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SUREVEST

WEALTH MANAGEMENT

Social Security – What If It Goes Bankrupt?

Recently, I was teaching a Taxes in Retirement class and the discussion shifted to how to decide "when" to collect Social Security. I was explaining the conditions in which it makes the most sense to defer Social Security until age 70. One attendee asked how he should factor in the possibility of Social Security Benefits getting cut if the system goes bankrupt. That's a good question.

Just to be clear, our Social Security System will never go bankrupt. However, if no changes are made to the current system, the Social Security "trust fund," which was built up by collecting more payroll taxes than it paid out, will be depleted. Benefits would need to be reduced at that point to match the payroll taxes being collected.

That will happen sometime around 2034 if we do nothing. Once the trust fund is depleted, benefits would be cut to approximately 75% of their current level to keep the system solvent through 2087. The reality is this "do nothing" approach is unlikely as there is growing pressure to "fix" the system.

The options to fix Social Security are:

1) Increase payroll taxes. This is the simplest and most effective. The current payroll tax collects 6.2% from employees (and another 6.2% for employers). This would need to be increased to 7.6% to keep Social Security benefits fully paid for another 75 years, according to a study by the National Academy of Social Insurance. It will take some cash out of workers' pockets, which is never popular and will hurt economic growth. Imagine that…if we put more away for the future, we have less to spend today.

2) Eliminate the cap on taxable earnings. The cap currently limits the 6.2% payroll tax to only the first $132,900 of earnings (2019). We could close approximately 71% of the Social Security funding gap if the cap were eliminated entirely. This would only affect 4-5% of the workforce—those who have wages above $132,900. These people may be a bit perturbed because they already have the worst return on their Social Security contributions.

3) Raise the retirement age. This seems logical since people are living so much longer than they did in 1935 when Social Security began. Unfortunately, this solution is surprisingly ineffective. A three-year increase in the full retirement age from 67 to age 70 for people born after 1960 would only cut the funding gap by 25%.

4) Means-testing for beneficiaries. This would mean that high-income retirees would have their benefits reduced or eliminated since presumably they don't need the benefit. Polls found this option to be highly unpopular with voters who thought it was unfair.

The likely scenario is some combination of these options. While Congress is figuring out all of this, I encourage you to save as much as you can. After all, the maximum Social Security you can collect at Full Retirement Age in 2019 is only $2,861 per month. It is 32% higher ($3,770) if you wait until age 70. I have a feeling most people reading this article will want to spend more than that, even if they don't cut benefits.

How do you plan Social Security claiming decisions with this uncertainty?

So, back to the original question: How do I factor in a potential cut to Social Security benefits when deciding whether to collect early (62), at my full retirement age (66-67), or wait until 70? This is just like trying to make decisions based on what future tax rates "might be." Almost everyone I spoke with thought future tax rates would be increased (due to deficits) right up until they were cut at the end of 2017.

Personally, I always go on the assumption that the rules/rates will continue at their current levels until I have solid information to the contrary. The likely scenario is Social Security will be preserved and benefits will not be cut. I would plan on that. However, if you believe Social Security Benefits are going to be cut in the future, then the logical decision would be to collect early or at full retirement age, instead of deferring to age 70.

-Jeremy Kisner, Senior Wealth Advisor