THE Wealth REPORT

MIXING WORK INCOME WITH SOCIAL SECURITY BENEFITS

Social Security withholding and tax rules related to earning income during retirement are not simple, but there are strategies that can help optimize your situation.

Overview

Up until COVID-19, there was a solid trend of people continuing to work and delaying Social Security benefits until past age 62. This trend began in the 1990s and, except for a brief upward tick (by four percentage points) during the Great Recession, continued until 2020.[1]

Although full data hasn't been gathered, there is anecdotal evidence that many older workers retired earlier than planned rather than risk their health by working on-site during the pandemic. However, preliminary studies suggest that the coronavirus did not motivate large numbers to retire early. This is possibly because many couldn't afford to, especially after the dramatic stock market crash in the spring of 2020.[2] Even people who did retire and began drawing Social Security benefits may have returned to work by now or are least looking for a job in today's robust labor market.

This scenario presents the complex quagmire of earning income while you're claiming Social Security benefits. On this topic, there are two things to remember. First, up until full retirement age, workers whose total income exceeds a certain limit will see their Social Security benefits reduced temporarily. Second, these workers may experience higher taxes than expected.

Deciding when to start claiming benefits has always been a tough call. But now, between: (1) weighing the risks of working during the pandemic; (2) stock market volatility playing havoc with retirement portfolios; and (3) figuring out how to optimize tax strategies, determining when to draw Social Security income is even more difficult these days.

Social Security Benefits Reduced

The key to understanding benefits starts with the age at which you begin drawing them. You can start as early as age 62, but your monthly payout will be permanently reduced from what you would receive if you waited until "full retirement age" (FRA), also known as "normal retirement age" (NRA). Unfortunately, this age differs depending on the date you were born. See the accompanying table for reference.[3]

Year of birth	1943-1954	1955	1956	1957	1958	1959	1960 or Later
FRA	66	66 + 2 months	66 + 4 months	66 + 6 months	66 + 8 months	66 + 10 months	67

Social Security benefits are further reduced if you begin taking them before full retirement age *and* earn more than the income limit. In 2022, the limit is $19,560. But please note this about your reduced benefits: Social Security benefits that are held back because you earn too much will be returned once you reach full retirement age. At that point, the monthly payout is permanently increased to account for the withheld benefits.

Working and Drawing Before Full Retirement Age (FRA)
Social Security will withhold $1 in benefits for every $2 you earn over the limit. The reduction will apply in any year you both collect benefits and earn above the limit, up until you reach full retirement age. Income earned in the same calendar year but prior to claiming early retirement benefits is ignored for the purpose of the Social Security benefit reduction.

Example:[4]

SS benefit: $800/month ($9,600 for the year)

Total earnings including wages: $29,560/year
$29,560 - $19,560 (income limit) = $10,000 excess
$10,000 ÷ 2 = $5,000 (withhold $1 in benefits for every $2 in excess)
$9,600 - $5,000 = $4,600
$4,600 ÷ 12 = $383.33/month
SS benefit reduced to $383.33/month ($4,600 for the year)

Working and Drawing in the Year You Turn Full Retirement Age
The earnings income limit is higher in the year that you reach full retirement age: $51,960 (in 2022). Also, the benefit reduction declines to $1 for every $3 you earn over $51,960. Furthermore, Social Security stops counting your earnings at the month before you reach your FRA birthday.

Example:[5]

SS benefit: $800/month ($9,600 for the year)

Total earnings including wages: $63,000/year
FRA birthday in August
Wages earned January through July: $52,638
$52,638 - $51,960 (income limit) = $678 excess
$678 ÷ 3 = $226 (withhold $1 in benefits for every $3 in excess)
$800 - $226 = $574
SS benefit reduced to $574/month through July

SS benefit increased to $800/month in August through the end of the year

Starting the following January, the SS benefit will increase to reflect lost benefits when your income exceeded the limit. If the years you worked before FRA rank among your 35 highest earning years, your SS benefit will be further increased to reflect a higher benefit calculation (after all, you continued to pay FICA taxes during that time).[6]

Working and Drawing After Full Retirement Age
Once you reach FRA, you can earn as much as you like with no reduction in your Social Security benefits.

Note that only wages from a job or self-employment count toward your Social Security income limit for withholding purposes. Income from pensions, annuities, investment income, interest, veterans benefits or other government or military retirement benefits are not considered earned income.[7]

Higher Income, Higher Taxes

However, what constitutes total income for the purposes of taxes is different. At least 15% of Social Security income is exempt from federal income taxes, but combined with all of your wages and other taxable income sources, your tax bill could increase substantially. In fact, your total income determines how much of your Social Security benefit is taxed. Your reportable income equals half of your Social Security benefit plus all other forms of income, such as a job, a company pension and bond yields.

Once you exceed a certain income threshold, Social Security benefits are taxed on a graded scale of taxation. For an individual tax filer, if your total income is:[8]

- $25,000 to $34,000, then up to 50% of your Social Security benefits are taxable
- More than $34,000, then up to 85% of your Social Security benefits are taxable

For joint filers, if your total income is:

- $32,000 to $44,000, then up to 50% of your Social Security benefits are taxable
- More than $44,000, then up to 85% of your Social Security benefits are taxable

"In some cases, those in the 22% federal tax bracket could end up paying a marginal tax rate as high as 40.7%, because additional retirement income causes more of their Social Security income to become taxable."[9]

Strategies To Maximize Retirement Income

- Wait until full retirement age to begin withdrawing from Social Security: Claiming later will yield a higher monthly payout.

- Convert traditional IRA assets to a Roth IRA: Required minimum distributions (RMDs) could bump you into a high marginal tax rate situation. Before you reach age 72, consider repositioning traditional IRA assets. If you convert to a Roth after you retire (but before you have to start taking RMDs), your tax rate will likely be lower. Also, converting small portions of IRA assets over several years (as opposed to a full conversion in one year) can help keep your income from tipping into a higher tax bracket.

- Stash excess cash: If excess income tips your Social Security taxes into the 85% category in one year, consider taking more taxable distributions from other sources in that same year so you can withdraw less in subsequent years — and thus avoid the higher marginal tax rate.

- Mix taxable and nontaxable assets: To avoid the higher income category, consider drawing on your cash reserves, a Roth account or selling off investments with small gains to supplement your Social Security income.

- At least one spouse delays drawing Social Security: Delay claiming Social Security until full retirement age or later. Waiting as long as possible to claim benefits can reduce your annual tax bill and maximize survivor benefits (if the higher earner delays).

Today's Labor Market

Older workers who recently retired still have a lot of options if they want to earn more income.

First, be aware that if you started claiming Social Security benefits but wish you hadn't, you have up to 12 months to cancel your application and still be able to reapply later. However, you will have to repay all the benefits you and your family received, including spousal benefits, as well as premiums garnished from your benefits to pay for Medicare. If you are outside of the 12-month window but below full retirement age (thus unable to apply to withdraw), you can ask the SSA to suspend benefits.[10]

Whether you stop receiving benefits or not, you can still get back into the job market. In fact, now may be one of the best times in history for seniors to find work. These days, amid low unemployment numbers, high voluntary resignation rates and a dearth of experienced job candidates, many employers welcome the knowledge, skills and reliability of older workers.

In fact, more than 1,000 U.S. employers, including Microsoft, Marriott and Macy's, have signed the AARP Employer Pledge to promote equal opportunity for all workers regardless of age.[11] This move creates greater opportunities for seniors who want to work, either because they need the money or they want to remain intellectually, physically and socially engaged in the work environment.

Some older workers are even able to negotiate flexible conditions — such as part-time hours, a four-day workweek or phasing into training or consulting work. These are all good scenarios for people who are drawing down Social Security benefits, as a reduced salary has less impact on their government payout and tax bill.

Final Thoughts

With some of today's retirements now lasting 20, 25, 30 years or more, it only makes sense that some people may want to work longer. For these working people in good health, it likely doesn't make sense not to draw Social Security benefits upon turning age 70. After all, these workers have earned that government "pension" by contributing money into the Social Security system throughout their careers, and delaying until age 70 yields the highest payout available.

If you are in a position in which you earn substantial income while drawing benefits, it's a good idea to work with an experienced tax professional to navigate your income and tax projections. Also remember to include your financial advisor in these consultations, as it may be prudent to reposition some investment assets based on your current tax situation and retirement income needs.

[1,2] *Anqi Chenand and Alicia Munnell. Center for Retirement Research at Boston College. May 2021. "PRE-COVID TRENDS IN SOCIAL SECURITY CLAIMING." https://crr.bc.edu/wp-content/uploads/2021/05/IB_21-9.pdf. Accessed Feb. 28, 2022.*

[3] *Social Security Administration. 2022. "Starting Your Retirement Benefits Early." https://www.ssa.gov/benefits/retirement/planner/agereduction.html. Accessed Feb. 28, 2022.*

[4,5] *Social Security Administration. 2022. "Receiving Benefits While Working." https://www.ssa.gov/benefits/retirement/planner/whileworking.html. Accessed March 2, 2022.*

[6] *AARP. Dec. 21, 2021. "Social Security is withholding money from my retirement benefit because I'm still working. Will I get that money back?" https://www.aarp.org/retirement/social-security/questions-answers/withholding-while-working.html#:~:text=Social%20Security%20is%20withholding%20money,I%20get%20that%20money%20back%3F&text=Yes%2C%20but%20not%20in%20a,account%20for%20the%20previous%20withholding. Accessed March 2, 2022.*

[7] *Social Security Administration. 2022. "Receiving Benefits While Working." https://www.ssa.gov/benefits/retirement/planner/whileworking.html. Accessed March 2, 2022.*

[8,9] *T. Rowe Price. 2021. "How Social Security Can Impact Taxes." https://www.troweprice.com/content/dam/iinvestor/planning-and-research/Insights/investor-magazine-winter.pdf. Accessed Feb. 28, 2022.*

[10] *Social Security Administration. 2022. "Withdrawing Your Social Security Retirement Application." https://www.ssa.gov/benefits/retirement/planner/withdrawal.html. Accessed March 2, 2022.*

[11] *Bruce Horovitz. Time. Dec. 20, 2021. "Companies Embrace Older Workers As Younger Employees Quit or Become Less Reliable." https://time.com/6129715/age-inclusive-workplaces/. Accessed Feb. 28, 2022.*