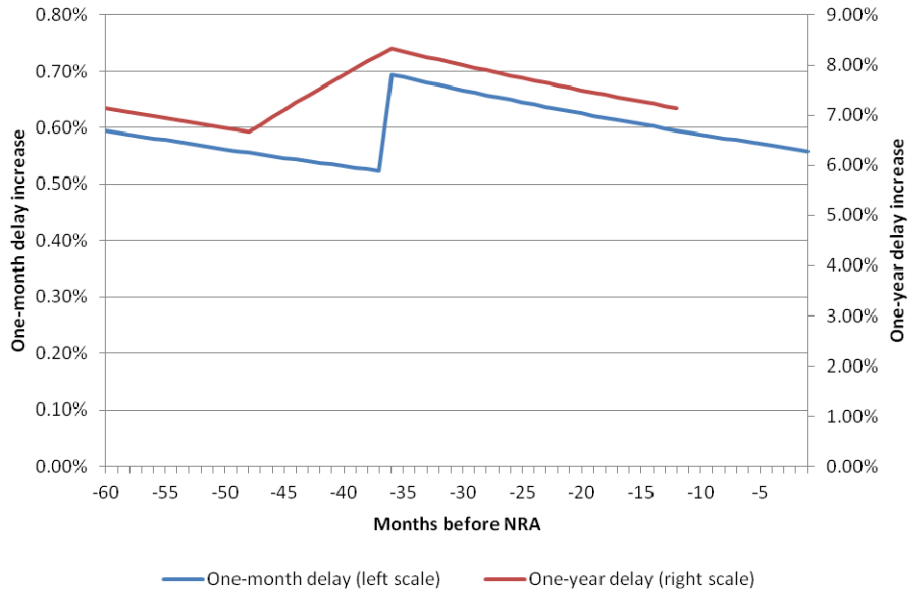


Figure 3. Social Security Delayed Retirement Credit Benefits Increase By Year Of Birth.

Year of birth	Credit per year
1917-24	3.0%
1925-26	3.5%
1927-28	4.0%
1929-30	4.5%
1931-32	5.0%
1933-34	5.5%
1935-36	6.0%
1937-38	6.5%
1939-40	7.0%
1941-42	7.5%
1943 and later	8.0%

were born, as shown in Table 3 (top of next page).

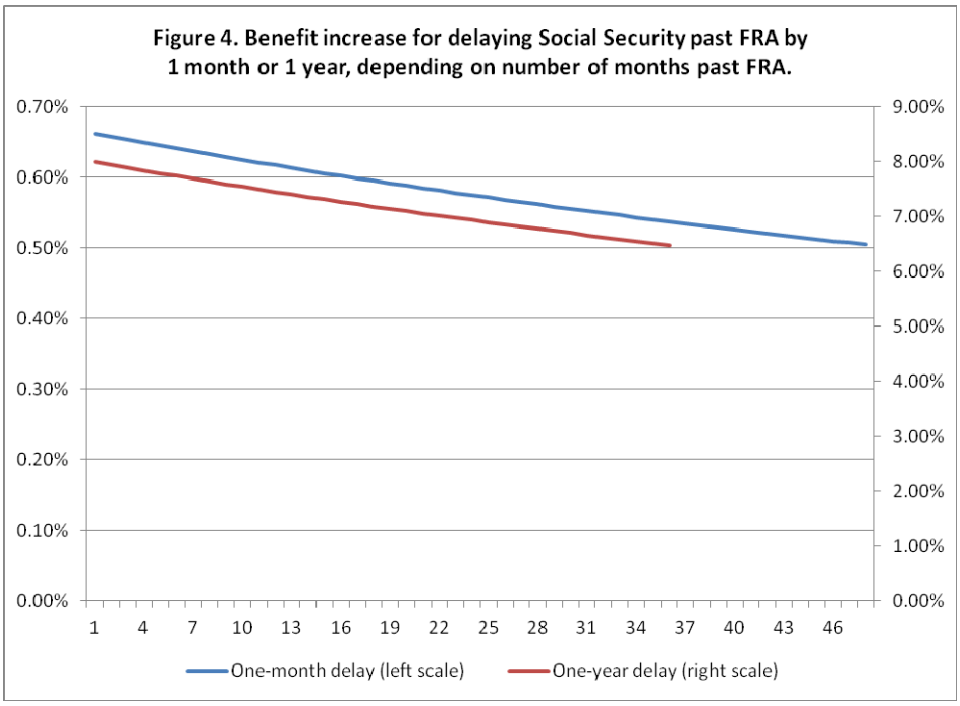
Example 3a. Sheila was born in 1937, and would therefore have a full retirement age of 65 (as shown earlier in Figure 1). For every year Sheila waited past age 65, her benefit would be increased by 6.5% per year. This means if Sheila delayed taking retirement benefits until age 70, she would receive 132.5% (100% + (6.5% * 5)) of her original PIA.

In a similar manner to the impact on early benefits, the rising full retirement age impacts how much of a benefits increase applies for those who wait until the maximum age 70.

Example 3b. If Sheila instead had been born in 1960, her full retirement age would have been 67. If she chose to delay benefits until age 70, she would receive 124% (100% + (8% * 3)) of the monthly benefit, rather than 132.5% for the individual born in 1937.

Notably, as the system shifts over time, delaying retirement results in a greater increase per year, but a fewer number of years to earn delayed retirement credits as the full retirement age also rises.

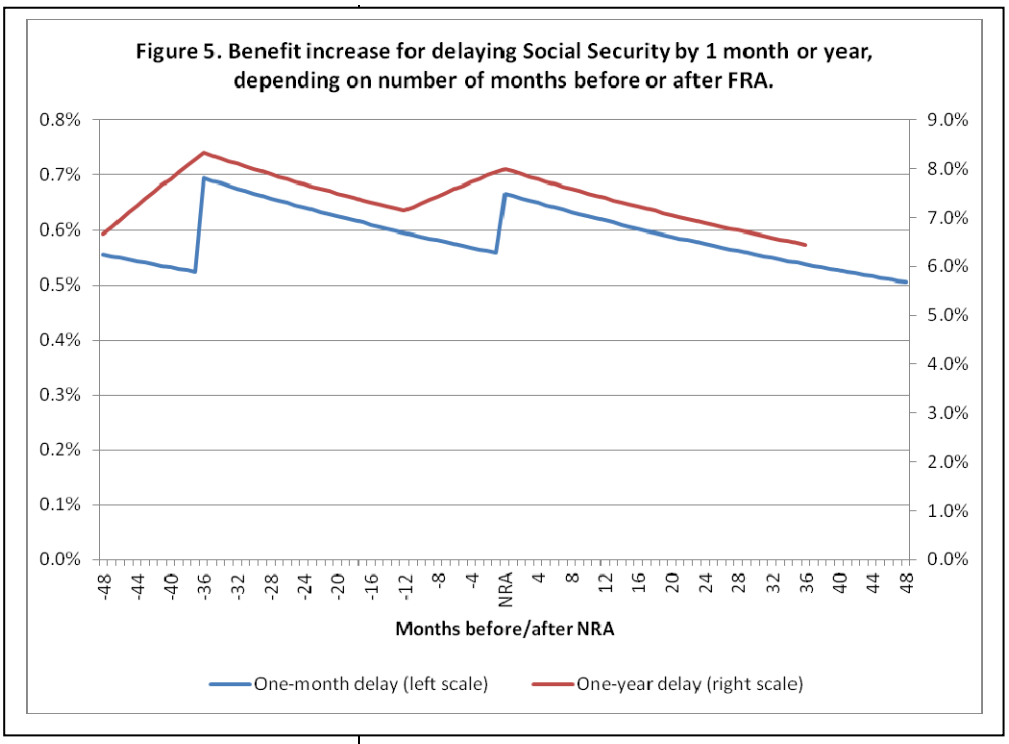
While older clients may have already received increases in the past by delaying benefits, clients who are not already age 70 - and thus subject to these rules - must have been born in 1941 or later. As a result, in today's world all clients who delay benefits essentially face an increase of either 7.5%/year or 8%/year; however, the cumulative impact of delayed retirement benefits under age 70 will still decrease further in the coming decade as the full retirement age for today's retirees rises from age 66 to age 67. Figure 4, below, shows the marginal benefit of delaying benefits past full retirement age for an individual who was born in 1945, who has reached full retirement age in 2011 and is receiving an 8%/year increase for delaying, and may be considering whether to delay benefits further. Notably, because the delayed retirement credit is a percentage of the individual's PIA, not the individual's current benefit, the relative value of delaying does not compound, and in fact diminishes slightly as the base of benefits rises.



In practice, for today's retirees just reaching full retirement age - earning an 8% delayed credit with a full retirement age of 66 - the worker could receive anywhere from 75% (4 years early) to 132% (4 years delayed) of their PIA, varying based on whether they elect the maximum early benefit (age 62), the maximum late benefit (age 70), or something in between. On an ongoing basis, Figure 5 (next page) shows the 1-month or 1-year benefit increase for each delay depending on

the number of months before or after full retirement age for an individual with a full retirement age of 66.

(Editor's Note: For further discussion of the determination of retirement benefits for an individual, and the impact of starting benefits early or delaying them late for an individual, see the September 2009 issue of The Kitces Report, or email michael@kitces.com to request a copy.)



Ongoing Inflation Adjustments

In addition to the adjustment to benefits for retirees who choose to retire before full retirement age (as early as 62) or after FRA (as late as age 70), ongoing benefits also receive an annual Cost-Of-Living Adjustment (COLA) to keep up with inflation.

The importance of COLAs, though, is not only that they increase Social Security retirement benefits over time, but that they adjust the underlying PIA before any further adjustments for early or late benefits. Thus, by delaying benefits, the client enjoys a higher base upon which cost-of-living adjustments apply in the future.

> *Example 4*. Charlie has a full retirement age of 66, and a PIA of $1,000/month. If he elects to start Social Security at age 62, he will receive $700 per month, upon which inflation adjustments will compound. Assuming 3% inflation, he will receive a $21/month adjustment in the first year. On the other hand, if he delays until age 70, his benefit will be $1,320/month. In addition, with a 3% COLA, his first-year benefit adjustment will be $40/month, increasing his payment to $1,360. Thus, part of the virtue of delaying benefits is not only the increase in payments itself (from $700 to $1,360), but a higher base for accumulating future COLAs ($21 vs. $40), which can have a material difference compounded over decades if Charlie lives well beyond life expectancy.

Understanding the Breakeven Framework

The basic framework for determining whether it "pays" to delay Social Security retirement benefits is fairly straightforward: the client gives up a current payment that could have been invested or consumed, in order to receive higher payments for life thereafter, and can eventually make up the foregone payment and then some with incremental higher payments down the road, if he/she lives long enough. The time period necessary to recover the foregone payment with a series of slightly higher future payments is typically called the "breakeven" period.

> *Example 5*. Carleton has the opportunity to receive $1,500 per month today (at full retirement age), or $1,620/month by delaying a year (to one year past full retirement age, for an 8% increase). How long will it take to recover the $1,500/month x 12 months = $18,000 of payments not received in the first year, by taking home an extra 8% x $1,500 = $120/month for all the months and years thereafter? Based on the simple math, $18,000 / $120 = 150 months (12.5 years).

However, it is not quite as simple as saying $18,000 / $120 = 150 months until the breakeven point where the incremental extra $120/month recovers the first year of benefits not received. First of all, such a simple analysis ignores the time value of money. Whether the $18,000 is saved and invested, or is consumed (but thereby allows other dollars to not be spent and remain saved/invested), the value of this amount will have the opportunity to grow over time. Thus, after the second year, the $18,000 will have grown to $19,080 (assuming a 6% return), while the client who delayed is only earning growth on $1,440 worth of payments for the year (and on a balance that only invests $120/month, not even $1,440 for the whole year!)! Eventually, there will be enough $120/month payments (with growth) to overcome the setback of not having all $18,000 invested up front (with growth), but it takes much longer. In other words, once the time value of money is accounted for, the breakeven point extends much further.

On the other hand, this simplified approach also ignores the impact of Social Security's cost of living adjustments. For the client who elects early benefits, the $18,000 will be received in pocket in year 1. For the client who delays by a year, though, he/she will not only receive an extra $120/month for life, but that $120/month itself will also receive cost-of-living adjustments over time. Thus, for example, the $120/month of excess payments will increase to $139/month after 5 years, $161/month after 10 years, and $187/month after 15 years (assuming a 3% inflation rate). This rising series of payments helps to accelerate the breakeven point.

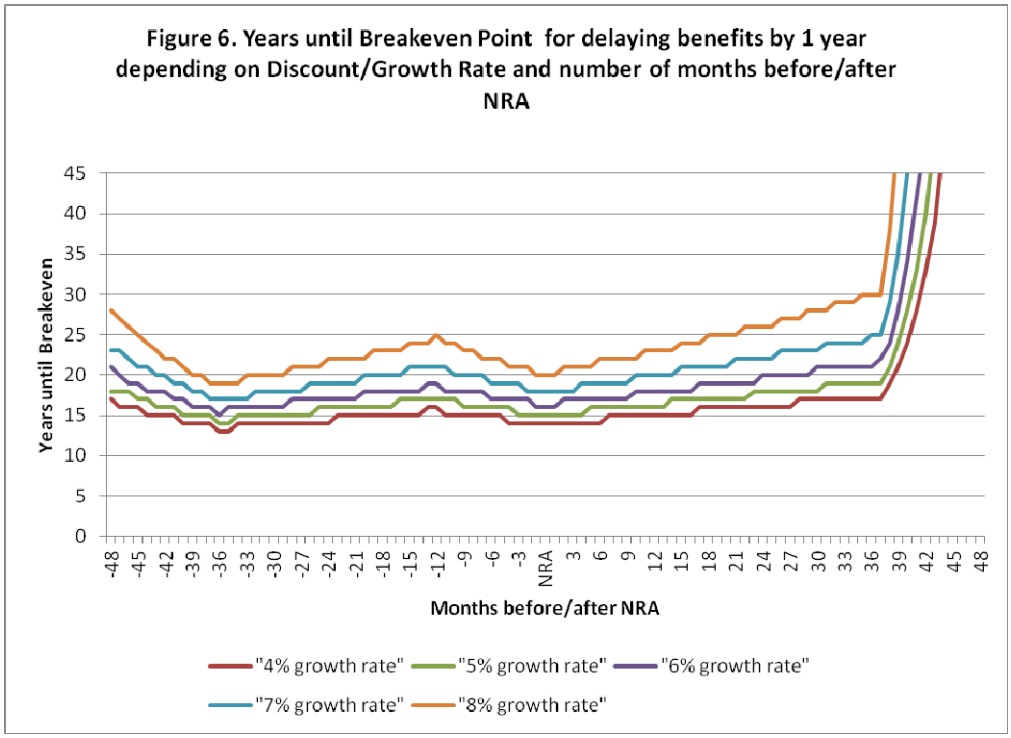
Accordingly, Figure 6 (top of next page) shows the number of years to breakeven for an individual whose full retirement age is 66 and who delays benefits by 1 year, assuming a growth/discount rate from 4% to 8% for the available Social Security benefits received and a 3% inflation rate. As the chart reveals, the breakeven point can vary from as short as 15 years (going forward from that age), to as long as 25+ years, resulting in a breakeven age that ranges from the late 70s to early 90s. Notably, the *higher* the assumed rate of return, the longer the breakeven period; the more difficult it is to overcome an initial invested lump sum (for the payments not received) with slightly higher payments over time. As the investor approaches age 70 - beyond which there is no benefit to further delays because payments don't increase anyway - the breakeven point shoots upwards and approaches infinity (i.e., don't delay past 70!). Conversely, while higher growth rates extend the breakeven period, higher inflation rates (not shown here) shorten the

Withdraw and Re-Apply:
The Social Security "Do Over"

Under long-standing rules for Social Security, individuals receiving retirement benefits had the option to "change their mind" and file a form to withdraw and reapply to the Social Security system. By withdrawing, the individual was required to pay back all benefits previously received (although not adjusted for interest or time value of money), and could then reapply for Social Security retirement benefits at his/her current age, thereby adjusted for a later starting point (i.e., eliminating any reductions for early benefits, or even retroactively receiving delayed retirement credits). This process created a breakeven period - the time it took to recover the lump sum payback of prior benefits received, with a higher ongoing Social Security payment. And in practice, it was a very favorable payback period - the internal rate of return at life expectancy was even better than any annuity that could be bought in the marketplace (which, similarly, exchanges a lump sum for a series of future payments).

However, the appeal of the Social Security reset changed in late 2010, when the Social Security Administration changed the rules. Under the current guidelines, workers can only reset their benefits within 12 months of their original filing for Social Security (previously, they could do it at any time, even if it had been 8 years from age 62 to 70); in addition, the current Social Security reset can only be done once in a lifetime. For example, if Trevor had a PIA of $1,000/month but began benefits at age 62 (receiving $750/month assuming an age 66 full retirement age and a 25% early benefit reduction), he could decide to reset at age 63. In the process, he would send a check to the Social Security office for $8,400 (the past year's worth of benefits),and his benefit would increase to $800/month (since now he'd be applying "only" 3 years before full retirement age, reducing his PIA by only 20%). However, if Trevor has already gone more than 12 months since he started benefits, he cannot withdraw, repay, and reapply to receive the higher benefit anymore.

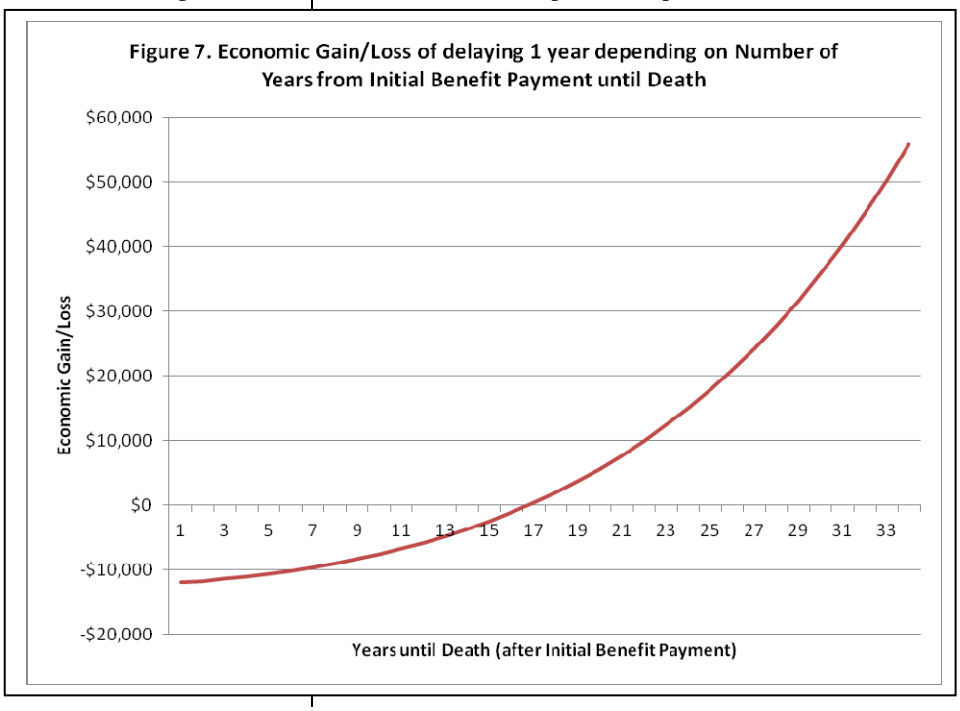
The new limited time period in turn makes the Social Security reset/do-over strategy very limited. It no longer functions as an ongoing "strategy" - where the client might start benefits early in anticipation of resetting later if everything is going well, or simply sit down at age 70 and decide a do-over is desirable to undo prior decisions. Instead, it now is just an option for a client who begins Social Security benefits and, due to a change in circumstances, decides that he/she would rather not have started benefits after all and would like to have a near-term "do over".



100, the $12,000 of foregone payments in year 1 have produced an economic value of over $50,000 by receiving 30+ years of increased payments! Thus, to say the least, the results of the breakeven period are very asymmetrical; in other words, the penalty for not living to life expectancy is modest, while the benefit for outliving life expectancy is tremendous. The cumulative effect of delaying for multiple years only compounds the effect for clients who live well past life expectancy.

breakeven period, as the benefit of receiving a higher payment - upon which COLAs will compound - is better when inflation is higher.

On the other hand, it's worth noting that the analytical process does not end once the client reaches the breakeven point. For instance, if a client is eligible for a PIA of $1,000/month at full retirement age of 66, waiting one year past FRA gives up $12,000 in total payments; in exchange, the client gets a payment that is 8%/year higher, for life. Assuming a 6% growth rate and 3% inflation, it takes roughly 17 years (age 83 for a client who started the delay at age 66) to break even, as shown in Figure 7 (right). *However*, the picture is very different if the client lives beyond that point! While the maximum "risk" of delaying was $12,000, the client is $12,000 ahead only 6 years beyond the breakeven point. By the time the client reaches age



Notwithstanding this breakeven framework, though, the planning strategies for married couples are significantly more complex, because Social Security decisions of one member of the couple can impact the other.

Unique Benefits for Spouses

The Spousal Benefit

In addition to claiming Social Security based on his/her own AIME and PIA, a person is eligible to claim a Social Security benefit based on 50% of his/her spouse's PIA. The applicant will receive the higher of the two, not both simultaneously. In fact, the individual can receive a spousal benefit, even if he/she doesn't have enough credits to be eligible for his/her own individual benefit.

An individual can claim a spousal Social Security benefit based on his/her spouse's earnings record as early as age 62. However, a spousal benefit cannot begin until the primary spouse (upon whose earnings the benefit will be based) has applied for benefits.

> *Example 6a*. Terrence is 59 and Molly just reached age 62. Terrence has a PIA of $1,200/month. Molly is eligible to claim a spousal benefit of $600/month based on Terrence's earnings record and PIA. However, because Terrence isn't even old enough to be eligible for benefits yet (much less actually complete an application for them), Molly cannot yet begin her spousal benefit.
>
> *Example 6b*. Continuing the prior example, assume instead that Terrence is age 64, but has not yet started his own Social Security benefits because he is choosing to wait until full retirement age. Although Terrence is eligible by age, because he has not actually applied for his benefits yet, Molly is still ineligible to apply for a spousal benefit. (However, the opportunity for Terrence to file and then suspend his own benefits while providing Molly access to her spousal benefits is possible, once he reaches his full retirement age; see sidebar on page 11.)

In a similar manner to individual benefits, a spousal benefit is reduced if the spouse begins payments before his/her full retirement age (based on the individual who's receiving spousal benefits, not the original spouse whose earnings record it is based upon). A spousal benefit is reduced 25/36 of 1% for each month for the first 36 months (a faster pace than the reduction for early benefits for individual retirees), and 5/12 of 1% for each additional month benefits are taken before full retirement age. Unlike with individual benefits, delaying past full retirement age will not increase spousal benefits.

> *Example 7a*. Ned was born in 1957 (full retirement age of 66 and 6 months), and has a PIA of $1,600/month, and his wife Sheila, who was born in 1960 (full retirement age of 67), has a PIA of $500/month based on her own earnings. Sheila can elect to use Ned's PIA for a spousal benefit, meaning she will receive a payment of $800/month (50% * $1,600 monthly benefit) instead of only

Spousal and Survivor Benefits After Divorce
An individual may still be eligible for a spousal benefit even after a divorce. The marriage must have lasted at least 10 years, and the individual must be currently unmarried. The rules for spousal benefits for a divorced spouse are the same for married spouses, including: the claiming individual must be at least age 62, and can receive 50% of the ex-spouse's PIA at his/her own full retirement age.

Even if the ex-spouse remarries, the individual can still receive a spousal benefit as long as that individual himself/herself is currently unmarried. This means that for a single worker, his/her 1st spouse, and 2nd spouse (and even more spouses, as long as each marriage lasted 10 years) are all eligible for the same spousal benefits based on his/her earnings. If an individual remarries, his/her spousal benefit is based upon their current spouse. If that individual divorces a second time, though, he/she can claim a spousal benefit upon either of the previous spouses (whichever provides the higher benefit), assuming the marriages each lasted at least 10 years.

Unlike spousal benefit rules for currently married spouses, though, an individual can apply and receive benefits even if the ex-spouse has not applied for benefits yet, as long as the ex-spouse is at least age 62 and therefore *eligible* for benefits. This only applies, though, if the couple has been divorced for at least 2 years.

A divorced spouse is also eligible for survivor's benefits based on the ex-spouse's earnings record, as long as the marriage had lasted 10 years. As with standard survivor benefits, the individual must be over age 60 (or over age 50 if disabled). If the individual remarries before age 60, survivor benefits from the ex-spouse will not apply, and only survivor benefits based on the current spouse can be claimed (at that current spouse's death). However, if the individual remarries *after* reaching age 60, he/she can still claim a survivor benefit based on the original ex-spouse's

$500/month. If Sheila chose to receive her benefit at age 62, her $800/month spousal benefit would be reduced by 25/36ths of 1% for the first 36 months, and 5/12ths of 1% for the additional 24 months early (since she is electing a total of 60 months early). This would reduce her benefits by (25/36% x 36) + (5/12% x 24) = 35%, which would result in a spousal benefit of ($800 x (1 - 35%)) = $520/month (which is 32.5% of her husband's original $1,600/month PIA). Notably, in practice a spouse cannot receive a spousal benefit until age 62 and 1 month due to the timing of the election, which would result in a spousal benefit of $523/month (which is approximately 32.71% of her husband's PIA).

Example 7b. Continuing the previous example, if Sheila had chosen to wait until her full retirement age of 67, she would have received a monthly benefit of $800/month, without any reduction for an early election.

Example 7c. Continuing the example, assume Sheila waits even further, until her age 68. In this scenario, she would still receive the same $800/month benefit she would have been eligible for at her full retirement age of 67. Again, unlike an individual's primary benefits, there are no delayed retirement credits to increase the spousal benefit for those who wait past full retirement age.

Note that the early benefit adjustment is calculated based on the full retirement age of the person receiving the benefit, not the worker whose earnings record is being used. Thus, in the earlier examples, Sheila is eligible for a monthly benefit of $800/month, regardless of whether Ned begins his own benefits at his full retirement age ($1,600/month) or some earlier (e.g., age 62) or later date (e.g., age 70), because his PIA remains $1,600/month.

Example 7d. Continuing the earlier examples, assume that while Sheila waits until her full retirement age (67) to begin spousal benefits, Ned also delays his retirement; since he is three years older, when Sheila reaches full retirement age, Ned has reached age 70. Since Ned's full retirement age was age 66 and 6 months, waiting until age 70 earns him 3.5 years of delayed retirement credits; at 8%/year, this increases his retirement benefit by 28%, from his $1,600/month PIA to $2,048/month. However, even though Ned's retirement benefit will be $2,048/month, Sheila's spousal benefit is *still* $800/month based on Ned's $1,600/month PIA, regardless of his delayed retirement (and Sheila's $800/month spousal benefit in turn is still adjusted based on *her* retirement age).

The Survivor Benefit

In addition to the spousal benefit - which applies while both spouses are alive - the Social Security system also provides a so-called survivor (or widow/widower's) benefit, to the surviving spouse of a couple after the first death. Survivor benefits can be paid to a widow or widower, based on 100% of the deceased spouse's *benefit* (not PIA), at the *receiving* spouse's full survivors retirement age (which may be different than the full retirement age for retirement benefits, depending on the year of birth; see Figure 8, below).

The receiving spouse can elect to begin survivor benefits earlier - as early as age 60 - on a reduced basis. An early survivor's benefit is always reduced by 28.5% at age 60; thus, depending on the year of birth (and therefore the individual's full survivors retirement age), the actual monthly reduction for early survivor benefits varies. As with spousal benefits, an increased benefit for delaying past full retirement age is not available. Notably, survivor benefits are also available under the following circumstances:

Figure 8. Social Security Full Retirement Age (For Survivor Benefits) Based On Year Of Birth.

Year of Birth	Full (survivors) Retirement Age	Months between age 60 and full retirement age	Monthly % reduction
1939 or earlier	65	60	.475
1940	65 and 2 months	62	.460
1941	65 and 4 months	64	.445
1942	65 and 6 months	66	.432
1943	65 and 8 months	68	.419
1944	65 and 10 months	70	.407
1945 - 1956	66	72	.396
1957	66 and 2 months	74	.385
1958	66 and 4 months	76	.375
1959	66 and 6 months	78	.365
1960	66 and 8 months	80	.356
1961	66 and 10 months	82	.348

- A disabled widow/widower, as early as age 50
- A widow/widower at any age if he or she takes care of the deceased's child who is under age 16 or disabled, and receiving Social Security benefits
- Unmarried children under 18, or up to age 19 if they are attending high school full time. Under certain circumstances, benefits can be paid to stepchildren, grandchildren, or adopted children.
- Children at any age who were disabled before age 22 and remain disabled.
- Dependent parents age 62 or older

A spouse who claimed survivor benefits as early as age 60 can later switch to his/her own benefit (based on his/her own earnings record and PIA) at a later date. The surviving spouse is entitled to the larger of the two benefits - a survivor's benefit based on the deceased spouse's earnings record, or the individual's own retirement benefit based on his/her own earnings record. Applying for and starting a survivor's benefit does not prevent an individual from delaying his/her individual retirement benefits, or vice versa.

The Interplay Between Spousal and Personal Benefits

An individual is eligible to claim a retirement benefit based on his/her own earnings record, and a spousal or survivor benefit based on a spouse; however, the individual only receives the *higher* of the two, not both. Nonetheless, a significant planning opportunity for couples emerges, due to the fact that while the individual only gets the higher of the two benefits, there is control about *when* each of those benefits is applied for. And since the timing of when a personal, spousal, or survivor benefit is started in turn affects the benefit amount received, coordinating the timing amongst them creates an opportunity for wealth creation. This is true not only because the reduction for individual retirement benefits (and therefore, the value for delaying them) is different than the reduction for claiming spouse or survivor benefits early, but also because individual benefits (unlike spouse or survivor benefits) can receive a delayed retirement credit for waiting past full retirement age.

Filing A Restricted Application
In some cases, a spouse may wish to claim a spousal benefit, while still delaying his/her own individual retirement benefit to receive a higher future amount. For those who have reached full retirement age, this can be accomplished by filing a so-called "restricted application" to claim the spousal benefit, but not yet receive his/her own individual retirement benefit.

Since the restricted application is limited to those who have reached full retirement age, in practice it allows an individual to claim his/her full spousal benefit (assuming the spouse has applied for benefits) while earning delayed retirement credits on his/her own individual retirement benefit. If attempted before full retirement age, though, an application for one benefit (individual or spousal) will also constitute a deemed application for the other (if eligible for both).

Example 8a. Darren is 66 years old (his full retirement age) and has a PIA of $1,800/month. His wife Julie is also 66 years old (her full retirement age as well), and has a PIA of $900/month. As a result, Julie is eligible to claim either her individual retirement benefit of $900/month, or a spousal benefit based on Darren's record, which at 50% of his PIA would also be $900/month. Offhand, then, it seems like little value is created. However, if Julie begins her spousal benefit based on Darren's earnings, she can continue to defer the start of her own benefits, earning delayed retirement credits (see sidebar on previous page on filing a restricted application). As a result, Julie could claim $900/month now as a spousal benefit, delaying her own benefit until age 70 and starting it then when it has increased by 8%/year x 4 years = 32% to $1,188/month (plus cost-of-living adjustments). As a result, Julie effectively has the best of both worlds: she can receive her $900/month now, *and* her higher future benefit for delaying retirement, allowing her to receive a higher lifetime benefit

without giving anything up along the way!

Example 8b. Continuing the prior example, assume instead that Darren and Julie are each 64 years old, still with a full retirement age of 66. If Darren has already applied for benefits and Julie begins her spousal benefit now - reduced by 25/36% x 24 months to $750/month for being 2 years early - then she is deemed to have applied for her own individual retirement benefit - which will be reduced to 5/9% x 24 months to $780/month (since the reduction for individual benefits is different than that for spousal benefits). Thus, Julie will receive $780/month (her individual benefit), squashing out any spousal benefit. Had Julie applied for her individual benefit and not her spousal benefit at this time, the result would be the same, as she would have a deemed application for her spousal benefit because she is eligible to receive it, and she cannot file a restricted application before full retirement age.

Example 8c. Continuing the prior example further, if the early decision to take spousal benefits will be a moot point because it forces a (higher) individual benefit anyway, Julie may wish to just start her individual benefit and *not* claim her spousal benefit (which she can do if she's not eligible, perhaps because Darren has not yet filed for his benefits yet). However, *this will not help* under the circumstances. The reason is that the Social Security Administration technically views you as always starting your own benefit first; if you later apply for spousal benefits, the SSA simply increases your benefit for the difference between your PIA and the spousal benefit PIA. In this case, the difference is $0, because Julie's PIA is $900/month and 50% of Darren's PIA is also $900/month, and $900 - $900 = 0. So if Julie applies for individual benefits early, she will not receive any bump-up when she later applies for spousal benefits anyway, because her spousal-based PIA was not higher than her own.

Example 8d. Continuing further, if Darren's PIA was $2,000/month - which would make the spousal amount $1,000/month - Julie's spousal benefit when eligible would increase her benefits by $1,000 - $900 = $100/month, even if she started her own benefits at age 64 (where the early election reduces her individual benefits from $900/month to $780/month). Under such a scenario, when Julie reached full retirement age and became eligible for a spousal benefit, her payments would rise to $780 + $100 = $880/month (by adding on the difference between her original PIA and her original spousal benefit). Notably, though, she still does *not* receive the $1,000/month spousal benefit she otherwise would have received if she had just waited until full retirement age!

File and Suspend

One of the key constraints for an individual to start spousal benefits is that his/her spouse must also have applied for benefits in order to be eligible. However, in some situations, this is problematic because the individual wants to claim a spousal benefit, but his/her spouse does *not* want to start their own benefits yet (perhaps wishing to avoid an early benefit reduction or to earn more delayed retirement credits).

A solution to this dilemma is the so-called "File and Suspend" strategy, which was established under the Senior Citizens Freedom to Work Act and signed into law by President Clinton in 2000. Under the File and Suspend rules, a spouse *who has reached his/her full retirement age* may file for benefits and then immediately request to suspend the payment of those benefits. Once the application for benefits has occurred, a spousal benefit based on his/her earnings may be requested as well; however, by suspending the payments, the spouse can earn delayed retirement credits for his/her own benefit.

Notably, though, until the spouse has reached his/her full retirement age, the file and suspend strategy is not available (although if a spouse files for benefits early, benefits can still be suspended at full retirement age to earn delayed retirement credits, but the prior early benefits adjustment will also still apply). In addition, completing the file-and-suspend process suspends *all* benefits - which means it renders you ineligible to claim your own spousal benefit; as a result, it is generally not effective for both spouses to file and suspend (since there's no reason for both spouses to file and suspend to render the other spouse eligible for benefits if the other spouse wouldn't be eligible because of his/her own file and suspend application!).

Either way, it is again important to note that while an individual cannot receive a spousal benefit until the spouse himself/herself has actually applied for benefits, the decision by *that* spouse to apply early/late does not affect the spousal benefit. In either case, the spousal benefit itself is calculated based on the worker's PIA, which is not adjusted for the early/late onset of benefits.

> *Example 8e*. Extending the prior example further, Julie will be eligible for a spousal benefit of $900/month at her full retirement age, based on Darren's $1,800/month PIA. Whether Darren starts benefits at age 66 (at $1,800/month), at age 62 (reduced to $1,350/month), or as late as age 70 (increased to $2,376/month), Julie's spousal benefit will continue to be $900/month, adjusted only for whether Julie elects to begin her spousal benefit before *her* full retirement age.

In some cases, an individual may wish to begin spousal benefits, but is constrained because his/her spouse does not want to file an application for his/her own benefits yet. The File and Suspend strategy (see sidebar, prior page) provides a means to accomplish the best of both worlds, by having the spouse file for benefits (making the individual eligible for spousal benefits) and then suspending those benefits so the spouse can still earn delayed retirement credits.

> *Example 8f*. Extending the earlier example even further, if Julie wishes to begin her spousal benefit at her full retirement age (since it won't increase further), while delaying her individual benefit until age 70, she may file a restricted application. However, this option is only possible if Darren applies for benefits; yet he may, too, wish to delay until his age 70. This dilemma can be resolved by having Darren apply for Social Security and then suspend his benefits; by not receiving payments, his individual benefit will still earn delayed retirement credits until age 70, but because an application has been filed, Julie may begin her benefits now.

The Interplay Between Survivor and Personal Benefits

Unlike spousal benefits - where the application for an individual benefit is also a deemed application for the spousal benefit (if eligible) and vice versa, unless a restricted application is filed - in the case of survivor benefits, individuals can freely choose to claim either without affecting the other. Thus, for instance, a surviving spouse can claim survivor benefits as early as

Understanding the Government Pension Offset

Notwithstanding the normal rules that apply to spousal and survivor benefits, an important exception applies to certain government workers.

Specifically, if an individual receives a pension from a Federal, state, or local government that is based on earnings that were *not* subject to FICA taxes (i.e., the employee was not participating in Social Security), then 2/3rds of the pension income received from that job will offset (i.e., reduce) that individual's Social Security spousal or survivor benefits. Under these Government Pension Offset (GPO) rules, even a modest pension can eliminate most or all of a spousal (or survivor) benefit.

For instance, if a client receives a $1,200/month pension ($14,400/year), Social Security spousal and/or survivor benefits will be reduced by $800/month (2/3rds of the pension). If the benefits have begun before the Social Security Administration discovers the overlap, the recipient must pay back any "excess" benefits received.

The purpose of the GPO rules are to prevent a so-called "double dipping", where someone receives spouse/survivor benefits (which were originally intended as benefits for dependent spouses who stayed home and didn't work) while still being in the workforce receiving a pension as well. It applies most commonly to Federal government workers under the "old" Civil Service Retirement System (CSRS) who did not opt into CSRS-Offset in the 1980s (but not current government workers, who are subject to the Federal Employees Retirement System {FERS} and pay ongoing Social Security taxes as well), and some state/local government employees who have a municipal retirement plan and don't pay FICA taxes or participate in the Social Security system.

For more information on the details - and some special grandfathering rules - regarding the Government Pension Offset, see the SSA's guidance (ssa.gov/pubs/10007.html). In addition, it's also important to note that individuals who have at least some years of service under a Federal, state, or local government retirement system and haven't paid FICA taxes may also have their own, individual retirement benefits partially reduced, under the so-called "Windfall Elimination Provision" (more information at ssa.gov/pubs/10045.html).

age 60, and defer her individual retirement benefit as late as age 70 (earning delayed retirement credits). Conversely, the surviving spouse could claim her individual retirement benefit early (as early as 62), and delay the survivor payment until the full amount at full retirement age (no reason to wait further, as survivor payments cannot earn delayed retirement credits for waiting beyond full retirement age). Ultimately, at the point a surviving spouse has applied for and is receiving both an individual benefit and a survivor benefit, his/her total payment will be the *higher of* the two (not the sum total).

Another important difference between spousal and survivor benefits is that while spousal benefits are always based on 50% of the spouse's PIA (regardless of whether early or late benefits were claimed by that spouse), the survivor's benefit is based on the deceased spouse's benefit *at the time of death*, including any reduction for claiming benefits early or increased for delayed retirement credits. Notably, if the deceased spouse had not filed for early benefits, the surviving spouse will automatically be eligible for a benefit equal to the deceased spouse's full PIA benefit, even if the deceased spouse had not survived to full retirement age. In other words, by default a surviving spouse receives a survivor benefit equal to the deceased spouse's PIA, *unless* the spouse reduced it by actually applying for benefits early, or increased it by delaying benefits past full retirement age and earning delayed retirement credits.

> *Example 9*. Marcus passed away at age 64, and was survived by his 63-year-old wife Deborah. Marcus' PIA was $1,000/month, and his full retirement age was 66. Had Marcus applied for benefits right before he passed away, he would have received $867/month, and his $867/month benefit would have become Deborah's survivor benefit. However, if he had not applied for early benefits before death, Deborah would be entitled to Marcus' full retirement benefit that he would have received at retirement based on his PIA, which was $1,000/month.

Bringing It All Together

Notwithstanding the complexity of Social Security benefits for couples, the basic framework for evaluating Social Security strategies is the same: something is given up now, in exchange for higher payments (for one, the other, or both spouses) in the future; there is some breakeven period over which the initial give-up is recovered through higher payments; and once the breakeven period is reached, the outcome grows exponentially in favor of the strategy if payments continue long beyond the breakeven year.

What's changed, though, is the overlay of individual, spousal, and survivor benefits (for both the husband and the wife) that all interact with each other, and the fact that the time horizon itself is extended because the analysis now extends as long as *either* spouse is still alive (due to the ongoing payment of individual and/or survivor benefits after the first death).

Because of the extended time horizon of joint survivorship, most decisions to delay benefits are generally favorable, as it is easier to reach the required breakeven periods (unless there are known health conditions affecting both spouses).

The most common delay decision for married couples will be having a higher earning spouse delay benefits as long as possible - until age 70 - to maximize both the

Tools For Analysis
Because of the large number of different permutations of benefits for husbands and wives, delays, early benefits, restricted applications, file and suspend strategies, and more, all of which are impacted by the difference in age and benefits between the spouses, it is difficult to generalize strategies.

Fortunately, some emerging tools and software solutions are available to help analyze all the combinations and options. Two of the most popular new tools include:
- **Social Security Timing** - Found at the website www.socialsecuritytiming.com, and created by Joe Elsasser, CFP, this service allows advisors to analyze the various combinations of benefits, and develops a recommendation based on the exact details of the client.
- **Savvy Social Security Planning for Boomers** - Created by Elaine Floyd, CFP, at the Horsesmouth.com website at www.hosesmouth.com/mktgpage/sssp, this toolkit includes a spreadsheet software program to conduct customized break-even analyses for specific client situations, as well as additional educational resources and client materials.

Both programs were designed by financial planners, and adapted into a tool for sale to advisory firms that need software support to analyze client the complex number of Social Security combinations for couples.

individual retirement benefits while alive, and the survivor benefits if the higher earning spouse dies first. In the meantime, any intermediate steps to increase benefits for the couple through their 60s is desirable, whether that's having the higher income spouse file and suspend to earn delayed retirement credits while "unlocking" spousal benefits for the lower earning spouse, or having the higher income spouse file a restricted application to receive a current spousal benefit while again delaying his/her own benefits until age 70. Depending on the income difference between the spouses, it may even be desirable to have the lower income spouse file a restricted application to only take spousal benefits from the higher earner's record, switching to his/her own individual benefits at age 70 as well.

On the other hand, if both spouses have fairly comparable benefits, it is very effective to have one member of the couple file and suspend, so that the other person can file a restricted application for benefits to receive his/her spousal benefits while still earning delayed retirement credits (although this is more about maximizing current income, than increasing a survivor benefit, since the survivor benefit may be comparable to the surviving spouse's individual benefit anyway). If one spouse is less healthy, it may be more desirable to simply have him/her start benefits (rather than filing and suspending); again, though, his/her spouse can still file a restricted application for spousal benefits.

If there are significant age differences between the spouses, some strategies may be constrained, simply because one spouse may be too young to even apply for benefits at the relevant time given the other spouse's age. For instance, it does little good for a higher income spouse to file and suspend at full retirement age (e.g., 66), if the lower income spouse is only 56, and would be ineligible for spousal benefits until the higher income spouse had delayed until age 70 anyway. The greatest planning opportunities will likely occur when the spouses are within just a few years of each other in age, where decisions about file and suspend or restricted applications may be most relevant to coordinate the timing of both spouses' benefits.

In a future newsletter, we will explore some of these dynamics further, looking at some of the software that is available to help optimize the exact timing of Social Security benefits for a couple, taking into account their exact age and benefit differences.

Conclusion

Social Security planning for couples presents unique challenges, and also unique opportunities, because of the special rules that apply to spousal and survivor benefits for married couples. Decisions to accelerate or delay benefits for one member of a couple can have a material potential impact on the lifetime benefits of the other member of the couple. And clients have few alternatives to turn to for advice besides planners; employees of the Social Security Administration (SSA) are generally trained to focus on monthly benefits for an individual, not lifetime benefits for couples, and furthermore are actually prohibited from giving advice (although a recent survey SocialSecurityTiming.com showed 77% of people expect to receive advice from the SSA)!

While the framework for married couples is similar to individuals, based on a breakeven analysis, the decision to delay benefits for couples tends to be favorable more often, as higher benefits can be payable for the lifetime of the individual (as retirement benefits) and his/her spouse (as survivor benefits), and the life expectancy of a couple tends to be longer than the required breakeven period. Accordingly, the focus turns to maximizing benefits while delaying for the higher earning spouse, through techniques such as file-and-suspend and restricted applications.

In the end, though, it's important to know the special rules that apply under the Social Security system for married couples, as some decisions can irrevocably eliminate a planning opportunity, or turn the situation into a planning disaster.