New guide explores making the most of Social Security

September 4 2008

Many older Americans may be shortchanging their golden years by tapping into Social Security too soon, according to a University of Illinois expert who has studied the federal retirement program for nearly two decades.

More than three of every four Americans trim their monthly Social Security checks for life by claiming benefits early, a choice many might forego if they better understood the program's options and consequences, law professor Richard L. Kaplan says.

An authority on elder law, Kaplan has written a practical guide that appears in the July-August issue of the *Journal of Retirement Planning* to help people decide when to start collecting Social Security benefits.

The guide covers a myriad of variables, including the implications of tapping early retirement benefits – available as early as age 62 – rather than waiting until full retirement age, which is gradually increasing to 67 for people born in 1960 or later.

"It depends on individual circumstances, but I think a lot of people claim early inappropriately," Kaplan said. "Some have unfounded fears that Social Security will go bankrupt. Others do it because their friends are doing it. There's a huge social network component to this."

He says one of the biggest mistakes people make is underestimating their life expectancy, which now averages about 77 years in the U.S., up from just 61 ½ when Social Security was established in 1935.

Miscalculations often stem from looking at family health history without factoring in medical progress that has made once-fatal ailments treatable, Kaplan said.

"They should talk to their doctor, but the fact that their parents died young does not mean they should jump into Social Security," he said. "It depends on what their parents died from. Even if they have the same condition, their experience is likely going to be better."

Claiming Social Security at age 62 nets a roughly 25 percent cut in benefits that extends for a lifetime, Kaplan said, trimming a monthly payment that would amount to $1,000 at full retirement age to $750.

Beyond that, he said, the reduction in benefits also extends to a surviving spouse if the retiree dies and the spouse has no Social Security worker benefit that would provide a bigger payout.

"So particularly if the surviving spouse is younger and/or healthier, the retiree needs to think about the impact on that person," Kaplan said. "People say 'I don't expect to live long, so I'd better get my money now.' That may be, but if they're married it's going to reduce what the spouse has to live on."

Health insurance is another variable people need to consider as they mull when to start taking Social Security, he said. While retirement benefits can be claimed as early as age 62, Medicare coverage doesn't begin until 65, leaving a potentially costly gap.

That gap can be even wider for prospective retirees with younger spouses, he said, citing a 67-year-old who is still working to continue employer-provided insurance for his 60-year-old wife.

Working – whether for health insurance or income – also factors into the decision on when to start collecting Social Security, he said. Benefits prior to full retirement age are trimmed by $1 for every $2 earned above an annually adjusted threshold that stands at $13,560 in 2008, creating what amounts to a 50 percent marginal tax rate on the affected earnings.

Kaplan says claiming benefits early makes more sense for people who plan to live on the money than those who intend to invest it and build a nest egg for retirement later on.

"The benefit increases actuarially about 7.6 percent a year from age 62 to 70, so the question is do you really think you can earn that kind of return after tax with no investment risk," he said. "If people want to play the commodities, maybe they can do it, but that's not zero investment risk."

Kaplan says the rush for early benefits may stem in part from a misguided notion that not claiming benefits at age 62 means waiting until full retirement age to make a claim.

"It's not just 62 or retirement age," he said. "Benefit commencement is on a month-to-month basis, so there are 96 decision points between age 62 and 70, when benefits max out. And the longer you delay, the bigger the monthly benefit."

Source: University of Illinois at Urbana-Champaign

Citation: New guide explores making the most of Social Security (2008, September 4) retrieved 3 May 2024 from https://phys.org/news/2008-09-explores-social.html