Poof! Two Important Social Security Claiming Strategies Disappear

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Background

In late 2015, legislation was enacted that increased spending levels and raised the debt limit to avoid a fiscal showdown between the White House and Congressional Republicans that has become common in Washington, at least until after the 2016 elections. As part of the budget deal, two important Social Security claiming strategies (or loopholes as some would suggest) have been eliminated: file and suspend and filing a restricted application for spousal benefits. This article will describe how these strategies work, potential grandfathering opportunities and suggestions for advising clients moving forward.

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File and Suspend

At Full Retirement Age (FRA), a worker is entitled to receive 100% of their Social Security retirement benefits, or Primary Insurance Amount (PIA), using the Social Security Administration's technical jargon. For each year that a worker delays his benefits until age 70, he receives an 8% delayed retirement credit. For example, if a worker's FRA is 66 and he claims at age 70, his benefit will increase by 32% (8% for four years). Suppose a worker decides to wait until age 70 but changes his mind at age 68. He still receives a 16% increase for the two years benefits were delayed. For individuals who can afford to wait to receive Social Security, the 8% delayed retirement credit is a good deal. (Of course, spending investable assets to meet current living expenses between ages 66 and 70 introduces an opportunity cost, which may result in a lower overall net return).

Year of Birth	Full Retirement Age (FRA)
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	67

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Generally, a lower-earning spouse is entitled to receive 50% of the higher earning spouse's benefit upon reaching FRA. One of the requirements, however, is that the higher earning spouse must have filed for benefits. Suppose both spouses are age 66. If the higher earning spouse files for benefits, it will allow the lower earning spouse to collect now, but forfeit the higher earning spouse's ability to earn the annual 8% delayed retirement credit.

Enter file and suspend. This strategy provides the higher earning spouse the option of filing and immediately suspending benefits. This allows the lower earning spouse to collect the 50% spousal benefit presently while the higher earning spouse delays his benefit, presumably until age 70, collecting the generous 8% annual credits along the way.

Example. John's benefit is $1,000 a month and Mary's benefit is $300 a month. Both John and Mary are age 66 and have reached full retirement age. Of course, Mary is better off with half of John's benefit than her own because $500 is greater than $300. John can file and suspend, triggering the $500 benefit to Mary now, while his $1,000 benefit grows by 8% each year he waits until age 70, ignoring cost-of-living adjustments. In the meantime, Mary receives four years of spousal benefits even though John is not collecting.

Is file and suspend a loophole that should have been closed a long time ago or savvy strategy taken away from future Social Security recipients? Regardless of one's personal opinion, the key takeaway is that there is a grandfathering provision that permits a worker to file and suspend, and allow another person to collect on his earnings record, up until April 30, 2016. It is important to note that the original bill would have stopped spousal benefits currently being paid using the file and suspend strategy. The bill was amended and the rule is clear: as long as the suspension is done by April 30, 2016, spousal benefits may be paid.

Remember that in order to file and suspend, the worker must be FRA. This means anyone who does not reach FRA by April 30, 2016, will not be eligible to file and suspend. Also, remember that because a worker files and suspends, it does not necessarily mean the spouse must claim immediately.

Example. Phil reaches FRA in March 2016 and files and suspends. His spouse, Susan, will not reach FRA until March 2017. While she can begin receiving spousal benefits after Phil files, the amount will be reduced by roughly 5% since she is claiming one year prior to her FRA. In order to claim the full spousal benefit without reduction, she can wait until she reaches age 66 in 2017, a year after Phil files and suspends.

The final piece to the phase-out of the file and suspend strategy is the elimination of the lump-sum option. In the past, workers who suspended benefits may have had the opportunity to collect benefits retroactively in the form of a lump-sum. Suppose a worker files and suspends at age 66 and becomes terminally ill at age 69. He could have elected to collect the three years of benefits retroactively as a lump-sum payment, forfeiting the delayed retirement credit. Now, Social Security will only resume his benefits at age 69, adjusted for the delayed retirement credits. The lump sum option is no longer available.

Restricted Application

Under current law, upon reaching FRA a worker may file to receive a spousal benefit while allowing his benefit to earn delayed credits. In effect, the application is "restricted" to receive only the spousal benefit presently, with the intent to switch to the worker's own much higher benefit at age 70.

Example. At FRA, Julie's monthly benefit is $1,000 and her husband Tom's benefit is $600. Tom has reached FRA and files to receive his benefit. Julie wants to wait until age 70 to collect her own benefit so she files a restricted application to collect 50% of Tom's benefit, or $300, now. At age 70, she switches over to her own benefit of $1,320 (reflecting the 8% delayed retirement credit for four years), ignoring cost-of-living adjustments. Effectively, this strategy allows Julie to collect some benefits now, and larger benefits later.

The key point is that in order to take advantage of a restricted application, the worker must have attained FRA. When a worker claims benefits prior to FRA, the Social Security Administration will pay the individual the greater of their own benefit or the spousal benefit. There is no opportunity to elect receipt of only the spousal benefit. Also, remember that the amount will be permanently reduced since payments begin prior to FRA.

The new legislation is phasing out the restricted application strategy. Now, when a person files for benefits, whether before, at or after their FRA, Social Security will pay the greater of the individual's own benefit or 50% of their spousal benefit. In the example above, Julie would get her own $1,000 monthly benefit at FRA and will no longer be able to restrict her filing to receive only 50% of Tom's benefit. Of course by taking benefits now, Julie will forfeit the opportunity to earn delayed retirement credits.

The good news is that anyone who had turned age 62 by December 31, 2015, will be grandfathered. This provision means eligible individuals will still be able to file a restricted application but only upon reaching their FRA. In other words, simply because an individual satisfies the grandfathering provisions does not necessary mean he can file a restricted application today. The individual must still attain FRA. Also remember that the spousal benefit is payable only if the individual's spouse has filed to receive benefits.

Putting it All Together

If the file and suspend and restricted application strategies were not complicated enough, advisors now have to account for the two different grandfathering dates. Below are two examples that may help illustrate how clients may navigate these new rules.

Example. Roger and Pauline are both age 64. Roger's monthly benefit is $1,400 and Pauline's benefit is $500. Since both Roger and Pauline reached age 62 by December 31, 2015, they are both eligible to take advantage of filing a restricted application, although no action is required today. One option is when Pauline reaches her FRA, she claims her $500 benefit and Roger, who also reaches his FRA, claims the $250 spousal benefit. In four years, he switches over to his much higher benefit of $1,848. When Roger claims his own benefit, Pauline will get $700 since 50% of $1,400 is greater than her own benefit of $500. At age 70, total household income increases to $2,548.

Alternatively, at FRA Roger can claim his own benefit of $1,400 and Pauline can claim the spousal benefit of $700. This strategy produces more household income between FRA and age 70, but less thereafter. Cost-of-living adjustments are ignored.

	Monthly income if Roger files a restricted application in 2018		Monthly income if Roger files for own benefit in 2018	
	2018	2022	2018	2022
Roger	$250	$1,848	$1,400	$1,400
Pauline	$500	$700	$700	$700
Total	**$750**	**$2,548**	**$2,100**	**$2,100**

Example. Rhonda will reach her FRA in March 2016. Her husband Lewis is two years younger and thus he will reach his FRA in 2018. Rhonda's monthly benefit is $2,000 and Lewis's benefit is $1,500. One option is for Rhonda to claim benefits in March. She will receive $2,000 a month. Alternatively, she could file and suspend, delaying benefits until age 70, increasing her benefit to $2,640. Since Lewis is older than age 62 on December 31, 2015, he qualifies to file a restricted application at FRA. He could choose to collect 50% of Rhonda's benefit, $1,000, in 2018 allowing his benefit to earn delayed retirement credits. Rhonda, however, must file and receive her own benefit when Lewis reaches FRA or file and suspend by the April 30, 2016, deadline in order to afford him this option. If Rhonda does neither, Lewis may only claim based on his own work record. Cost of living adjustments are ignored.

	Monthly income if Rhonda files and receives her benefit in 2016; Lewis files a restricted application in 2018				Monthly income if Rhonda files and suspends by April 30, 2016, and receives her benefit in 2020; Lewis files a restricted application in 2018			
	2016	2018	2020	2022	2016	2018	2020	2022
Rhonda	$2,000	$2,000	$2,000	$2,000	$0	$0	$2,640	$2,640
Lewis	$0	$1,000	$1,000	$1,980	$0	$1,000	$1,000	$1,980
Total	**$2,000**	**$3,000**	**$3,000**	**$3,980**	**$0**	**$1,000**	**$3,640**	**$4,620**

A Silver Lining

For those clients who will not meet the grandfathering provisions, advisors have two fewer tools to work with. The good news is that many other savvy Social Security strategies remain, including:

> Delayed retirement credits. For clients in good health and who have other financial resources at their disposal, delaying Social Security until age 70 can really pay off. Not only does this strategy maximize a worker's own benefit, but it also maximizes the survivor's benefit. A thorough break-even analysis should be conducted based upon each client's unique set of circumstances.

> Survivor strategies. Untouched by the new legislation are savvy strategies unique to surviving spouses. For example, suppose a survivor has a modest earnings record. She might decide to take her benefits based on her own work record at age 62, then switch over to the higher survivor benefit at FRA. Alternatively, for survivors with a robust earnings record, the best option may be to take the survivor's benefit at age 60 (50 if disabled), then switch over to her own larger benefit at age 70.

> Divorced spouses. Spousal benefits based on an ex-spouse's earnings record are available for clients who are divorced, provided the marriage lasted at least ten years and the individual has not remarried. Also, as long as the divorce occurred more than two years ago, the ex-spouse does not need to claim in order for your client to receive benefits. If your client meets these criteria, you should incorporate spousal benefits into your analysis.

Finally, the budget deal did avert a 52% increase in Medicare Part B premiums for approximately 30% of beneficiaries in 2016. Instead, the rate hike was 15%. Also, the Social Security disability fund, which was on track to only pay 80% of benefits in 2016, has been sufficiently funded to provide full benefits until 2022.

The Bottom Line

The new rules have created mass confusion as individuals try to determine how, if at all, their benefits and intended claiming strategies may be impacted. Advisors will still need to help those individuals who meet the grandfathering rules understand and take advantage of the file and suspend and restricted application strategies. Even for clients who are not eligible, the decision when to claim benefits can have a significant impact on their ability to generate sustainable, inflation-adjusted cash flow throughout retirement. For forward-thinking advisors seeking to separate themselves in a crowded marketplace, providing Social Security assistance remains a valuable differentiator.

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