CONSUMER SPECIAL REPORT

The Truth About When to Begin Taking Social Security

It's all about time. And timing is everything.

Greg Miller & Associates

FINANCIAL PLANNING | INCOME PLANNING | RETIREMENT PLANNING | WEALTH MANAGEMENT

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With so many Americans reaching the early retirement age of 62, the question of when to begin taking Social Security benefits has never been more on the mind of "sixty-somethings." Many "online calculators" exist that attempt to give simple answers to this pressing question; the truth is that there are so many factors to consider that relying solely on an online calculator to provide a meaningful answer is unwise.

One figure that has been quoted in the mass media is that you can get a return of 6% to 8% for every year you delay drawing Social Security benefits up to age 70. While that estimate is roughly accurate (the increase from year to year fluctuates between 6 and 8%) it also paints a distorted financial picture by ignoring many factors of potential importance.

Factors to Consider When Determining the Best Time to Begin Taking Social Security Benefits

Each factor is discussed in a separate section, as follows:

1. The Social Security Surrender Penalty
2. Do you currently need the income from Social Security benefits?
3. How are taxes on Social Security benefits calculated?
4. Will you want or need to continue working after you begin to take Social Security benefits?
5. What impact will retirement account Required Minimum Distributions have on your taxable retirement income?
6. Longevity – What is your family history? What is your health history?

Section One: The Social Security Surrender Penalty

Let's look at a hypothetical example: say you purchased an annuity that had enough money in it that would allow you to quit working and retire today. You call your insurance agent, asking him to cash it in for you today (surrendering the policy) and the agent asks if you're sure. "Yes I'm sure" you reply! Then, the agent says something you hadn't considered, "I'd be glad to have the annuity cashed in and you'll have a check in your hands next week. But … to do this, you're going to be assessed a 25% penalty on the money in your annuity and, I'm sorry to tell you, you'll never get that money back. Before I send in the request … are you sure you want to do this?"

So ask yourself this: if your annuity was worth $1,000,000, would you be willing to forfeit $250,000 in order to get $750,000?

Let's look at a chart that illustrates what percentage of your full retirement benefit you forfeit when you choose to start receiving Social Security benefits prior to your Full Retirement Age (FRA).

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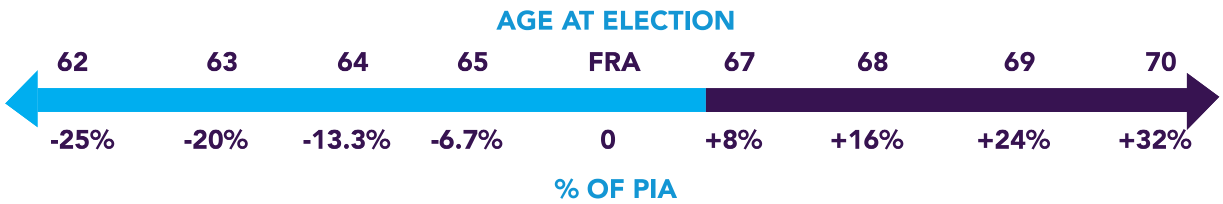

Did you realize that when you opt to begin receiving Social Security at age 62, you are surrendering 25% of your full Social Security retirement benefit (Primary Insurance Amount, aka PIA)? On what other financial account would you be willing to accept a 25% surrender charge? Since Social Security is one of the most powerful incomes you can possess, does it make sense to accept that kind of loss? Please bear in mind, the power of Social Security goes beyond the mere benefit. It's a tax-favored income; it's guaranteed for life, indexed for inflation and cannot be reduced. Are you sure you want to suffer a 25% surrender charge?

If you're married, the issue becomes more complicated. Spousal benefits are reduced even more at age of election. For example: Bob is 64, and Sally is 63. Sally would receive the better of her PIA at 80% or 35% of Bob's PIA benefit.

Spouse Age	62	63	64	65	66	67
Roughly the % of Primary Spouse PIA	32.5%	35%	37.5%	41.7%	45.8%	50%

In the example above, Sally won't get "half of Bob's" Social Security, as people commonly assume, at age 67. Instead, she'll end up with 35% of Bob's PIA, a reduction of 30% percent of Sally's spousal benefit. How many tax-favored, inflation indexed, guaranteed lifetime income accounts would you be willing to take a 30% surrender penalty on? Here is another way to look at the above situation. Let's say that Bob's PIA benefit is $2,000 per month. If Sally waited until full retirement age, she would receive 50% of Bob's benefit, or $1,000. If Sally elects to receive benefits at age 63, she would receive 35% of Bob's benefit, or $700, which amounts to a 65% reduction in the rate of the benefits.

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If your financial professional hasn't discussed the Social Security surrender penalty with you yet, don't be surprised. In our experience, the vast majority of those who refer to themselves as "financial professionals" aren't up to speed with Social Security benefit planning strategies. Social Security planning is a specialty that many professionals do not possess.

Section Two: Do you currently need the income from Social Security benefits?

If you can't retire without taking Social Security benefits, then you need to decide if you're ready to retire or willing to keep working. If you can't retire without Social Security and you're determined to retire now despite the financial disincentives, then it's not so much a financial calculation as it is a lifestyle choice. If you decide to retire, and you can only do so by taking Social Security now and accepting the surrender penalty, that's a decision that ultimately rests with you alone. Only you can balance the emotional side of this important decision against financial considerations and decide if it's worth it. We think most people would just go ahead and retire and move on. In our opinion, most people who want to retire now won't postpone this decision by a couple of years simply because they might come out ahead 15 to 20 years in the future.

Section Three: How are taxes on Social Security benefits calculated?

Whether your Social Security benefit is included in your income for tax purposes — and, if so, what percentage is included — is based on a formula known as Provisional Income. Provisional Income is the sum of all income, including interest and dividends from savings and investments, long and short term capital gains, income from working, interest from tax-free municipal bonds, income from pensions and interest from annuity income plus 50% of your total Social Security benefits.

Here's an example:

	Income from Work	Municipal Bond Interest	Interest from Savings	Pension Income	Annuity Interest Income	Capital Gains	50% of Social Security	Provisional Income
Single	$6000	$1000	$1000	$6000	$0	$1000	$9000	$24000
Married	$0	$6000	$6000	$6000	$0	$0	$18000	$36000

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If you are unmarried and your Provisional Income is less than $25,000, as in the Single example on the previous page, none of your Social Security benefit is included in your income and is untaxed. If you're single and your provisional income is between $25,000 and $34,000, then 50% of your Social Security benefit is included in your income and taxed. If you're single and your provisional income is greater than $34,000, then 85% of your Social Security benefit is included in your income and taxed.

If you're married and your provisional income is less than $34,000, then none of your Social Security benefit is included in income and is untaxed. If you're married and your Provisional Income is between $34,000 and $44,000, then 50% of your Social Security benefit is included in your income and taxed. If you're married and your Provisional Income is greater than $44,000, then 85% of your Social Security is included in your income and taxed. Here's a chart that summarizes these calculations:

	Provisional Income		
Unmarried	**<$25,000**	**$25,000-$34,000**	**>$34,000**
Married	**<$34,000**	**$34,000-$44,000**	**>$44,000**
% of Social Secuirty Taxed	**None**	**50% included in income**	**85% included in income**

When deciding when to start taking benefits, think about whether or not and how much of your Social Security will be taxed. If your Provisional Income is low and your Social Security won't be taxed, you might want to start taking benefits sooner rather than later.

You will also want to consider arranging your income in such a way as to minimize your Provisional Income. Interest income from savings, interest from corporate and government bonds, interest and capital gains from investments, municipal bond interest and wages (income from working) all play a part in your Provisional Income, and all are factors that are under your control.

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- Interest from savings and from corporate or government bonds: Interest you earn on savings accounts such as certificates of deposit, savings accounts or money markets that is not earned inside of IRA/401k-type accounts is included in your provisional income whether you withdraw it to spend or leave it in the account to grow and compound. If you are not withdrawing interest earned on your savings or bonds, you can choose to reposition that principal into a tax-deferred account or continue to earn interest but exclude that interest from either your income or provisional income unless you take a withdrawal. For some people, making this change can be enough to reduce taxation on their Social Security income.

- Many retired investors were brought up to believe that tax-free municipal bond interest is, as the name implies, free from being taxed, but in reality, the fact that it's included in the calculation of Provisional Income means that it's not truly tax-free. Similar to taxable interest from savings accounts, repositioning municipal bond assets into tax-deferred accounts removes that interest from the calculation of Provisional Income until you decide to withdraw it to spend and can cause taxation of Social Security to be lowered or even eliminated entirely.

- Wages: We will discuss the effect that wages have on Social Security benefits in a separate section, but from a big picture perspective, every dollar you earn is included in Provisional Income. If you don't really need the income and choose to work less or stop working entirely, you may be able to reduce Provisional Income and reduce or eliminate taxation of Social Security income.

- Dividends and capital gains from investments: As with the other items above, if you aren't spending the dividends or capital gains you're earning on investments and reposition those assets into tax deferred accounts, you potentially have the ability to cut the taxes that you pay on Social Security.

Bear in mind that there are factors beyond your control that could, by themselves, be causing your Provisional Income to be greater than the highest bracket ($34,000 if single; $44,000 if married). For example, if your pension is $44,000, whether you're married or single, 85% of your Social Security income will be taxed. In other words, from a reduction of Provisional Income perspective, there's no benefit to repositioning money into tax-deferred accounts. Of course, from an overall income tax perspective, such an option could be worthwhile, but whether you reposition money into tax-deferred accounts or not, the percentage of Social Security that's included in your income for tax purposes will remain unchanged.

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Section Four: Will you want or need to continue working after you begin to take Social Security benefits?

One of the most important considerations to account for is earned income before you reach "Full Retirement Age" (FRA) when you are receiving Social Security retirement benefits. Each of us has a "Full Retirement Age." Depending on when you were born, that age gradually increases before capping at age 67. If you work after beginning to take Social Security benefits and before you reach your full retirement age, you may have to return part of your Social Security. You can find your FRA below:

Full Retirement Age

If you were born in 1946 or earlier, you are already eligible for your full Social Security benefit. If you were born from 1947 to 1960, the age at which full retirement benefits are payable increases gradually before capping at age 67. The following chart lists the full retirement age by year of birth.

**Note: People who were born on January 1 of any year should refer to the previous year. Source: Social Security Administration; www.ssa.gov*

Year of Birth	Full Retirement Age
1943-54	66
1955	66 & 2 months
1956	66 & 4 months
1957	66 & 6 months
1958	66 & 8 months
1959	66 & 10 months
1960+	67

The amount of money you can earn is indexed by inflation in most years. Here's the Social Security Administration's summary of how working and having earned income while receiving Social Security retirement income affects your Social Security benefits.

"You can get Social Security retirement or survivors benefits and work at the same time. But, if you are younger than full retirement age and earn more than certain amounts, your benefits will be reduced. It is important to note, though, that these benefit reductions are not truly lost. Your benefit will be increased at your full retirement age to account for benefits withheld due to earlier earnings." (Source: Social Security Administration; http://www.ssa.gov/pubs/10069.html)

"If you are younger than full retirement age, there is a limit to how much you can earn and still receive full Social Security benefits. If you are younger than full retirement age during all of 2014, we must deduct $1 from your benefits for each $2 you earn above $15,480." (Source: Social Security Administration; http://www.ssa.gov/pubs/10069.html)

"If you reach full retirement age during 2014, we must deduct $1 from your benefits for each $3 you earn above $41,400 until the month you reach full retirement age." (Source: Social Security Administration; http://www.ssa.gov/pubs/10069.html)

The good news is that you won't really "lose" the benefits that you give back because you get them back in the future. The bad news is, until you reach full retirement age, working can cause you to give back some of your Social Security benefits.

It's important to note that earned income means just that: income that you earn from actively working. Earned income does not include interest, dividends or pensions. Those types of income can increase your Provisional Income enough to cause some of your Social Security to be taxed but cannot cause you to have to "give back" benefits.

Section Five: What impact will IRA/401k and other retirement account Required Minimum Distributions have on your taxable retirement income?

One of the most overlooked planning areas is the consideration of what to do if you have significant retirement accounts (IRA/401k-type accounts) and how the withdrawals the government will force you to take when you reach age 70 ½ may cause your Social Security to be taxed.

Many people ask, "Well, what can I do about that? After all, I have to make those withdrawals, right?" In short, yes. If you do nothing now, then you will have to take those required withdrawals. The question, then, becomes: What can you do now?

The answer comes back to a discussion of taxes. As of now, tax rates are at low levels compared to what they have been historically. What do you think will happen with tax rates in the coming years? Do you think it's possible that tax rates and tax brackets might change? If you think they might increase, then you may want to consider taking withdrawals from your IRA/401k-type accounts before you are forced to do so.

One option that could be beneficial is to not simply withdraw from your IRA-type accounts but instead, convert your traditional IRA accounts into ROTH IRA accounts. ROTH IRA's do not have required minimum distributions because you have already paid taxes when you convert the IRA/401k to ROTH. Furthermore, if you have other resources and income and don't need income from your IRA accounts, you could allow your ROTH accounts to grow and compound tax-free and potentially leave a larger legacy to your heirs, which they can then withdraw from tax-free. While a spouse can inherit a ROTH IRA and not be forced to take minimum distributions, anyone else who inherits a ROTH IRA is required to take minimum withdrawals annually, although they do not have to pay taxes on the withdrawals. The amount they are required to withdraw is typically fairly small and an inherited ROTH can potentially continue to grow for the benefit of your children and even grandchildren.

Remember – implementing this strategy could potentially reduce or eliminate the taxation of your Social Security for a long, long time. Saving taxes on Social Security is not like deferring taxes on interest. Every dollar you save or eliminate in tax on Social Security is money that never has to be repaid.

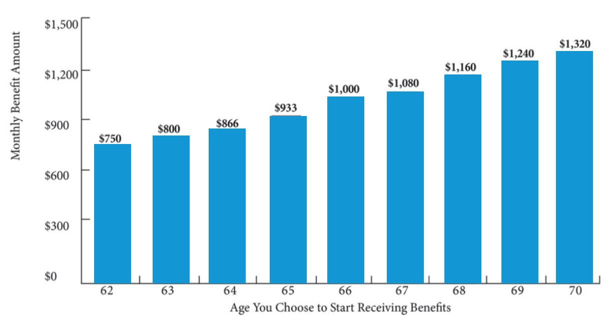
Section Six: Longevity

The single biggest and most difficult question to answer in determining when to take Social Security benefits is how long you are going to live. If we knew exactly how long you would live, it would be infinitely easier to know when to start taking benefits. In general, the longer you will live, the more sense it makes to delay taking benefits. Remember, taking benefits early will result in reduced benefits, while delaying for a period of time yields higher benefits.

People often ask what the "break-even" is in terms of number of years between taking benefits as soon as possible versus delaying. The answer is that it depends, but for a general idea, let's look at a graphic from the Social Security Web site:

Monthly Benefit Amounts Differ Based on the Age You Decide to Start Receiving Benefits

This example assumes a benefit of $1,000 at a full retirement age of 66



Someone who took early benefits at age 62 would receive a monthly benefit of $750, or $9,000 per year. Over the next 18 years, until reaching age 80, this person would be paid $162,000. Compare this situation to the person who waited to age 66 and receives $1,000 per month, or $12,000 per year. Over the next 14 years, until reaching age 80, the person who delayed starting his or her benefits would be paid $168,000. Not much difference, is there? And it took roughly 18 years before the person who delayed caught up to the person who started right away.

Does that mean you could conclude that it takes about 18 years to break even? Again, it depends. The current economic situation should always be kept in mind.

So, when should you start receiving Social Security benefits?

Your answer to this question will depend on your personal circumstances. In this equation, you should consider both your family's longevity as well as your own health. Take the story that Andy Atchinson, Co-Founder of www.PlanMyBenefit.com, shared with us. Larry, the father of one of Andy's coworkers, retired the month he turned 55 (not a typo: fifty-five!).

The reason Larry retired at age 55 was because he had properly planned for retirement, and because his father died prematurely at the age of 60 without having ever enjoyed retirement, Larry was afraid that he, too, might face an early demise. Larry turned 77 in 2012, after having been retired for 22 years. So while you should consider your family heritage, your own health should also play a big part in your decision. An article published on February 11, 2010, in TIME Magazine titled "Health Check Up: How to Live 100 Years," had this to say: "While genes are certainly an important component of aging, they may not be the most relevant factor, if only because we don't have much control over them. The good news is that according to animal studies, only about 30% of aging is genetically based, which means the majority of other variables are in our hands. " In the case we referred to above, this man's father had serious heart issues. The man who retired at 55 had no heart issues and still doesn't. He's going strong, and there's an excellent likelihood he'll live another 10 years or more.

In thinking of your own health, there's something else to bear in mind: medical technology is advancing by leaps and bounds every year. Medical catastrophes that might have killed us ten or twenty years ago are now routinely resolved. Medicine now keeps us alive longer than ever before; chances are you'll live longer than you expect and, likely, longer than your parents did.

According to a US Census Bureau report released November 17, 2011, and supported by the National Institute on Aging (Report CB11-194), "The nation's 90-and-older population nearly tripled over the past three decades, reaching 1.9 million in 2010. Over the next four decades, this population is projected to more than quadruple."

If you're not planning for the possibility that you may live into your 90s, you may be in for a rude awakening.

By this point, you should understand why we made the assertion at the beginning of this paper that online calculators are of limited utility when it comes to making Social Security decisions. The reality is that no two families are the same, even if they appear identical on paper. One couple might want to leave a big inheritance; another might want to spend every penny while they're alive.

We would suggest that this is a complicated enough planning area that it makes sense and is worth your time to visit with a competent financial professional who is well versed in advising people, taking into account all of the factors relevant to your specific situation. The money you may save in unnecessary taxes and in the achievement of your maximum wealth potential could make it well worth your time. You will also be given the peace of mind that comes from knowing that an experienced set of eyes has gone over your finances, mitigating the possibility that you made some critical miscalculation.

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Greg Miller & Associates would like to offer you a free Social Security in-person consultation, as well as a 10-page, customized Social Security Timing Report. The report is generated from software that compares every possible election strategy available to married couples, single people, divorced people, widows, government employees, and even those who have already elected. The software then generates a full report incorporating multiple possible ages of death and cost of living adjustments. Your customized report will also feature claiming instructions, a cash flow report, an income gap report, and more.

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