

USA TODAY

Turning 62?

Have Your Retirement Cake and Eat it, Too

by

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February 22, 2008

Most financial decisions require trade-offs. If you want to earn better-than-average returns in the stock market, for example, you need to tolerate above-average risk. Similarly, an adjustable-rate mortgage offers lower initial payments than a fixed-rate mortgage. But if interest rates rise, you and your furniture could end up on the sidewalk.

America's oldest baby boomers, who are turning 62 this year, face similar trade-offs in deciding whether to claim their Social Security benefits early. A little-known Social Security option, though, gives early retirees a way to have their cake and eat it, too.

Here's the quandary: If you claim benefits at 62, you can retire while you're young enough to enjoy it, but you'll receive reduced benefits for the rest of your life. By contrast, waiting to file until at least full retirement age (66 for boomers who turn 62 this year) will increase your monthly payments, reducing the risk that you'll run out of money in your old age. For many boomers, though, that means working longer — a hard pill to swallow if you hate your job and want to spend more time with your grandchildren.

What most retirees don't realize is that they can change their minds. Under the Social Security Act, individuals who receive early-retirement benefits from Social Security can withdraw their application, repay the benefits they've received and refile for higher benefits at a later date, says Mary Jane Yarrington, senior policy analyst for the National Committee to Preserve Social Security and Medicare.

Of course, for this strategy to work, you have to rustle up enough money to repay all the Social Security benefits you've received. You don't, however, have to pay interest on the benefits. And depending on your situation, you could still fare better than if you'd kept receiving reduced Social Security benefits, says Laurence Kotlikoff, a Boston University finance professor and developer of ESPlanner, a financial-planning software program.

Kotlikoff offers this example: A 70-year-old retiree has \$400,000 in regular assets and \$200,000 in retirement savings. She claimed early-retirement benefits and receives \$11,556 a year. Had she waited until age 70 to file, her benefits would total \$20,000 a year.

To withdraw and reapply for benefits, the retiree would have to repay \$79,305. But even with that payment, reapplying for Social Security would raise her standard of living by 14%, Kotlikoff says. This strategy, he says, would

provide her with the equivalent of an inflation-indexed annuity — a contract sold by an insurance company that guarantees regular payments for life — for about 40% less than the lowest-cost annuity available on the private market.

How to reapply

If you're interested in repaying and reapplying for benefits, visit your local Social Security office, or call 800-772-1213 and make an appointment, says Social Security spokesman Mark Lassiter. You'll need to fill out Form 521, which is available at Social Security's website, www.ssa.gov. If your spouse is receiving benefits based on your earnings record, Social Security will require your spouse's consent before approving the application, Lassiter says.

Once you repay your benefits, you can restart them whenever you want. But there's no reason to wait past age 70. After that, there's no advantage to delaying benefits.

Gaming the system?

If you don't need Social Security to pay your living expenses, you might be tempted to use this option to make a little extra money. Under current rules, you could start taking Social Security benefits at 62 and put the money in a certificate of deposit or other low-risk investment. Later, you could repay the benefits, reapply and keep all the interest you've earned.

One drawback to this strategy: You could owe taxes on your early-retirement benefits. If all your income comes from Social Security, your benefits usually aren't taxable. But if you stash all of your Social Security benefits in a CD, you'll probably need to rely on other income, such as withdrawals from your individual retirement accounts, to pay expenses. That income could trigger taxes on 50% to 85% of your benefits. That said, if you repay your benefits and reapply, you could be eligible for a deduction based on taxes you've already paid on the benefits.

H.K. "Bud" Hebler, founder of retirement-planning website Analyze Now (www.analyzenow.com), doesn't recommend this investment strategy because the government could change the rules. If Social Security decides to eliminate the option to reapply, he says, "You could really be stuck."

Reapplying for benefits, Hebler says, is best-suited for people who took early retirement, regret that decision and want to increase their benefits.

Some drawbacks to consider before you restart the benefits clock:

- Claiming early-retirement benefits could put your spouse at risk. If one member of a married couple dies, the surviving spouse can receive his or her own benefits or the deceased spouse's benefits, whichever are greater. Now, suppose you're the primary breadwinner, file early and die before you reapply for higher benefits. Your spouse will receive reduced survivor's benefits for the rest of his or her life, Lassiter says. And under Social Security rules, widows and widowers can't repay and reapply for a deceased spouse's benefits.

- If you die soon after repaying your benefits, you won't recoup your investment. If you're the primary breadwinner, though, your spouse could still come out ahead because he or she would inherit larger survivor's benefits.