When clients seek Social Security advice

Clients find Social Security confusing. Here are some case studies that can help them make the best decisions on maximizing benefits. • Komal Motwani

Social Security regulations and claiming strategies can be complex and can vary from client to client.

Clients frequently turn to their advisors with questions on Social Security benefits and how to maximize them. Here are some case studies based on real-life events that may help you provide some insights and educate clients based on their individual situations.

Lynn, a successful real estate agent, just turned 63. Her full retirement age is 66 years and 10 months. Her husband recently died, and she is in a higher tax bracket than he was. Lynn asked her financial professional for advice on Social Security survivor benefits.

Lynn was informed by the Social Security office that she may not qualify for survivor benefits because her income is too high.

Here are Social Security's survivor benefits rules:

1. A surviving spouse can collect 100% of the late spouse's benefit if the survivor has reached full retirement age. However, the curveball is that the amount will be lower if the deceased spouse claimed benefits before they reached full retirement age. Survivor benefits are frozen in time at the date of the worker's death. So, they are worth 100% of what the deceased worker received at that time.

2. Technically, a qualified widow or widower qualifies for survivor benefits if they are at least 60 years old and had been married to the deceased for at least nine months. However, the amount will be reduced (71.5% to 99% of the deceased worker's basic amount) if the deceased started taking benefits before reaching full retirement age.

3. If you are younger than full retirement age and earn more than the yearly earning limits, benefits may be further reduced. One dollar is deducted from your benefit payments for every $2 you earn above the annual limit.

Based on points 2 and 3, even though Lynn meets the marriage requirement, her benefits may be reduced substantially based on her higher income. If she starts to collect her survivor benefits at age 62, the benefits will be further reduced to begin with, as she has not reached her full retirement age (Point 2).

I concur with the Social Security office analysis. However, if and when she plans to retire or if she reaches full retirement age at that time, it will be prudent to reevaluate her circumstances and review her benefits. She plans to continue to work for the foreseeable future. She may still qualify for survivor benefits or receive her own benefits (whichever is the higher of the two) at the time of her retirement or when she reaches her full retirement age, whichever comes first.

What about spousal benefits?

Although we are not experts on Social Security, we try to educate clients on such matters and encourage them to schedule a meeting with a Social Security officer to receive accurate information on a case-by-case basis. A participant can transfer all or part of their qualified retirement plan benefits to a former spouse without being liable for income taxes on the transfer if the transfer is made pursuant to a qualified domestic relations order.

John (age 65) and Jasmine Smith (age 68). John has a normal retirement age of 66 years and six months. He plans to continue working until his full retirement age. At that time, he will begin to claim his own Social Security benefit, although he enrolled in Medicare this year. His wife, Jasmine, started claiming Social Security early, at age 62.

John and Jasmine wanted to understand the ramifications or changes that will occur to Jasmine's Social Security when John files for his own Social Security at his normal retirement age. Can Jasmine switch to spousal benefits and receive half of John's income?

Because Jasmine filed for Social Security early, her benefits may be reduced permanently. When John files for his benefits, Jasmine's total monthly payment (spousal benefits) will be less than half of her spouse's primary benefit amount at full retirement age. Jasmine can claim spousal benefits only if her current spouse has filed for his own benefits.

If John were to claim his Social Security retirement benefits early, this would not affect Jasmine if she waited until her full retirement age to claim her spousal benefits (she can collect the full benefit amount). This is because dependents' benefits are based on the primary benefit amount, which is based on earnings at full retirement age.

In this case, whether John claimed benefits early doesn't really have an impact on the amount Jasmine can collect; spousal benefits are half of the primary amount if she waited until full retirement age to claim benefits. Because she claimed her own benefits early, the spousal benefits also may be reduced. Remember, you only get the higher of the two benefits — your own benefits or half of spousal benefits. We still recommend clients speak with a Social Security officer to gather more information.

What about withholding?

Recently, in a client meeting I was asked an interesting question: At what age or income level will the Social Security and Medicare taxes or withholdings cease?

The current tax rate for Social Security is 6.2% for the employer and 6.2% for the employee, or 12.4% total. The current rate for Medicare is 1.45% for the employer and 1.45% for the employee, or 2.9% total.

Only the Social Security tax has a wage base limit. The wage base limit is the maximum wage that's subject to the tax for that year. For earnings in 2023, this base is $160,200. The maximum amount of Social Security tax an employee will have withheld from their paycheck in 2023 will be $9,932 ($160,200 x 6.2%).

There's no wage base limit for Medicare tax. All covered wages are subject to Medicare tax. Workers who earn more than $200,000 are also subject to a 0.9% additional Medicare tax.

How do they come up with the numbers?

Now, how are the Social Security benefits calculated?

The amount your client gets from Social Security benefits every month depends on two factors: 1) the amount of their lifetime earnings and 2) their age at retirement. In essence, the more they earn and the longer they wait to claim benefits, the bigger the monthly check they will receive. The maximum amount someone can receive in 2023 is $4,555 per month if retiring at age 70.

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According to their calculations

Here are some other things to know about how the Social Security Administration calculates retirement benefits.

1. The Social Security Administration gathers data on up to 35 of your highest-earning years, stopping at age 60.
2. The Social Security Administration indexes those earnings for inflation so that income you earned in, say, 1993 is revised to reflect what that income is in today's dollars.
3. After that, Social Security applies a somewhat-complex formula to determine your primary insurance amount, which is the benefit payment you would receive if you wait until you reach full retirement age.
4. You're also eligible for cost-of-living benefit increases starting the year you turn 62, even if you don't take your benefits until later.
5. The Social Security Administration decreases your benefit if you retire before your full retirement age, and it increases your benefit if you delay retirement until after your full retirement age (up to age 70).

Source: NerdWallet