Optimizing Your Social Security Retirement Benefits

What does it mean?

Getting a good return on your investment

Optimizing your Social Security retirement benefits means getting the best return possible on each dollar you've contributed to the system. Every pay period, you pay 6.2 percent of your salary in taxes that finance your future benefits (retirement, disability, and survivor's benefits) and those of other Americans. In addition, your employer pays an equal share of taxes; if you're self-employed, you contribute both your own portion and the employer portion by paying a self-employment tax.

Most Americans should plan a benefit strategy

Most jobs are covered by or are eligible for coverage under Social Security. This means that most Americans will use their benefit coverage at some point during their lives. The amount of Social Security benefits you receive will partly be determined by law, inflation, and other conditions outside your control. However, if you make wise decisions regarding when you retire and how much you earn, you can potentially increase the amount of benefit you will receive.

Will you get out of Social Security what you're putting in?

What you pay into the system isn't exactly what you get out of it

If you have a 401(k) or another qualified retirement plan, you probably know exactly how much you contribute to it each month. From year to year, you watch as your savings grow. But do you know what you contribute to Social Security? Because Social Security taxes are involuntary (unlike contributions to a private retirement plan), you probably don't. You may know approximately what distribution you will receive from an IRA, for example, but when you're ready to retire, how much of what you've paid into the Social Security system will you collect? The answer to that question is tricky because you may never need to use some of the benefits you have earned. In addition, Social Security is both a pay-as-you-go system of benefits and a social program. What you pay into the system isn't exactly what you get out of it.

How the average indexed monthly earnings (AIME) benefit formula favors low-income individuals

If you retire at normal (full) retirement age, your retirement benefit will be 100 percent of your primary insurance amount (PIA). Your PIA is calculated by applying a benefit formula to your AIME. If you have had low earnings over your lifetime, your benefit will be much lower than the benefit of someone who had high earnings. However, because the benefit formula is weighted to favor individuals with low earnings, you will get back a greater percentage of what you put in than someone who had high earnings.

Example(s): *Willie, Billie, and Millie are triplets. They all performed in a traveling circus and retired after working for 33 years. This is how the benefit formula affected them: Willie, a lion tamer, had high earnings over the years. When he retired, his AIME was calculated to be $2,930. After the benefit formula was applied, his PIA was calculated to be $1,210.20. Thus, his monthly retirement benefit amount of $1,210 is 41 percent of his AIME. Billie, a trapeze artist, had average earnings over the years. When she retired, her AIME was calculated to be $1,948. After the benefit formula was applied, her PIA was calculated to be $938. Her monthly retirement benefit amount of $938 is 48 percent of her AIME. Millie, a clown, had low earnings over the years. When she retired, her AIME was calculated to be $877. After the benefit formula was applied, her PIA was calculated to be $568.70. Her monthly retirement benefit amount of $568 is 65 percent of her AIME.*

You can't change the benefit formula

Clearly, the individual with the highest lifetime earnings (Willie) receives the highest monthly retirement benefit. However, the individual with the lowest lifetime earnings (Millie) receives a benefit that reflects the highest percentage of lifetime earnings. Though you can't change Social Security's benefit formula, you can make some decisions during your lifetime that will affect the amount of your retirement benefit.

Decisions that affect the amount of your Social Security retirement benefit

When you receive your retirement benefit

Choosing when to start receiving retirement benefits is a personal decision but one that shouldn't be made hastily. Taking time to clip grocery coupons may save you a few dollars; taking a few minutes to decide when you want to start receiving retirement benefits could save you thousands. This is because retiring earlier or later than normal (full) retirement age can greatly change the amount of your monthly retirement benefit.

When you retire at normal (full) retirement age, you will receive a retirement benefit equal to 100 percent of your PIA. If you retire early (often at age 62, but anytime before normal (full) retirement age), you will receive a reduced benefit. If you retire later than normal (full) retirement age (but before age 70), you will receive an increased benefit. Because you want to receive the highest benefit, you want to postpone retirement as long as possible, right? Not necessarily. Even though you will receive less money per month if you retire early, over your remaining lifetime you may receive more than someone who retired late or at normal (full) retirement age. For example, if you retire at age 62, you will receive 48 more benefit checks than someone who retires at 66. This may add up to a substantial amount of money that will be difficult to compensate for even with an increased benefit check. On the other hand, you may want to work as long as possible because you need to provide for your family. In addition, if you postpone receiving your Social Security retirement benefit, you will increase your benefit substantially because your monthly earnings may increase and you will receive a late retirement credit.

Tip: *When deciding at what age you want to begin receiving Social Security retirement benefits, consider other retirement benefits you may receive as well. For example, you may be able to retire at age 62 (or earlier) and begin receiving a pension from your employer as well as a Social Security supplement that will pay you a benefit equivalent to what you would receive from Social Security until you reach normal (full) retirement age. Consider, too, your tax situation, and how your decision will affect your spouse or dependent family members.*

How much you earn during your lifetime

Since your retirement benefit check will be based on your average monthly earnings, earning more during your lifetime is one way to maximize your Social Security retirement benefit. The indexed income you receive in a certain number of your highest earnings years (usually 35) is added up and divided by the number of months that elapsed during those years. The result is your AIME amount. Then, a benefit formula will be applied to determine your PIA upon which your monthly benefit will be based.

You can't increase your monthly benefit by changing the formula used to calculate it; that formula is determined by law. However, you may increase your monthly benefit by increasing your AIME amount. You may also wish to increase your AIME to ensure that you will be eligible for minimum Social Security benefits in the event that you've worked only sporadically in a job covered by Social Security.

How much you earn after you retire

Part of your Social Security retirement benefit is not payable if you're under normal (full) retirement age and have earned income in retirement in excess of a certain amount. This amount is known as the retirement earnings test exempt amount. In 2017, you can earn up to $16,920 if you have not yet reached normal (full) retirement age or up to $44,880 during the year you reach normal (full) retirement age (up to, but not including the month you reach normal (full) retirement age). If you make the same as or less than these amounts, your Social Security retirement benefit won't be reduced.

Once you have reached your normal (full) retirement age, your earnings in retirement won't reduce your Social Security benefit. So to optimize your benefit, you can calculate how your earned income might affect your benefit and consider postponing any earned income in retirement until you reach your normal (full) retirement age. However, keep in mind that the benefit reduction is based on your actual earnings and is not permanent; your monthly benefit is reduced starting in January of the year following the year you had excess earnings and will be reduced until the excess earnings are used up. Additionally, if your monthly benefit is reduced in the short term due to your earnings, you'll receive a higher monthly benefit later. That's because the Social Security Administration (SSA) recalculates your benefit when you reach full retirement age, and omits the months in which your benefit was reduced.

Get the information you need to plan your strategy

Before you can plan a strategy to optimize your retirement benefits, you need to find out how much you might receive. You can use the SSA's Retirement Estimator tool available on the SSA's website (ssa.gov) to estimate your future Social Security benefits based on your earnings record. You can also visit the SSA website to sign up for a *my* Social Security account and obtain a copy of your Social Security Statement that contains a detailed record of your earnings, as well as estimates of retirement, survivor, and disability benefits, along with other information about Social Security. If you're not registered for an online account and are not yet receiving benefits, you'll receive a statement in the mail every five years, from age 25 to age 60, and then annually thereafter.

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