Final budget dramatically changes Social Security claiming options

The 2016 budget makes sweeping changes to Social Security claiming rules for retirees surrounding the Restricted Application and the Voluntary Suspension.

Changes to the Restricted Application

The first change concerns the Restricted Application for spousal benefits. Prior to the new law, an individual who was eligible for both a spousal benefit based on the work record of a spouse and a retirement benefit based on his or her own work could choose to elect only a spousal benefit at Full Retirement Age. This allowed his or her own benefit to accumulate 8%-per-year Delayed Retirement Credits and then switch to his or her own larger benefit at any point in the future up to and including age 70. This option is called a Restricted Application.

The new law phases out this option. For people born Jan. 1, 1954, or earlier, the option to file a Restricted Application for only spousal benefits will remain available. But for people born Jan. 2, 1954, or later, an application for retirement benefits or for spousal benefits will automatically trigger entitlement to the other benefit. Further, if a participant is not eligible for spousal benefits (because his or her spouse had not yet elected) but later becomes eligible for a spousal benefit, entitlement is automatic and occurs on the first day of eligibility. Since the option to file a Restricted Application for only spousal benefits is only available under prior law at Full Retirement Age and the rules take effect only for people who are currently under age 62, this option is still effectively phased in over a four-year period.

Changes to the Voluntary Suspension

The second change concerns voluntary suspensions. Under current law, a lower-earning spouse is eligible for spousal benefits only after the primary wage earner under whose record she is filing has filed for benefits. Spousal benefits do not earn Delayed Retirement Credits, so delaying a spouse's benefit past Full Retirement Age represents lost checks, with no compensatory increase in the benefit amount.

An important planning point for couples has always been the understanding that the widow benefit that is available after the death of the first spouse is based on the deceased's benefit amount, including any 8% increase the deceased would have received due to delaying benefits. The combination of these two rules regularly creates tension between the claiming desires of the spouse and the primary claimant. The spouse wants to receive the highest widow benefit possible, but does not want to forfeit spousal benefits in the short term, since there is no compensatory increase in the spousal benefit for delay.

The solution under prior law was for the higher wage earner in the couple to file for benefits, then immediately request those benefits be suspended. The checks to the higher wage earner would stop, allowing the higher wage earner's benefit to grow by 8% per year, increasing not only the retirement benefit, but also the benefit payable to the spouse upon his death. While the benefit was in suspense, the spouse was able to collect a spouse's benefit.

The new law causes a Voluntary Suspension to stop all benefits payable under the earnings record of the person whose benefit was suspended. In other words, the spouse will not be able to collect a spousal benefit during the time that the wage earner's benefit is suspended.

The new law also eliminates the ability to request a retroactive lump sum for all benefits between the date of the request and the date of suspension, so the only reason to request a Voluntary Suspension under the new rules will be to accumulate Delayed Retirement Credits.

This portion of the law is phased in over a much shorter timeframe. Only people who suspended benefits in the past or within the first 180 days after enactment will fall under the old rules, and will continue to fall under the old rules until they reach age 70 or un-suspend benefits. People who request a suspension after 180 days of enactment will fall under the new rules. This was a significant change in language from the initial draft of the bill and the final bill. In the initial draft, this provision would have applied to benefits payable after 180 days rather than requests made after 180 days. Thus, the new language is akin to "grandfathering" those who either have already suspended benefits or will suspend benefits within the first 180 days of enactment.

Some benefits excluded

Notably all of these changes concern the interaction between retirement and spousal benefits, and do not include widow benefits. So, widows will continue to have the opportunity to restrict an application to only widow or only retirement benefits and later switch to the other benefit.

Challenges ahead

The challenge with these new rules is that they effectively create three sets of rules based on a client's birthday. One set applies for the first 180 days after enactment of the law, another set applies for the next four years, and yet another set applies after four years once the last of the group who still has access to the Restricted Application has passed age 66. In a married couple, each member of the couple could fall under a different set of rules.

During this transition period, software will be more important than ever to ensure that advisors are applying the right set of rules.

We expect all updates to the Social Security Timing® software to be completed by Friday, Nov. 6. We will post notices on the Social Security Timing website and email all users as soon as the changes are live in in the software.

If ever there were a sense of urgency in ensuring that your clients are able to get the most they are eligible for under Social Security, that time is now. The rules now have a defined expiration date. With changes to systems as large as Social Security, good information will be at a premium, and bad information will be prevalent. Be sure to check back here for additional resources to help you communicate these changes to your clients.