Social Security for Affluent Retirees

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How and when to begin taking Social Security benefits is a significant financial decision when approaching retirement. The starting age determines the amount of the monthly benefit, outside income may cause benefit withholding or subject the payments to taxation, and longevity will determine the total amount received. If married, spouses and families will need to plan together to maximize combined benefits and ensure the longer-living spouse has the income needed to maintain desired standard of living. Even for the affluent investor, careful preparation is key to making the most of retirement benefits.

Attorneys, in particular, may have sources of retirement income not available to most others. They may benefit from being a partner in the law firm, receive proceeds from the sale of their own practices – which may be turned into income, and may have other ongoing compensation such as referral fees or similar. In all of these, the investment vehicle chosen to supply the benefits determines the duration of those benefits.

A Fail-Safe

Annuities are often used in these situations to create private pensions. Although they may provide insurance against outliving retirement funds, annuities are only as permanent as the financial strength of the sponsoring insurance company. It's good to have a permanent source of income as a failsafe – and that's where Social Security can be beneficial to even the affluent retiree.

Taking Social Security benefits before full retirement age (FRA) will subject the payments to withholding if a claimant earns more than approximately $17,000/yr (in 2017). What most people don't know is that the withheld amounts will be restored at FRA. The impact of earnings limits on early benefits is not permanent but the decision to file early affects income throughout retirement.

Because Social Security retirement benefits are capped, those with higher standards of living in retirement rely less on the benefits than those who live on less. For the affluent retiree, Social Security is more about longevity insurance (not outliving income) than it is about bolstering monthly retirement income. Therefore, it generally makes sense for the affluent retiree to delay taking Social Security benefits until age 70 (unless family history suggests a short longevity). This will ensure the highest income benefit later in life if other sources of income are depleted.

Possible "Means Test"

The Social Security Administration projects that its funds will be expended by 2033. At that time, current payrolls are projected to only cover 3/4 of anticipated program needs. Benefits will have to be cut commensurate with current tax receipts.

There have been many proposals to "fix" Social Security. Among these is the idea to "means-test" recipients. Those who have greater means may find future benefits unavailable or reduced. Some planners suggest this situation compels the affluent to file for Social Security benefits as soon as eligible to receive benefits before they are cut. History suggests this isn't a compelling reason for timing Social Security benefits. In the past, changes have been affective for future retirees while those who are receiving benefits – or are close to filing a claim – have been excluded.

After FRA, half of Social Security retirement benefits become taxable at $25,000 of combined income ($32,000 for joint filers). By $34,000 of combined income ($44,000 joint), 85 percent of the benefit is subject to taxation (in 2017). Combined income is the added amounts of adjusted gross income, 1/2 of Social Security benefits, and non-taxable income. Where many affluent investors favor non-taxable income investments to reduce overall income taxation, even this income may subject Social Security to increased taxation.

Value of Roth Accounts

Prior to retirement, affluent investors should consider the value of Roth accounts (IRA and 401(k)). Due to income limits, most affluent investors are not able to save directly to Roth IRAs but should take advantage of Roth 401(k) options, when available. Traditional IRA and 401(k) balances may be converted to Roth prior to retirement – with associated tax consequences. It can make sense to accept the higher taxation for these conversions during working years to protect retirement income later. Conversions to Roth have the dual benefits of providing tax-free income and reducing the future required minimum distribution (RMD) amount.

Unless certain criteria are met, Roth IRA owners must be 59 1/2 or older and have held the IRA for five years before tax-free withdrawals are permitted. Additionally, each converted amount may be subject to its own five-year holding period.

The combination of EGTRRA and recent tax law changes opened another avenue for potential tax-free savings for highly compensated employees (HCE) if plans allow for in-service withdrawals of after-tax contributions to a 401(k). Although this is a great benefit unknown to most people and companies, there are a number of restrictions so individual planning is key.

Social Security retirement benefits may not be the greatest source of income for affluent retirees but they could be a hedge against outliving other sources of income. In any financial decision, it's important to consider all variables and work with knowledgeable professionals.

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