18 Social Security Surprises Facing Advisors, Clients

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I've been writing a weekly Q&A column for the last year, and the no. 1 issue I am asked about is claiming Social Security. It is no. 1 by such a wide margin that I can't even guess what topic is in the runner up slot.

"When should my spouse and I take Social Security?" The answer is usually some version of "if this, then that, unless this or that." The rules and exceptions and exceptions to exceptions are worse than what I remember of chemistry.

Social Security's handbook has over 2,700 rules. Explanations of the rules are found in the Program Operating Manual System (POMS). I caution my fellow financial planners about being too harsh on Social Security personnel for not always having the correct information. Theoretically, all the answers are in the POMS, but that does not mean they are easy to find.

Today, I thought I would share some of the surprises planners and their clients encounter frequently. I've numbered them just to keep tabs with them, not to rank them.

1. At full retirement age (FRA), one may receive their retirement benefit or a spousal benefit equal to half their spouse's retirement benefit, whichever is larger. Many do not realize that to claim that spousal benefit, the spouse on whose record the 50 percent payment is based must be receiving or have suspended retirement benefits.

2. A favorite discussion is using a "restricted application" or a "file and suspend" strategy to maximize the amount of lifetime benefits paid to married couples. Many are disappointed to find that these options only exist at full retirement age.

If a worker starts benefits prior to their FRA, and their spouse is receiving retirement benefits, the worker does not get to choose between their retirement benefit and a spousal benefit. They are automatically deemed to have begun their retirement benefit, and if their spouse is receiving retirement benefits, a supplement is added to reach the spousal benefit amount. All this is reduced for starting early. The total will be less than half the normal retirement benefit.

3. Similar to the above for retirement benefits, if your spouse applies for retirement benefits early and you are receiving disability benefits, your spouse will automatically be deemed to be applying for a spousal supplement and the reduction that goes with starting this early.

4. One exception to being deemed to have started your retirement benefits to note. While caring for dependent children under age 16, you can get a spousal benefit, regardless of your age (must be 62 normally), without being deemed to have claimed your own retirement benefit. Your spouse will still need to have claimed their retirement benefits.

5. If you start your retirement early and your spouse has not claimed or suspended their retirement benefit, you cannot get a spousal supplement until they do file.

6. Continuing off 5 above, if you have claimed your retirement benefit early, when you reach your FRA, if your spouse then files for their retirement and you want to switch to a spousal benefit, you will not get 50 percent. The formula is (A-B)+C Where A=½ the worker's Primary Insurance Amount (PIA, their benefit at their FRA), B= 100 percent of the spouse's PIA, and C= the spouse's EARLY retirement benefit. Since starting early means C is less than B, the total is less than 50%. One only gets half their spouse's benefit if the spousal benefit is claimed at FRA.

7. Spousal benefits do not receive delayed credits. If taking the spousal benefit is good for a couple, delaying the claim for spousal benefits past the recipient's FRA has no additional benefit.

8. Same for widow/widower benefits. They can be started early but there is no benefit to delaying past FRA as no delayed credits apply. Before a worker dies, delaying does increase the potential survivor's benefit.

9. Taxpayers whose income is low can find that some forms of tax planning can result in higher than expected taxation. Many retirees will make distributions from IRAs or qualified retirement plans prior to age 70½ to have a low tax rate applied. Roth conversions are often done for the same reason. A relatively small amount of taxable income can cause up to 85% of Social Security payments to become taxable.

10. New this year, an increase in taxable income as just described can also cause a reduction or elimination of subsidies available to lower income households under the new health insurance law. Social Security payments, even the tax-exempt portions, are included in this evaluation. SSI is excluded.

11. With today's mobile workforce, it is not unusual to find some taxpayers that worked at a job and earned a pension benefit but was not subject to withholding for Social Security and another job that was subject to Social Security taxes. Many such folks are unpleasantly surprised that their Social Security benefits may be reduced due to the Windfall Elimination Provision.

12. If your client "files and suspends," Medicare premiums cannot be paid automatically from Social Security and must be paid directly to the Center for Medicare & Medicaid Services (CMS). Be sure your client is getting billed properly by CMS. If it is not paid timely, your client can lose their Medicare Part B coverage.

13. When collecting retirement benefits, increases in Medicare Part B premiums are capped to the same rate of increase of the retirement benefits under a "hold harmless" provision. This is tied to actual receipts so while delaying past your FRA earns your client delayed credits, there is no cap on the Medicare increases. Worse, the uncapped increase is locked into every future premium. This hold harmless quirk is not relevant to high income taxpayers. Hold harmless does not apply to high income taxpayers paying income-related Medicare B premiums.

14. If you take your retirement early, it not only reduces your retirement benefits, benefits for your survivor is also based on that permanently reduced amount.

15. Because the income thresholds that determine how much of one's Social Security is taxable are not indexed for inflation, over time more and more of the benefits can become taxable.

16. A person needs to have been married to an ex-spouse for at least ten years immediately before a divorce is final, in order to be eligible to receive a spousal benefit off a former spouse's record.

17. If you marry again, you are no longer eligible for a spousal on your ex's record and a new 10-year clock starts on the marriage to your new spouse. If you are over 60 when you get married again, you will still be able to claim survivor benefits on your ex.

18. Because it used to be allowable to pay back all your retirement benefits and start over, many people think they can change their minds about starting retirement benefits early. Withdrawing your claim this way basically erased the claim as though it never happened and future benefits would therefore be higher.

Today, if you regret your choice, you can only withdraw your claim and payback benefits within 12 months of your early start. After 12 months, you are stuck with your choice until your FRA at which point you can suspend and earn delayed credits up to age 70. The credits are applied to your reduced benefit.

These are just a few quirks we run into with some frequency. Such complexity makes planning for Social Security benefits and claiming strategies an area where land mines await the unaware. It is also an area full of opportunity for financial planners to add value.

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