

The End of Social Security's Interest-Free Loan?

Social Security's payback option can be beneficial, but proposed changes that may be in place by the end of 2010 will limit the number of Social Security recipients able to do so.

Life gives us few “do-overs,” but the Social Security Administration (SSA) allows retirees a do-over by paying back all Social Security benefits received and refiling for benefits, so they can receive higher monthly payments based on delayed retirement credits. Benefits repaid incur no penalty and no interest payments, and taxes paid on benefits are credited back. In effect, you receive an interest-free loan. However, this do-over ability is being reconsidered by the SSA. An article in *Kiplinger* reports that the payback option may become more restricted by year-end.¹

Currently, retirees who pay back their Social Security benefits and refile receive higher payments based on delayed retirement credits. For example, if John has a full retirement benefit of \$1,000, filing early at 62 would give him a reduced monthly benefit of \$750. On the other hand, waiting until full retirement age (FRA) would give him \$1,000, and waiting until age 70 would give him \$1,320 per month. This means John could file at age 62, then pay back all benefits received and refile at age 70, which would increase his benefit to \$1,320 per month.

Paying back Social Security benefits and refiling not only improves John's income if he outlives the average U.S. male, but could also benefit his spouse since she would be eligible to receive a higher survivor's benefit. In essence, the payback option provides a cheap way to buy longevity insurance.

Changes to the System

Under the proposed changes, those who file for benefits will no longer be eligible to pay back and refile after 12 months. You can still pay back and refile within 12 months of your original filing date and not be charged any additional interest or fees.

For those who make a mistake in filing too early, the payback option is an excellent option to undo that mistake. However, there are several reasons to not use the payback option as an interest-free loan to receive money upfront to invest or spend:

- ▲ Social Security guarantees a rate of return for each year you delay. Investing the money on your own involves taking risk. Besides, it is difficult to find a guaranteed investment that will give you 8 percent per year plus inflation.
- ▲ If you take benefits early and are still working, you may not receive all of your benefits due to the Earnings Test.
- ▲ If your intention is to refile to get a larger survivor benefit for your spouse, you might die before you can pay your benefits back, and your spouse would be stuck with a smaller survivor benefit.
- ▲ The SSA could change the law so you could no longer pay benefits back penalty free, or it could revoke the payback ability completely, permanently locking you into a reduced benefit.

In fact, that last possibility is what the SSA is proposing. The Center for Retirement Research at Boston College estimates that the payback strategy has cost the SSA between \$5.5 billion and \$11.0 billion.²

Considering the pressures that the Social Security trust fund faces, that is one cost that the SSA could easily reduce. According to *Kiplinger*, “Under the newly proposed rule, retirees would be allowed to withdraw their application for Social Security benefits only once during their lifetime and only within 12 months of when they began receiving benefits.”³ The new rules would effectively eliminate the opportunity to take advantage of a free loan.

But if you’ve made a mistake by filing early, refile could still be a good option for you and your spouse. And if you filed for benefits more than 12 months ago, you may want to refile before the SSA changes the rules. And finally, if the proposed restriction passes, it is even more important to implement the correct Social Security filing strategy the first time around.

¹ Mary Beth Franklin, **Social Security Payback Option May Disappear**. *Kiplinger*, August 26, 2010.

² Alicia Munnell, Alex Golub-Sass and Nadia Karamcheva, **Strange But True: Free Loan From Social Security**. *Center for Retirement Research at Boston College*, March 2009.

³ Mary Beth Franklin.

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