SO, YOU CHANGED YOUR MIND! UNDOING THE SOCIAL SECURITY BENEFIT TIMING DECISION

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ABSTRACT

Individuals can choose to start their Social Security retirement benefit as early as age-62, or as late as age-70. The decision does affect the amount of benefit that they will receive each year until they die. Many elect to take earlier rather than later because they fear that, if they do not, a premature death would result in an economic loss of benefits. In this paper we explore the provisions of the Social Security Act that allows one to withdraw the election of early benefits [Form SSA-521 Request for Withdrawal of Application, Effective. Oct. 2012; also see http://www.socialsecurity.gov/planners/retire/withdrawal.html]. We first summarize recent Social Security reforms.

SOCIAL SECURITY REFORM

There are two possible ways that the original election can cause a subsequent regret. First, an individual elects to start early at a significant discount. Some 90 percent of our poorest workers elect to start their retirement benefit at age 62 and subsequently discover later in life that they do not have sufficient income to maintain a quality life. Second, an individual elects to defer until later to receive an enhanced benefit, and subsequently discovers that she has a serious health problem that will lead to early death.

The "file and suspend" option allows one who reached full retirement age to suspend benefits, probably intending to wait until she reaches age-70. Since she filed, a spouse or other beneficiary can begin to claim spousal or dependent benefits, and she gains the benefit of delaying benefits that grow at a rate of 8 percent plus cost of living increases. For anyone filing and suspending after April 29, 2016, the "suspension" applies to all benefits to all beneficiaries, including spouses and dependents. The election to receive retroactive benefits from the date of suspension is still available until age-70.

The "restricted application" allows one to file to take a spousal benefit only and later file for her full benefit. The final benefit is frequently claimed at age-70. To qualify for this restricted application, the spouse must have filed for her benefit (the file and suspend restrictions apply). This strategy, however, is only available for those born before 1954.

These changes made by the Bipartisan Budget Act of 2015 [Public Law No: 114-74 (11/02/2015)] make planning more difficult, but some attractive characteristics remain. For more information see J. Blankenship at http://financialducksinarow.com/10657/the-death-of-file-suspend-and-restricted-application/.

INTRODUCTION

If an individual starts her benefit at full retirement age (age 66 for every one born in 1943 through 1954, but increases to age 67 for those born in 1960 or later) she will receive the Primary Insurance Amount (PIA) each month until she dies. The PIA is a function of the average monthly covered earnings that the individual paid Social Security taxes on during her 35 highest earnings years. The earnings are adjusted annually for price level changes. The Social Security taxes paid on covered earnings on years 36 and above have no effect on the PIA. The calculation of the PIA is shown in Exhibit A.

While age 66 is currently the full retirement age for starting to receive Social Security retirement benefits, an individual may elect to start the benefit as early as age 62 or as late as age 70. If one starts the benefit at age 62, she will receive a reduced amount (75% of their PIA, 70% for those born in 1960 or later). For those who delay taking the benefit until after full retirement age, the benefit is enhanced at the rate of eight percent for each year that they wait.

For individuals who paid Social Security taxes on the maximum covered earning for 35 years and reached age 66 in 2014, the annual benefit at age 66 is $27,420, but increases to $37,632 if the individual waits until age-70 to start the benefit.

The cost of waiting to receive the increased amount of $37,632 per year starting at age 70 is foregoing four years of benefits at $27,420, a total of $109,680. Ignoring inflation, or the time-value-of money, the individual would have to live to age 81 to recover the cost of waiting ($109,680 / [$37,632 - $27,420 = $10,212] = 10.74 years).

Later, we will examine the case of Julie Ana an individual who decided to wait to claim the enhanced benefit but subsequently discovers she has a terminal disease that will lead to an eminent death.

PRIOR RESEARCH

Much prior research has been done on the decision: when should an individual begin to start taking their Social Security retirement benefit? Some researchers have reached a blanket conclusion such as Susie Orman (2003) who flatly stated that an individual should always start the benefit at age 62. Others, such as Gilkeson (2015) found that the Social Security claiming decision should reflect a wide range of personal factors. His paper examines specifically the decision for a person that "does not need the money." Haddad, et. al., (2013) focuses on the utilitarian needs of low income retirees; the decision depending upon the need to improve the quality of the individual's later life. Haddad, et. al. (2015), attempt to quantify the gain or loss from waiting, considering the time value of money.

Based on all of this prior research, it appears that the original decision is, indeed, a personal one that defies the best efforts of the academic community to definitively label it. Therefore, in this paper, we do not explore the reasoning behind the original decision but, instead, look at how the decision can be undone, if that is desired.

UNDOING A DECISION TO START EARLY

It is entirely possible that an individual may change her mind after making her decision when to start her Social Security Retirement benefits.

If an individual is receiving Social Security Retirement benefits and changes her mind, she may be able to withdraw her Social Security claim and re-apply at a future date. However, if an individual changes her mind 12 months or more after she became entitled to retirement benefits, she cannot withdraw her application. Additionally, she is not entitled to more than one withdrawal in a lifetime.

If an individual withdraws her application, she and her family must repay all the benefits received based on the application. The repayment must include the benefits paid to her spouse or to her children. Any of these who received benefits based on her application must also consent in writing to the withdrawal.

If she is already entitled to Medicare, she may also choose to withdraw Medicare coverage, but does not have to. If she is not entitled to Medicare, she will not automatically be enrolled at age-65.

She must request the withdrawal by filling out Form SSA-521 and state why she wants to withdraw the application. If she already has Medicare, she must also clearly state whether the Medicare coverage should or should not be included in the withdrawal. She has 60 days to cancel an approved withdrawal. After which she would lose any entitlement for the period covered by her original application.

If she cannot withdraw her application but has reached full retirement age, and is not yet age-70, she can ask that her benefit payments be suspended. This is somewhat important because it may allow her to receive a larger lump-sum payment later.

APPLYING FOR BENEFITS ON A RETROACTIVE BASIS

Once an individual is past full retirement age and has not yet filed for benefits, she may be entitled to up to six months of retroactive payments. However, if an individual wants to assure that she can retroactively retrieve more than six months of deferred payments, she must use the "file and suspend" strategy. Then, at any time before her benefits begin automatically at age-70, she can ask for a lump-sum payment for all the suspended benefits.

One must keep in mind that there are downsides to this request. One will lose all the delayed retirement credits that you have accrued at the rate of 8 percent plus cost of living adjustments for each year that benefits are suspended. It will prevent you from ever being able to collect spousal benefits while deferring your own retirement benefits.

Because survivors' benefits are tied into the amount the individual is entitled to, any thing that reduces her benefit will also affect their benefit. Therefore, filing and suspending benefits is best suited to single individuals who do not have a spouse or children. For married persons or single persons with former spouses and children the "file and suspend" strategy necessary to preserve the lump-sum option requires careful consideration.

One other consideration that should be looked at is the possibility that a large lump-sum Social Security payment could result in a large federal income tax payment in the year that it is received. For example, it would probably increase adjusted gross income (AGI) by 85 percent of the payment.

COLLECTING A LUMP-SUM BENEFIT

Julie Ana reached age-66, on January 1, 2014, and was entitled to begin receiving a PIA of $2,000 each month. However, if she waited until age-70 to claim her benefit, the amount would increase to $2,640 each month, plus COLAs [$2,000 * (.32 = 1.0 + (4 * .08))]. While Julie intended to wait until age-70 to begin her Social Security benefit, she and her husband, Jared, decided that he should begin to take his $1,000 spousal benefit at that time ($2,000 * .5). Therefore, Julie Ana filed for her benefit and immediately suspended it. This gave her the ability to collect a lump-sum payment retroactive to the date that she had filed.

Fast forwarding to November of 2017. Julie discovers that she has a terminal disease and should expect to die within a year or two. Because they need a large amount of money for medical expenses and a funeral, Julie and Jared decide that she should claim a lump-sum payment of $94,000 (47 * $2,000).

Because they are knowledgeable, Julie and Jared know that this decision will have a future cost. Julie's retirement benefit will now be $2,000 each month instead of $2,640. Additionally, when Julie dies, Jared's survivor's benefit will be $2,000 each month instead of $2,640. However, in this situation the claim for the lump-sum payment makes perfect sense. Jared would have had to live for 147 months (or about 15 years) after Julie died to make up for the difference in his survivor's benefit.

SUMMARY

Although individuals can choose to start their Social Security retirement benefit as early as age-62 or as late as age-70, the decision does affect the amount of benefit that they will receive each year until they die. Historically, many have elected to take earlier rather than later because they feared, that if they did not, a premature death would result in an economic loss of benefits. In this paper we explore the provisions of the Social Security Act (http://www.socialsecurity.gov/planners/retire/withdrawal.html) that allow an individual to undo a prior election.

We found two possible ways that the original election could cause a subsequent regret. First, when an individual elects to take early at a significant discount. Some 90 percent of our poorest workers elect to start their retirement benefit at age-62 and subsequently discover later in life that they do not have sufficient income to maintain a quality life. Second, when individuals elect to defer until later to receive enhanced benefits, and, subsequently discover serious health problem that could lead to an early death.

Legislation allowing individuals to repay discounted amounts received before full-retirement age in order to increase the benefit have had little success; most likely because lower income workers have had little or no savings available to make the payback. On the other hand, workers who have deferred taking the retirement benefit until as late as age-70 may successfully redo their decision and receive a retroactive benefit in the form of a lump sum payment. The lump sum payments, which can be more than one hundred thousand dollars, might provide critical funds for final illnesses, funerals or other expenses. Or, may simply increase the amount of wealth transferred to heirs.
There is a caveat, however; if there are survivors receiving spousal or other benefits based on the individuals benefit, those benefits will be decreased.

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EXHIBIT A

THE SOCIAL SECURITY RETIREMENT BENEFIT CALCULATION

The Social Security retirement benefit that a worker will receive, if retiring at full retirement age (age-66 for those born between 1943 and 1954)), is called the primary insurance amount (or PIA). Many of the worker's other benefits, including family benefits, are based on this PIA. The calculation of this PIA provides a much larger benefit to lower or middle income workers (relative to the amount of tax paid into the system) than it does to the high-income worker. Up to a certain level of inflation adjusted average monthly income[1] that social security taxes were paid on during the qualifying years (called a bend point) the PIA will include 90 percent of that amount. In the calculation, there is a second level of inflation adjusted average monthly income (from bend point one to bend point two). The PIA will include 32 percent of that amount. A third level of inflation adjusted average monthly income that Social Security taxes were paid on during the qualifying years is measured from bend point two to the social security taxable income ceiling. The PIA only includes 15 percent of this amount. This calculation is illustrated below, using the 2009 bend points, for a wage level inflation adjusted average monthly income of $8,900:

TABLE 1

Calculation of PIA

	First Bend Point $744		Second Bend Point $4,483		Maximum Income Level $8,900		Total
Range	(744 * .90)	+	((4,483 – 744) * .32)	+	((8,900 – 4,483) * .15)		
PIA	**[((670**	+	**1,196) = 1,866))**	+	**663]**	=	**$2,529**

As illustrated, the worker paying the maximum amount into the social security system on **$106,800** ($8,900 x 12) of annual wages, receives a monthly PIA of **$2,529** or **$30,348** annually. However, a middle income worker paying into the social security system on **$53,796** ($4,483 x 12) would receive a monthly benefit of **$1,866** ($670 + $1,196) or **$22,392** annually. Clearly, this illustrates the benefit advantage to the middle-range worker. The high-range income worker receives only **$663** more per month than the middle-range income worker while having paid almost twice as much in social security taxes.

EXHIBIT B

[1] Usually, the inflation adjusted average monthly income is based on the workers 35 best years in which social security taxes were paid. The original wages are inflation adjusted using a wage level inflation index rather than a consumer price level inflation index. We will not pursue this topic further but, for illustration purposes, will assume that we can use the bend points and the social security tax ceiling for 2009. The first and second bend points in 2009 were $744 and $4,483, respectively. The social security tax ceiling in 2009 was $106,800. Therefore, for our illustration, we assume the maximum inflation adjusted average monthly income is $8,900.

RELEVANT PROVISIONS OF BIPARTISAN BUDGET ACT OF 2015
PUBLIC LAW NO: 114-74 (11/02/2015)

Subtitle C--Protecting Social Security Benefits

SEC. 831. CLOSURE OF UNINTENDED LOOPHOLES.

(a) Presumed Filing of Application by Individuals Eligible for Old- Age Insurance Benefits and for Wife's or Husband's Insurance Benefits.--

(1) In general.--Section 202(r) of the Social Security Act (42 U.S.C. 402(r)) is amended by striking paragraphs (1) and (2) and inserting the following:

(1) If an individual is eligible for a wife's or husband's insurance benefit (except in the case of eligibility pursuant to clause (ii) of subsection (b)(1)(B) or subsection (c)(1)(B), as appropriate), in any month for which the individual is entitled to an old-age insurance benefit, such individual shall be deemed to have filed an application for wife's or husband's insurance benefits for such month.

(2) If an individual is eligible (but for section 202(k)(4)) for an old-age insurance benefit in any month for which the individual is entitled to a wife's or husband's\ insurance benefit (except in the case of entitlement pursuant to clause (ii) of [[Page 129 STAT. 612]] subsection (b)(1)(B) or subsection (c)(1)(B), as appropriate), such individual shall be deemed to have filed an application for old-age insurance benefits—

(A) for such month, or

(B) if such individual is also entitled to a disability insurance benefit for such month, in the first subsequent month for which such individual is not entitled to a disability insurance benefit.

(2) Conforming amendment.--Section 202 of the Social Security Act (42 U.S.C. 402) is amended— (A) in subsection (b)(1), by striking subparagraph (B) and inserting the following: (B)(i) has attained age 62, or (ii) in the case of a wife, has in her care (individually or jointly with such individual) at the time of filing such application a child entitled to a child's insurance benefit on the basis of the wages and self-employment income of such individual; and (B) in subsection (c)(1), by striking subparagraph (B) and inserting the following: (B)(i) has attained age 62, or (ii) in the case of a husband, has in his care (individually or jointly with such individual) at the time of filing such application a child entitled to a child's insurance benefit on the basis of the wages and self-employment income of such individual,".

(3) <<NOTE: Applicability. 42 USC 402 note.>> Effective date.--The amendments made by this subsection shall apply with respect to individuals who attain age 62 in any calendar year after 2015.

(b) Voluntary Suspension of Benefits.—

(1) In general.--Section 202 of the Social Security Act (42 U.S.C. 402) is amended by adding at the end the following: (z) Voluntary Suspension.--(1)(A) Except as otherwise provided in this subsection, any individual who has attained retirement age (as defined in section 216(l)) and is entitled to old-age insurance benefits may request that payment of such benefits be suspended—

(i) <<NOTE: Effective date.>> beginning with the month following the month in which such request is received by the Commissioner, and

(ii) <<NOTE: Termination date.>> ending with the earlier of the month following the month in which a request by the individual for a resumption of such benefits is so received or the month following the month in which the individual attains the age of 70.

(2) <<NOTE: Termination date.>> An individual may not suspend such benefits under this subsection, and any suspension of such benefits under this subsection shall end, effective with respect to any month in which the individual becomes subject to—(A) mandatory suspension of such benefits under section 202(x); (B) termination of such benefits under section 202(n); (C) a penalty under section 1129A imposing nonpayment of such benefits; or (D) any other withholding, in whole or in part, of such benefits under any other provision of law that authorizes recovery of a debt by withholding such benefits. [[Page 129 STAT. 613]]

(3) In the case of an individual who requests that such benefits be suspended under this subsection, for any month during the period in which the suspension is in effect-- (A) no retroactive benefits (as defined in subsection (j)(4)(B)(iii)) shall be payable to such individual; (B) no monthly benefit shall be payable to any other individual on the basis of such individual's wages and self-employment income; and (C) no monthly benefit shall be payable to such individual on the basis of another individual's wages and self-employment income."

Conforming amendment.--Section 202(w)(2)(B)(ii) of the Social Security Act (42 U.S.C. 402(w)(2)(B)(ii)) is amended by inserting ``under section 202(z)'' after ``request''.

<<NOTE: Applicability. 42 USC 402 note.>> Effective date.--The amendments made by this subsection shall apply with respect to requests for benefit suspension submitted beginning at least 180 days after the date of the enactment of this Act.