Daniel M. Isard

Social Security Benefits and Retirement Planning

When to take Social Security benefits is not a stand-alone decision.

Dear Dan,
I remember very clearly getting my first paycheck. I remember a deduction described as "Social Security." I remember reading articles predicting that Social Security would be bankrupt by the time I was ready to draw on it. Well, today I am 60 years old, and I just wrote to Social Security to get a copy of my benefits. Now I write to you for advice on which option I should elect. I am confused as to when to take Social Security. I am married and my spouse works with me in the business I own. My daughter will be my successor. The business and its real estate have no debts. So, when should I begin to take Social Security?
Signed, No Idea in the Hills of Kentucky

Dear No Idea,
When to take Social Security is not a stand-alone decision. Retirement planning requires an integrated approach that combines business succession planning, qualified retirement plan distribution, personal investments and Social Security benefit election. If you look at one component outside the scope of the others, you may make a bad decision and waste your money.

For those born between January 2, 1943, and January 1, 1955 (my peeps!), full retirement age is 66 years old. Full retirement age was 65, but to better fund the Social Security Trust Fund, Congress started to monkey around with the full retirement date. So, as a 60-year-old, you are eligible for full retirement benefit in six years.

As a general rule, you should not start to receive Social Security benefits until you stop earning income. Earned income, if it's above a statutory amount, is an offset to the Social Security benefits you may receive. Offset means a reduction to your benefits. The limit on earnings in 2015 is $15,720 per year. If you are younger than full benefit retirement age, then the offset is $1 for every $2 of earned income above the limit. Furthermore, if you earn more than $41,880 per year, the offset is $1 for every $3 of earnings. The limit on earnings is tied to the inflation rate and will presumably increase each year. So this is a big caution!

Here's an example given by Social Security regarding the application of the offset:

Let's say you file for Social Security benefits at age 62 in January 2015 and your payment will be $600 per month ($7,200 for the year). During 2015, you plan to work and earn $20,800 ($5,080 above the $15,720 limit). We would withhold $2,540 of your Social Security benefits ($1 for every $2 you earn over the limit). To do this, we would withhold all benefit payments from January 2015 through May 2015. Beginning in June 2015, you would receive your $600 benefit, and this amount would be paid to you each month for the remainder of the year. In 2016, we would pay you the additional $460 we withheld in May 2015.

So in this example, you can see how much you lose by working and getting earned income above the Social Security limit.

The definition of earned income is essentially restricted to wages, so dividends, interest earnings and capital gains do not count. Covenants Not to Compete, which are taxed as ordinary income, are not part of earned income. Rents are a passive form of income and not part of earned income. To the degree that any of the above is unreasonable, there could be some reclassification of the character of the income. For example, if you are working but not drawing a salary and you get a rental amount that is double the usual and customary, some of the rent could be reclassified as wages if there is an IRS audit.

There are additional rules on earned income for the first year you retire. For example, if you work through October and retire as of November 1, you would collect benefits based on November and December earnings, not the full year. You do not have to wait until the beginning of a calendar year.

An audit point for Social Security is often when you own your own business and are still working in it. You may be considered "working" regardless of whether you have earned income or not. One way the Social Security auditors review this is by looking at the amount of time you spend working. In general, if you work more than 45 hours a month in a business you own, you are not considered retired. And if you are not retired, you are not able to draw any benefit. However, if you work less than 15 hours a month, then you might be retired. But then again, if you work between 15 and 45 hours a month, you might not be considered retired. The issues the auditors look at are whether it's a job that requires a lot of skill, such as an embalmer, or if you are managing a sizable business. So it's best if you sell your business and then retire – then there is no question. Might you volunteer at the business? Of course, but for the sake of Social Security and the sake of your children, let them take over.

So, we've established that you should sell your company when you are ready to retire and begin taking Social Security. Again, the question comes back to "when." Let me give you an example of a recent client's dilemma. The husband paid into Social Security, and his wife never worked. He paid the maximum every year for the last 10 years. The benefit one receives is based on the payments paid in for the last 40 quarters. He is now 62 years old. If he waits until age 66, his full benefit will be about $30,000 per year. If he retires at age 62, he will be entitled to a benefit of $21,000 a year. If he continues to work and postpones taking benefits until age 70, he will get $40,000 per year.

Does he take the $21,000 per year now or wait four years to get $30,000 or eight years to get $40,000? Your quick conclusion may be that he will get almost a 100 percent increase if he waits eight years and takes benefits at age 70.

This is where we inject some logic into

the dialogue. Benefits are paid from the advent of the qualification until death. So what is the predictable life expectancy of the individual? If life insurance were offered to you at this age, would you buy it?

If my 62-year-old client were to predict he would live another 10 years, the decision on when to begin taking benefits is simple math. If he begins at age 62, he would get about $210,000 (10 years times $21,000); if he waits till age 66, he would get $180,000 (six years times $30,000); and if he were to wait until age 70, he would get benefits of $80,000 (two years of $40,000 each). In most cases, the crossover point is about 16 years.

This means that a 62-year-old would need to live to age 78 before he kicks himself and says, "Gee, should have waited until 66 to get Social Security." At about age 83, he would say, "Should have waited until I was 70 before collecting!"

To those who live long enough to complain about their choice, what a great thing to complain about! For me, the first day I am eligible without losing benefits for earned income, I am going to start collecting!

How you sell to your children is another story. You can certainly sell them the shares of stock you own. You can also have your corporation sell them the assets of the business and then liquidate the corporation. Regardless of whether you sell the shares or the assets, you have to be careful of a small tax trap called "family attribution."

Family attribution issues are outlined in the Internal Revenue Code. A sale of your stock to a child or grandchild must be a complete sale. However, a person is attributed to own the shares that are in his or her own name and those of his or her child or grandchild. So if the corporation retires your shares and your child or grandchild owns shares prior to the retirement, that means that not all of your shares were retired! This could change the sale from a capital gain to ordinary income, which means it will be taxed at a higher rate and will not allow you the tax-free recovery of your basis. The relief comes from the proper filing of a waiver. Fail to file the waiver and you could have the payments treated as a dividend and not a capital gain.

So, my idea-void reader, get the business valued by a qualified appraiser, get it financed and get to that government office and start taking the money! ✶

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