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‘Do Over’ Social Security Repayment Provision Entices Many Retirees

Government code affords a second chance in a tough economy

Written by John Sullivan

Boomer retirement, although delayed by the current economic crisis, will not be denied. And an increasing focus on the generation’s longevity and income risk is leading to a corresponding focus of effective Social Security distribution strategies. While much is made of the drawbacks of taking payments early on in retirement, a little-known “do-over” provision in the Social Security code, as well as two other provisions related to divorce, is getting significantly more attention.

Conventional wisdom among financial advisors dictates it’s better to wait as long as possible to begin receiving distributions in order to take advantage of higher systematic payments. The earlier such payments begin, the lower the amount received, sometimes significantly so. In a poor economy, clients might have little choice but to begin the process as soon as they’re eligible. For those forced to do so, a recalculation provision in the Social Security code can help, says Pam Villarreal, senior policy analyst at the National Center for Policy Analysis.

“If an individual retires at age 62 and begins taking their Social Security payments, say at age 65, they can repay the entire amount they’ve taken over the three years and have their future payments recalculated to receive a higher amount,” Villarreal explains. “As an added benefit, they can also take a tax credit for any Social Security benefit tax they’ve had to pay, or they can take a deduction on the amount of income subject to the benefits tax.”

In theory, she says beneficiaries can begin taking the payments and invest them in conservative instruments. They can then pay back the principal when they reach full retirement age, and pocket the investments’ return. They could then take advantage of any tax benefits and re-calculate to the higher amount for the remainder of the distributions. A good investment option, but one Villarreal doubts from which many individuals are currently taking advantage.

“While it is an option for many high-net-worth clients, the obvious drawback is that the money must be repaid,” she adds. “If early distributions were begun by the client, it was probably for a reason, especially in this environment.”

Stanley B. Corey, Jr., CDFA, ChFC, CFP, managing partner with Great Falls, Va.-based C5 Wealth Management, offers up a

further twist to the repayment provision with the following example:

A husband reaches full retirement age at age 66. His wife is also at full retirement age but plans to continue working. The husband claims the Social Security benefit and then suspends payment until he reaches age 70. The wife then claims the spousal benefit and continues working. At age 70, the husband can now obtain the increased benefit from delaying his payment, and the wife can switch to claiming her own benefit if it is now higher than the spousal benefit.

Cory also notes that by deferring the benefit, the higher amount will be beneficial to the surviving spouse in the event of husband's early death.

"Also on the repayment of benefits, depending upon the overall finances of the couple, someone who has a longer life family history and is in good health may benefit from repaying the amount received to obtain the higher future benefit," Corey says. "This may be especially helpful for someone who decides to return to work after having retired early."

Lastly, the "claim and suspend" method (initiated by the husband in the previous example) may work when the higher income earner turns age 66 and the lower income worker is 4 years younger. The earner first claims and then suspends the payments suspends and the lower income earner then claims the spousal benefit, which is higher than what would have been available from their own benefit calculation.

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