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The timing of Social Security

By Diane

Social Security benefits are a major retirement income source for many people. So, the timing of when you start receiving Social Security is important. In our experience, clients are worried about three main issues related to when to file: dying too young, waiting too long to claim benefits, and the tax bracket they'll be in when they retire. We'll look at each of these in more detail.

Dying too young

People who file for Social Security benefits at age 62 typically do so for one of two reasons. First, they're worried about dying too soon and not recouping the money they paid into the system. Or second, they're worried about the sustainability of the Social Security system. We'll focus on the first of these reasons and leave the second for another time.

Many experts say people think about Social Security wrong. Rather that viewing it through a break-even lens, they should think of Social Security as longevity insurance. It is designed to provide you income as long as you are on this earth. This helps reduce the risk of outliving your money, which would be a financial disaster.

Remember, if you claim benefits at age 62, your benefit is 25% less than if you'd wait until full retirement age (FRA). Each year you delay benefits between age 62 and your FRA, your benefit increases 8%. And if you delay beyond FRA, your benefit continues to grow until age 70. If you take the long view, filing early can mean leaving a lot of money on the table.

Waiting too long to claim

There are situations where it makes sense to file early. One is if you have a disabled child. They can't receive their Social Security benefits until you begin receiving yours. And if you're in bad health or have a family history of a shorter than normal life expectancy, you also might be a good candidate to file at 62. If you are a married couple and had a primary earner in the family but now both of you are in poor health, it might make sense to claim early also.

Tax brackets in retirement

Most people assume they will be in a lower tax bracket when they retire. For those who have saved a significant amount of money in company retirement plans or tax-deferred plans, this may not be the case. At the current time, required minimum distributions (RMDs) must start in the year you turn age 72. Your RMD becomes taxable income when it comes out of your IRA or 401(k). A large RMD can put you in the same or even a higher tax rate than what you were in when working. This is especially true when combined with Social Security and any pension payments. If you will face high RMDs and have other retirement income sources, you might consider taking distributions from your IRA/401(k) prior to RMDs kicking in. We wrote about this concept in 2019 before the age for RMDs changed, but the logic still holds.

Each one of us has our own set of circumstances when it comes to Social Security and our financial lives. We highly suggest going through our financial planning process with our team to find your best strategy when it comes to filing for Social Security.

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