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Social insecurity

By: Claude Solnik November 20, 2015

Accountants and financial advisors are changing the advice they give to some clients amid new Social Security regulations and the uncertainty over other aspects of that program in the future.

The Social Security Administration as part of the Bipartisan Budget Act of 2015 as of this spring will close a loophole known as “file and suspend” and “restricted application.”

A higher-earning spouse under this loophole can grow his eventual Social Security benefit at 8 percent annually until as late as 70, potentially collecting 32 percent more than he would at age 66.

Meanwhile, the lower-earning spouse can obtain a spousal benefit for half the higher-earning spouse’s amount at that time.

That makes it easier for higher-earning taxpayers to leave their own Social Security payments untouched and growing until age 70.

“I think it has a significant impact,” David Waddington, a partner at Manhattan-based Friedman with offices in Uniondale, said of the change. “It’s a pretty significant difference.”

He said more people will likely claim their own benefits early without this option.

“They might need the money. They will have to claim benefits early,” Waddington said. “If they could have employed that file-and-suspend-until-70 strategy, most likely they wouldn’t take benefits at 62.”

James Connolly, vice president and investment officer with Wells Fargo Advisors in Babylon, said the change means some people “may receive a lifetime of lower benefits.”

“If they were thinking about delaying taking their own benefit and using spousal benefits as a source of income, you may have to replace that income,” Connolly said.

Robert Spielman, a tax partner at Marcum with offices in Melville, said many people don’t even know about this loophole. As a result, only savvy taxpayers are likely to be affected.

“There are people who know about it and those who don’t,” Spielman said. “Some don’t understand the complexity of the Social Security rules and collect as soon as they can.”

Eliminating this loophole could cost the average middle-class family as much as $70,000, according to Lawrence Sprung, president of Mitlin Financial in Hauppauge

“They’re going to have to sit down and see how this could impact their financial plan,” Sprung said. “It’s going to be an important tool to go back and redo your financial plan, if it used this strategy.”`

Some taxpayers may opt to work longer, to increase their income, in light of the absence of this tool that lets them continue collecting interest on their own Social Security without drawing on it.

“I don’t think the decision to work longer will be influenced that much,” Waddington said. “I think it’s just going to be a matter of what else are we going to have to draw on?”

Younger people who will see the impact may want to start setting aside more to make up for potential lost income.

“We’re always encouraging younger people to start saving early,” Waddington said. “There’s always a doubt about Social Security. The demographics are such, so there will be more pressure on younger people.”

Sprung advises taxpayers to be able to fulfill their goals even if Social Security benefits are cut by 25 to 50 percent.

“Many times when we work with clients, we do a Social Security test against their plan,” Sprung said. “We test it and say, ‘If things go awry and Social Security benefits go down, how does that affect the financial plan?’”

The Social Security Administration already has increased the limit for the Federal Insurance Contributions Act, or FICA, tax to $118,500 from $117,000 the prior year.

AARP’s 2012 study “The Future of Social Security: Proposals You Should Know About” indicated eliminating the FICA cap could help sustain the Social Security fund.

“They could increase the FICA limit,” Connolly said. “They could eliminate that cap. If they eliminate that cap, some reports say that would extend the life of the trust fund.”

Waddington said raising the limit might not have the desired impact if it leads to higher payouts for those who are paying more into the system.

“The benefits should be neutral,” he said. “What you get on your benefit should be based on what you pay in.”

Some see Social Security as a huge unknown, especially for those decades away from collecting this benefit likely to face huge demands from Baby Boomers.

“Can we in good conscience put a plan together for a 40-year-old based on what the Social Security Administration tells us their benefit will be today?” Sprung said. “It could be significantly different 20 years from now.”

The government could increase the age at which taxpayers can collect or impose income limitations on those eligible for payouts.

“I’m sure when we approach insolvency, they won’t have any choice but to implement Draconian measures,” Waddington said. “But it’s easy enough to do. Someone will pick a threshold and say, ‘If you have income other than Social Security exceeding X dollars, your benefits will reduced by X or a sliding scale.’”

Even today, individuals’ circumstances can be the most important factors in determining when to draw down benefits.

“No one can predict mortality,” Waddington said. “It really depends on everyone’s facts and circumstances.”

“By postponing taking Social Security benefits, you increase the monthly benefit,” Spielman said. “That will more than offset time you didn’t take benefits, provided you live long enough.”

The break-even point for most retirees is between age 82 and 85, so those who die earlier might actually have done better if they began collecting sooner, he added.