Five Essentials of Social Security Benefits

You probably wouldn't expect to know how to effectively use all the features of a specialty saw in a craftsman’s workshop without some instructions. Likewise, you shouldn’t expect to understand all the ins and outs of Social Security without a little help. Just like that specialty saw, Social Security is a tool you should try to thoroughly understand before you begin using it. If you don’t, you run the risk of missing out on the planning advantages you could otherwise gain. Today, let's talk about five essentials of the Social Security benefit system that you really should understand in order to maximize your benefits.

- Benefits are determined by averaging your highest 35 years of earnings. Often, an individual’s highest earning years are toward the end of their career. By understanding how Social Security determines your benefits, you can rethink your retirement strategy so that you spend another year or more at a higher paying job to increase your overall average.

- Every year, the IRS re-evaluates cost-of-living based on increases in the consumer price index. This evaluation determines whether seniors on Social Security are entitled to a payment increase in order to combat the effects of inflation. While the cost-of-living adjustment each year will vary, the historical average is about 4 percent.

- Full retirement age varies depending on your date of birth. You can start receiving benefits as early as age 62, but doing so will result in a permanent reduction in benefits you receive. This knowledge prompts many to wait until they reach full retirement age before taking a benefit. But full retirement age isn't 65 for everyone. In fact, only those born in 1937 or earlier are considered full retirement age at 65. Those born later need to check the Social Security site to see when their full retirement age is. It’s also worth noting that retirees can gain even more Social Security income if they delay taking benefits past their full retirement age.

- Social Security benefits can be taxable. Most seniors collecting Social Security must still file a 1040 tax form at the end of every year. If these seniors have additional income through interest, dividends, or wages, then they may be required to pay federal income tax on their Social Security benefits. Depending on how much your combined income is, as much as 85 percent of your Social Security benefits may be taxable. Understanding this, you can put certain strategies into play to help reduce your future tax burden, such as using a Roth 401(k) for post-retirement distributions.

- Electing to take spousal benefits early can permanently reduce your benefit. Married individuals, or formally married individuals, have many different options for structuring their Social Security benefits. One option is for a lower-earning spouse to collect as much as 50 percent of the higher-earning spouse's benefit. It's important to remember that if you do this, you still may want to wait until you’ve reached full retirement age before triggering the benefit. Otherwise, it will permanently reduce the amount of benefit you can receive. Likewise, if you begin taking your own Social Security benefit before reaching full retirement age and switch to the spousal benefit after you’ve reached full retirement age, it's likely that you will not receive the full spousal amount you are entitled to.

Social Security is an important part of your overall retirement plan. It provides a lifetime income that goes far in helping your savings last.

Be sure to talk to your financial advisor about how to maximize your Social Security benefits. By working together with your advisor, you can better strategize when to take Social Security, so you can create the most effective plan and the most comfortable retirement.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investments or products may be appropriate for you, consult with your financial advisor.

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