SOCIAL SECURITY BENEFITS AT 65: DELAY, OR TAKE THE MONEY & RUN?

By Robert Muksian, Ph.D.

Those who are about to collect Social Security need to analyze whether they are better off receiving the lower amount of benefits now, or delaying and receiving the higher amount of benefits later. The answer depends in part on what you intend to do with the benefits, and can be analyzed by determining the "breakeven" age.

President Clinton signed into law the "Senior Citizens' Freedom to Work Act of 2000" on April 7, repealing the earnings limits that reduced Social Security benefits for retirees between age 65 and 70. All persons age 65 and older may now earn any amount of FICA-taxed wages annually and still receive full Social Security benefits.

However, as it was in the old law and remains in the new law, an individual may forego Social Security benefits until age 70 in order to take advantage of a delayed retirement credit.

Needless to say, those who are about to collect Social Security need to analyze whether they are better off receiving the lower amount of benefits now, or delaying and receiving the higher amount of benefits later. And since individuals can now work past age 65 without being penalized, the number of individuals facing this decision is much larger than under prior law.

The purpose of this article is to:

- Help those who will turn 65 in the next few years make a decision as to whether they should start collecting benefits between ages 65 and 70 or delay benefits in order to take advantage of the delayed credit, and
- Help those who have already chosen to collect now rather than delay realize the long-term effect of that decision.

SOCIAL SECURITY BENEFITS

The Social Security Administration advises individuals to complete a Medicare application a few months before they reach age 65; the application for Social Security occurs at the same time.

Under the new law, individuals will be asked if they wish to receive their Social Security benefits at age 65 or to delay receiving the benefits until a later age. Those who elect to delay would be entitled to a delayed retirement

TABLE 1. DELAYED RETIREMENT CREDIT

Year of Birth	Age in 2000	Annual Delayed Credit (%)	No. of Yrs Already Delayed	Cumulative Credit in 2000 (%)
1930	70	4.5	5	22.5
1931	69	5.0	4	20.0
1932	68	5.0	3	16.5
1933	67	5.5	2	11.0
1934	66	5.5	1	6.0
1935	65	6.0	0	0
1936	64	6.0		
1937-38	63-62	6.5		
1939-40	61-60	7.0		
1941-42	59-58	7.5		
1943 and later	57	8.0		

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TABLE 2. MONTHLY SOCIAL SECURITY DELAYED BENEFITS: BASE YEAR 2000

Age in 2000	Delayed Benefit Age 65	66	67	68	69	70
65	1,433	1,575	1,725	1,884	2,054	2,234
66		1,502	1,600	1,701	1,805	1,912
67			1,583	1,684	1,787	1,894
68				1,674	1,770	1,869
69					1,716	1,813
70						1,751

credit that depends upon the year of their birth and the number of months that pass before they reach age 70 or actual retirement, whichever occurs first.

The delayed credit would be applied as indicated in Table 1. The percentage in the Annual Delayed Credit column is a simple interest rate by which the individual's primary insurance amount (PIA) is increased based on the number of months of delay, at $^{1}/_{12}$th the annual rate. Thus, a person who is age 65 in year 2000 and delays benefits until age 69 years and six months (54 months from the birth month through December of the year prior to the retirement year) will have his or her PIA increased by 27% (6% ÷ 12 × 54). As indicated in Table 1, the credit is scheduled to increase to 8% per year for birth years of 1943 and later. Then, the delay could generate as much as a 40% cumulative (over five years) increase in the PIA for future retirees. However, it is important to understand that it is not the actual benefit that is increased by the indicated rate, but rather an individual's PIA.

What is the PIA? Social Security benefits are determined according to a complex formula that uses an average indexed monthly earnings (AIME) as the base for the PIA. The AIME is established by multiplying each worker's actual wage (up to the FICA wage limit each year) by an index factor. The index factor used depends on the national average wage for the year in which the individual reached age 22; for ages 60 through 64 the index factor is 1. The highest indexed wages (up to 35 years) are added and divided by the number of working months to produce the AIME.

The PIA is determined from the AIME using the concept of bend points that gives greater emphasis to the earlier years of lower wages. It is calculated at an individual's retirement age of 62, and then increased annually at the announced cost-of-living adjustment rate until the age at which benefits begin.

Based on all these formulas, the Social Security benefit for an individual aged 65 in 2000, who earned at least the FICA wage limit each year, is $1,433 per month.

If an individual delays receipt of benefits, the PIA is adjusted each year by the delayed retirement credit rate. At the same time, however, the PIA is also increased because an individual's AIME increases for each year of delay, since a new wage-earning year is, in effect, added to the equation.

Table 2 shows the estimated maximum Social Security benefits (for individuals who have earned at least the FICA wage limits) for those who are between age 65 and 70 in year 2000 and have begun collecting benefits. The table assumes that:

- The cost-of-living adjustment will be 2.4% (the same as for year 2000), and
- The FICA wage limit will increase by 2.4%.
- Since the new law provides for benefits to be retroactive to January 1, 2000, the actual delayed benefit will be the number of months from the birth month through December, 1999.

START NOW OR DELAY?

The issue facing any retiree who is about to receive Social Security is: Should you start to receive the lower amount of Social Security benefits now, or should you delay receiving benefits in order to get higher payment later on?

This question can be addressed by determining the "breakeven age." If you start to receive Social Security benefits now, your total accumulation of Social Security benefits starts sooner; if you delay benefits, your total accumulation starts later but accumulates faster. The breakeven age is the age at which those two total accumulations are equal; at that age, the higher level of delayed benefits have "caught up" with the lower level of regular benefits in terms of total accumulation, and you will be equally well off whether you delayed benefits or received them at age 65. If you survive past the breakeven age, you will have been better off delaying benefits and

TABLE 3. BEAKEVEN AGES FOR DELAYED RETIREMENT BENEFITS: SPEND THE BENEFITS

Age in 2000	Delayed Benefit Age 66	67	68	69	70
65	77.7	78.5	79.3	80.0	80.8
66		86.1	87.1	88.1	89.0
67			88.2	89.1	89.9
68				91.9	92.8
69					93.3

TABLE 4. SURVIVAL PROBABILITIES FOR INDIVIDUALS AGED 70

To Age	75	77	79	81	83	85	87	89	91	93	95	100
Probability	83%	76%	68%	59%	50%	41%	32%	24%	17%	10%	7%	2%

receiving the higher payments, and the longer you survive past the retirement age, the greater the "mistake" in not having delayed.

The breakeven age for any individual depends on what you would do with the benefits when you receive them. Three scenarios are presented here:

- Spend the aftertax monthly benefit as it is received;
- Invest the aftertax monthly benefit indefinitely; and
- Accumulate the aftertax monthly benefit from age 65 to age 70 and deplete the accumulated fund thereafter.

In each scenario, the future cost-of-living adjustments are assumed to be 2.4%, the same as for year 2000.

SPEND THE BENEFIT

This scenario assumes that the monthly benefit would be needed on a current basis, and it takes into consideration that either 50% or 85% of the benefit could be subject to income taxes. The assumption is that no part of the monthly benefit will remain available for discretionary use. The breakeven ages are shown in Table 3.

The table indicates that if a person is 67 in year 2000 and delays the Social Security benefits to age 69, breakeven will occur at age 89.1. Thus, if this individual does not expect to survive beyond age 89.1, he is better off taking the benefits now, but if he expects to live past 89.1, he is better off delaying and receiving the later, larger amounts.

Clearly a key element an individual must analyze is the probability of surviving past the breakeven age. According to tables used by the IRS, the probabilities of survival between ages 65 and 70 are high—for instance, the probability of an individual age 65 reaching age 70 is 88.5%. Based on these probabilities, individuals between age 65 and age 70 who have already chosen to take the benefit now rather than delay the benefit to age 70 most likely made the correct decision. It also appears to be a correct decision to take the benefit at age 65 in year 2000 rather than delay.

Table 4 presents probabilities (again based on the IRS tables) of surviving to the respective breakeven ages for individuals who have reached age 70. These tables do not differentiate by gender, but in general, the life expectancy of males is approximately three years less than indicated in the table, and the life expectancy of females is about three years longer.

INVEST THE BENEFITS

The assumption for this scenario is that 33$^1/_3$% of the monthly benefit will be set aside for income taxes, and the remainder invested each month for an indefinite term. The breakeven ages under this assumption will vary based on the expected investment returns; in this scenario the rates of return are net of commissions, taxes and/or fees. Table 5 shows the number of years to breakeven from age 70, the breakeven age, and the approximate survival probabilities to the breakeven ages for the indicated rates of return on the invested benefits.

Table 5 indicates that under this scenario, an individual is unlikely to achieve breakeven by delaying the receipt of Social Security benefits to age 70. Even risk-free investments in U.S. Treasuries of around 5% and 6% require survival beyond actuarial life expectancies in order for it to have been advantageous to delay benefits. Net investment rates-of-return beyond 7% require centenary survival for breakeven. Given historical market returns of 11% that are reduced by commissions on sales and purchases of equities, income taxes on dividends or interest, and capital gains taxes, an assumed net rate of return between 6% and 8% seems reasonable. Note that at a net return of 9.29%, breakeven will never occur.

ACCUMULATE, THEN SPEND

The assumption for this scenario is that if benefits begin at age 65, 33$^1/_3$% of the monthly benefit will be set aside for income taxes, and the remainder invested each month for a term of five years. Thereafter, an amount will be withdrawn from the accumulated fund each month such that combined with the regular benefit will equal the monthly benefit

TABLE 5. BREAKEVEN AGES FOR DELAYED RETIREMENT BENEFITS: INVEST THE BENEFITS

	Net Return on Investments					
	5%	6%	7%	8%	9%	9.29%
Years to Breakeven from Age 65	22	24.5	28.2	34.6	54	Infinite
Breakeven Age from Age 65	87	89.5	93.2	99.6	119	Never
Survival Probability from Age 70	32%	30%	10%	2%	0%	

TABLE 6. BREAKEVEN AGES FOR DELAYED RETIREMENT BENEFITS: FIVE-YEAR WITHDRAWALS

	Net Return on Investments					
	5%	**6%**	**7%**	**8%**	**9%**	**9.29%**
Accumulated Fund	$67,813	$69,454	$71,131	$72,847	$74,600	$75,110
Years to Breakeven	**10.5**	11.4	12.6	14.1	16.1	16.9
Breakeven Age From Age 65	75.5	76.4	77.6	79.1	81.1	81.9
Survival Probability From Age 70	**81**%	76%	74%	68%	59%	54%

which would have been received had one delayed benefits to age 70.

Table 2 shows that the maximum monthly benefit at age 65 in year 2000 will be $1,433. At a 2.4% cost of living increase each year to age 70, the monthly benefit will increase to $1,613 if an individual starts benefits at age 65. Table 2 also shows that if benefits are delayed to age 70, the monthly benefit would be $2,234, a $621 per month difference. Under this scenario, breakeven will occur when the accumulated fund is depleted by withdrawing a sufficient amount each month ($621 the first year) in order that the total monthly benefit will be the same as if one waited to age 70 to begin benefits. Table 6 shows the breakeven ages if the withdrawals begin at $621 per month and are increased by 2.4% each year, for various assumed rates of return (net of commissions and taxes). The table indicates that under this scenario, delaying benefits until age 70 might be advantageous at lower, but reasonable, assumed rates of return.

THE BOTTOM LINE

For those who are between ages 65 and 70, who continue to work, are in reasonably good health, and will spend the benefit currently (the first scenario), it most likely was not the wrong decision to take the benefit at 65 rather than delay until age 70, given the probabilities of survival to breakeven ages from age 70.

For those who have independent wealth or a good pension plan and will "never" need the Social Security benefit (scenario two), it is more advantageous to take the money at age 65 rather than delay benefits.

But for those who will ultimately need the monthly benefit (scenario three), there might be an argument for delaying the benefit given the probabilities of surviving to age 70 and then to the breakeven ages.

It is important to understand, however, that this analysis is a strictly objective presentation of a mathematical definition of breakeven. Subjective reasons—the state of one's health at age 65, the history of family longevity, or the risk of accidental death, is not addressed. There will be a significant loss of income should one choose to delay his or her benefit and then not survive to a delayed benefit date. If death should occur prior to the commencement of benefits, only a spousal benefit, if it is greater than the spouse's own benefit, may be available after a Social Security "lump sum death benefit" of $255. Therefore one's health at age 65 is of primary importance for obvious reasons.

The economic necessity of the monthly income would also obviously require taking benefits at age 65. However, if health or economics are not an immediate consideration, both the probability of surviving to age 70 (given one reaches 65) and then the probability that one will survive to the breakeven age are influencing factors. Each individual must evaluate his or her particular circumstances in arriving at a decision as to whether to take or delay Social Security benefits. ✦