

Innovative strategies to help maximize  
**Social Security benefits**

your Rock for Retirement®



**Prudential**

# Table of Contents

---

The five costliest mistakes retirees make about Social Security.....	2
What you haven't heard before about the taxation of Social Security benefits .....	6
How to bridge the income gap until higher Social Security benefits can begin.....	11
About the authors.....	13



“For years, financial services companies have downplayed the role of Social Security in bolstering financial security in retirement. But considering the increased financial risks retirees now shoulder, the tax preferences that Social Security receives, and the income options that Social Security now offers, we would argue that Social Security should play an even greater role in a retiree’s financial picture than it ever has before.”

What’s the greatest fear of today’s retirees? Running out of money in retirement. And what’s the greatest benefit Social Security can offer? Regular income that is guaranteed to increase over time—and continue for as long as you live.\* No other vehicle can match the combination of inflation-fighting increases, longevity protection, investment risk elimination, and spousal coverage that Social Security can—potentially making it one of the most valuable sources of retirement income.

Yet many retirees today do not understand how their Social Security benefits really work. Sadder still, most never focus on how to help maximize the very benefits that may help sustain them throughout retirement.

Nor have they been advised how to do so. Given that most financial service firms have been so focused on acquiring rollover dollars, they have placed little emphasis to date on helping retirees learn how they can best use Social Security to help generate optimal retirement income and risk protection. If guidance is provided at all, it is often likely done with misinformation or at least incomplete information, as this paper will show.

This information has been provided for your benefit and is not intended or designed to be tax advice. Neither Prudential Financial nor any of its associates can provide legal or tax advice for which you should contact your independent legal or tax advisor.

Maximizing Social Security benefits is more critical than ever—now that the majority of post-retirement risk has shifted from the employer to the individual. This results from the move away from traditional Defined Benefit (DB) pensions to Defined Contribution (DC) plans such as 401(k)s and even the shift to such hybrid plans as Cash Balance plans.

In this paper, we will strive to outline why Social Security deserves to be considered a valuable resource worthy of careful stewardship—and how today’s seniors can best maximize its benefits while helping minimize the taxes on their retirement income in general.

\* Social Security taxes are just that—taxes, and convey no property or contractual rights to Social Security benefits. As a result, a worker’s retirement security is entirely dependent on the political decisions of the President and Congress. Benefits may be reduced or even eliminated at any time.

# The five costliest mistakes retirees make about Social Security

While some retirees are simply uninformed, others are dangerously misinformed by the “conventional wisdom” surrounding Social Security. Unfortunately, these misconceptions prevent individuals from taking the steps that are well within their control to help maximize this important benefit. Here are five of the most costly mistakes we feel seniors make about their Social Security benefits.

## Mistake #1: Underestimating the real value of Social Security

For years, financial service providers have warned us that Social Security will never provide enough income during retirement. During the “accumulation stage” of our financial lives, this may have been a wise message for us to heed. But at the point of retirement, Social Security should be anything but ignored.

As the income guarantees provided by private employer pension plans disappear, Social Security guarantees become even more critical to individuals likely to spend 25 to 30 years in retirement. According to the Economic Policy Institute, on average, Social Security provides four times more income than private pensions for a median income household headed by someone age 56 to 64.<sup>1</sup>

In fact, the value of Social Security continues to grow along with wages in particular and the economy in general. A recent paper disclosed that between 1989 and 1998, the mean real Social Security wealth for those individuals age 59–61 increased by 43%.<sup>2</sup> Better still, these benefits are adjusted for inflation each year.

So rather than ignoring this retirement resource, we should embrace it. For many retirees, Social Security will become the centerpiece of retirement income. They need to understand how best to take their Social Security benefits and how their decisions will affect them throughout retirement—which will often last one-third of their lives.

### Example

A 65-year-old worker with \$80,000 of final wages and a non-working spouse can expect approximately \$30,000 of initial Social Security income.

Some never take charge of this benefit because they discount the viability of the system in general. But whatever your personal beliefs are about the Social Security reform debate or a “pay-as-you-go system,” most new retirees have been paying into the Social Security system for many more years than they have contributed to their Defined Contribution plan. They can count on both as critical sources of their retirement income.

No serious reform proposal has been offered that would reduce Social Security benefits for those at or near retirement.

Although Social Security is not guaranteed by law, it is backed by the promise of the U.S. government. Politically, it is difficult to imagine how the government would ever cut benefits for current retirees and throw millions of seniors into poverty.

Plus, the promise of Social Security income for a retiree is much more certain than the potential for an IRA to eliminate investment risk, protect against inflation, or generate lifetime income. Furthermore, with the demise of Defined Benefit plans, Social Security may be the only guaranteed lifetime income many seniors will have available to them.



## Mistake #2: Rushing to collect, then regretting the reduced benefits for the rest of your life

Most retirees apply for Social Security benefits early. In fact, according to the Social Security Administration, 72% of current recipients receive reduced benefits because they started their benefits prior to their Full Retirement Age.

Undoubtedly, many of these seniors didn't realize that *when* they collect affects how much they receive over the course of their lifetimes. And most certainly didn't stop to think that they could potentially double their initial payments if they only waited until age 70.

In fact, most financial planners still recommend taking Social Security money "early" so that the retiree can invest it, where they can earn much more than Social Security could provide down the road. Perhaps this was true back in the go-go market of the 90s. But most economic experts expect future equity returns to continue to be low and future yields on fixed-income investments to remain very low.

The discussion on when to take Social Security benefits tends to focus on the "break-even" age; that age when you could receive more income from starting Social Security benefits earlier versus starting them later. Some calculators will also factor in the time value of money since retirees receiving "early" Social Security benefits could theoretically invest this income for use later in retirement. But these assumptions often ignore key considerations:

- The value of Social Security Cost-Of-Living-Adjustments (COLAs), which, although not guaranteed by law, are a promise made by the government that would be difficult to cancel;
- The tax preferences awarded to Social Security income compared to IRA income;
- The potential interaction between spousal benefits and the ability to integrate each spouse's benefits to provide optimal income and protection;
- The widow's benefit, which can be passed on to a spouse at death;
- The ability of Social Security to provide income for the rest of your life; particularly important since no one can accurately predict how long that will be.

## Mistake #3: Not understanding how one spouse's decisions affect the other one's benefits

For married couples, how and when one spouse decides to take Social Security benefits affects the other spouse's lifetime benefits as well.

### Impact on spousal benefits

In general, spouses are eligible to receive the higher of:

- 1) Their own Social Security worker's benefit; or
- 2) One-half of their spouse's benefit (known as a spousal benefit).

Let's look at a case where the husband earned more than the wife during his lifetime—and is eligible for more than double her benefits. If he starts collecting Social Security prior to his Full Retirement Age, not only will he be reducing his benefits, he will likely be reducing his wife's lifetime income payments as well.

In the past, if a worker delayed collecting Social Security, the spouse would not be able to collect spousal benefits and would not be receiving Delayed Retirement Credits either. This reduced the value of delaying Social Security for many couples.

Fortunately, changes made under the Senior Citizens' Freedom to Work Act of 2000 allow a worker to "File and Suspend" Social Security benefits once the Full Retirement Age has been reached. This allows the spouse to begin receiving spousal benefits based on the worker's record while the worker continues to accrue Delayed Retirement Credits.

### Impact on spousal benefits

Delaying Social Security can also increase the protection to a surviving spouse. Upon the death of a worker, the spouse will receive the greater of:

- 1) His/her own benefit, including any Cost-Of-Living-Adjustments (COLAs); or
- 2) The deceased spouse's benefit, including any COLAs.

In essence, the value of delaying Social Security “lives on” as the higher benefit (which has grown even higher due to COLAs) is passed on at death to a spouse.

This is a wonderful way to protect a spouse from running out of money. The transition from Defined Benefit plans to Defined Contribution plans will make more spouses vulnerable to the risk of running out of money later in life, as the mandated offering of a qualified joint and survivor annuity often disappears. The larger Social Security income benefit could help offset potential healthcare costs, nursing home costs, and everyday expenses. It also protects surviving spouses from inflation (since they’ll receive annual COLAs). Plus, it costs them nothing more for this additional benefit. Better still, it is taxed at a lower rate than other ordinary income. It’s difficult to reproduce this security for a loved one through other financial vehicles.

But many retirees appear to focus only on the initial Social Security benefit amount and not the “second stage” of benefit calculation.

When this second stage calculation is taken into account, married couples may often find that it’s beneficial for the spouse who is eligible for the lower Social Security payments to start collecting his/her own worker benefits early—while delaying the other spouse’s benefits.

Then, at the death of the primary breadwinner, the lower-benefit spouse will “step up” to a much higher benefit than he/she would then be currently receiving.

In essence, when the primary worker delays benefits, at the death of the first spouse, the smaller benefit drops off and the larger delayed benefit continues.

A recent Center for Retirement Research brief emphasizes this point.<sup>3</sup> It suggests that, when considering whether to delay Social Security, not only should the worker’s expected longevity be considered, but perhaps more importantly, the spouse’s as well.

#### **Mistake #4: Getting blindsided by the “Tax Torpedo”**

Think of all the contributions that have been made to 401(k)s and other types of Defined Contribution plans over the years. Now add all the employer’s matches on those contributions...and all the earnings on those matches and those contributions. All that tax-deferred money is just sitting there, much of it likely to be rolled over to an IRA. But all of it eventually to be withdrawn—and taxed.

Not only will these withdrawals be subject to tax, but they will also generate higher incomes—and therefore trigger higher taxation of Social Security benefits.

Put it all together, and you’ll see that we’re facing what some journalists have called the “Tax Torpedo.”<sup>4</sup>

Individuals for the most part are “okay” with the taxation they face on their IRA withdrawals as this was part of the “deal” in contributing to a 401(k). They bought the argument of financial service providers that they would most likely be in a lower tax bracket when they retired, so tax deferral was a good deal.

Yet the tax situation is often worse for the retiree than expected. Once a very low income threshold is met (\$34,000 for singles and \$44,000 for married couples), every dollar received from an IRA causes up to 85% of a Social Security dollar to become taxed also. This creates a marginal tax of 46.25% in 2006—an amount that will likely increase in the future under current law.

Ironically, even though the Tax Torpedo hits seniors very hard, no one has really looked closely to avoid it. Fortunately, it can be avoided—as we’ll discuss in the next two sections of this paper.

Of course, it’s also likely tax rates will increase. Given that cuts into Social Security, Medicare, and Medicaid are politically challenging to make, politicians may resort to raising taxes to overcome our projected federal budget deficits. For one, Employee Benefit Research Institute president Dallas Salisbury believes, “I am absolutely, personally convinced that income tax rates are going to go through the ceiling over the next 10 to 20 years.”<sup>5</sup>



**Example: How delaying Social Security can benefit a surviving spouse**

	If both start collecting benefits at age 62, then he dies at 82	If she collects at 62, he delays benefits to 70, then he dies at 82
Initial benefit for husband	\$12,000	\$26,172
Initial benefit for wife (on her own work record)	\$12,000	\$12,000
Benefit that will continue for surviving spouse	\$20,700	\$36,444

So if the husband dies before his wife (but after he's begun collecting benefits), she will "step up" to the higher \$36,444 (plus future COLAs from that point forward). The "snowball" lives on and will be able to keep many widows and widowers out of poverty and in a secure retirement.

Note: The above example is hypothetical and for illustrative purposes only and assumes death of the husband in 20 years, at age 82. COLAs are projected using Social Security Administration projections as of January 2006.

**Mistake #5: Assuming that more control equates to more income**

Here's more "conventional wisdom" that unwisely prevents seniors from maximizing Social Security. Many believe that it's always better to maintain control over their money. Thus, they rush out to start collecting Social Security so they can control how it's invested. Some advisors recommend that, even if you don't need your Social Security benefits to live on, it's better to take them as soon as you're eligible and invest them on your own.

Yet the inability to delay "ownership" of their Social Security benefits may cost many retirees dearly. Some retirees will run out of money before they run out of breath. Others will hoard their assets and not enjoy retirement to the level that they could have if they had pooled their post-retirement risks with others.

“Why leave it to the government to provide increasing benefits? You can do it yourself better than Uncle Sam...”

...the argument goes.

# What you haven't heard before about the taxation of Social Security benefits

Put aside what you think you know about how Social Security is taxed. We don't believe the following information about the taxation of Social Security benefits has been previously presented. Even if it has been discussed publicly, it is not widely understood.

## Here's the key thing to remember:

Social Security income is not taxed the same as IRA income. So you can reduce your taxes by choosing higher Social Security income and lower IRA income when you develop your strategy for taking retirement income.

## Comparing how IRA and Social Security income are taxed

Remember that a retiree has choices on how and when to take IRA income and Social Security income. If you choose to take IRA income first while delaying the start of Social Security benefits, you're choosing to take higher lifetime Social Security and lower IRA income. Many individuals who take IRA withdrawals will trigger the taxation of their Social Security benefits that they have already received. In fact, every one additional dollar of IRA income often causes 85 cents of a Social Security dollar also to become taxable. A 46.25% marginal tax rate applies to that one additional dollar of income if the retiree is in the 25% tax bracket:  $(\$1 + [\$1 \times .85]) \times .25$ . Note that a first threshold exists (\$25,000 for singles and \$32,000 for married couples filing jointly) where up to 50% of Social Security benefits are taxed.

To our knowledge, all experts make the "false leap" that the tax on Social Security can't be avoided, and therefore assume that 85% of all Social Security will be taxed as ordinary income once singles and couples hit the retirement income thresholds of \$34,000 and \$44,000 respectively. However, this is not true!

Upon closer analysis of the Combined Income formula (aka Provisional Income formula), you can see that Social Security only goes into the formula at a 50% rate. All IRA income and even tax-free municipal-bond income counts at 100%.

So wouldn't it make sense that a retiree could take at least twice the amount of his/her income in Social Security rather than in IRA income?

Yes. Actually, a double benefit often occurs for those retirees who would otherwise face the taxation of their IRA and Social Security income. Again, think of trading IRA income for higher Social Security income. Once you reach age 70 and start taking a much higher Social Security amount, you are taking one additional dollar in the form of Social Security income as opposed to IRA income.

Better still, you do not pay tax on that Social Security dollar "out of the box," which is not true of the IRA dollar. Instead it goes into the Combined Income formula at a 50% rate. So, whereas a 25% tax rate applies, the retiree with IRA income (and lower Social Security) is paying taxes as follows compared to a retiree who, instead of receiving that dollar in the form of IRA income, receives it in the form of Social Security.



How combined IRA income and Social Security income is taxed:			How every dollar of “delayed” Social Security income is taxed:		
IRA income		\$1	Social Security Income		\$1
Tax rate	x	25%	Combined income formula	x	50%
IRA tax (A)	=	.25		=	.50
Additional Social Security subject to tax		\$1	% of Social Security income subject to taxes	x	85%
% of Social Security income subject to taxes	x	85%	Taxable Social Security income	=	.425
Taxable Social Security income	=	.85			
Tax rate	x	25%	Tax rate	x	25%
Social Security tax (B)	=	.2125	Social Security tax	=	.1062
Total tax in cents (A + B):	=	.4625	Total tax in cents:	=	.1062
Total tax in percentage:	OR	46.25%	Total tax in percentage:	OR	10.62%

### What is the Combined Income formula, and how does it work?

The Combined Income formula (also known as the Provisional Income formula) determines how much of a retiree’s Social Security benefits are subject to taxation. Up to the thresholds listed below, Social Security benefits are tax-free. Once the first threshold is reached, up to 50% of Social Security benefits are subject to taxation. Once the second threshold is reached, up to 85% of Social Security benefits will be taxed. Listed below are the current first and second threshold limits, respectively.

Single person:	\$25,000 and \$34,000
Married couple filing jointly:	\$32,000 and \$44,000

Modified Adjusted Gross Income (MAGI) plus interest from tax-exempt bonds\* plus 50% of Social Security benefits is compared against these thresholds. Note that it is “up to” either 50% or 85% of Social Security benefits that are taxed. See page 8 for how the tax is actually calculated.

\* There are additional amounts that must be included in MAGI. Please consult your tax advisor for details.

### Why this isn't just a tax benefit at the lower income levels

This example even assumes that the higher Social Security income is taxed at the full 85% of benefits. But in reality, the Combined Income formula calculates the tax on the smallest of:

- 1) 85% of the benefits; or
- 2) 50% of the benefits plus 85% of any excess over the second threshold; or
- 3) 50% of the excess over the first threshold, plus 35% of the excess over the second threshold.

Many individuals will therefore pay little to no taxes when they delay Social Security and take higher Social Security income and lower IRA income. Usually, this results from #3 above as the least of the three tests. Consider that a married couple could have \$64,000 of Social Security income (counting as \$32,000 at the Combined Income rate) before they would ever have "excess over the first threshold."

And although it is not intuitively clear, it is not just retirees who are near the income thresholds of \$25,000 to \$44,000 who will benefit, but individuals who receive much higher retirement income as well. Our research has found that many individuals with after-tax income, up to the mid \$90,000 range, can see significant tax savings from delaying Social Security.

### Why extending tax deferral isn't always the best route

Conventional wisdom has held that it's always better to delay taking income during retirement from a tax-deferred product (such as an IRA) for as long as possible. But this frequently does not hold true as the tax benefits from much higher Social Security make up for any benefits of delaying the receipt of IRA income.

The example on the next page represents the dramatic drop in Adjusted Gross Income in a given year for someone who delays Social Security and therefore earns a higher amount after age 70.

The retiree is trading IRA income for higher Social Security income after age 70.

- The retiree under Approach A took the traditional route and took Social Security early and is taking IRA withdrawals.
- Under Approach B, the retiree took Social Security later and is therefore taking \$25,000 more in Social Security this particular year and \$25,000 less in IRA withdrawals.

Even though the same \$90,000 of pre-tax income is provided, Approach B has an AGI of \$35,625 less than Approach A.

In other words, shifting \$25,000 of income to Social Security removed 142% of that amount from the AGI. AGI was reduced by half. Many retirees could see a 75% drop of actual taxes paid when considering both federal and state taxes. This is the Tax Torpedo in reverse.



**Example: Tax impact of delaying Social Security payments**  
**Married couple filing jointly**

Approach A: Taking reduced Social Security early and supplementing with higher IRA withdrawals

Approach B: Delaying Social Security

	Approach A	Approach B
Adjustment amount		\$25,000
IRA income	\$45,000	\$20,000
Social Security	+ \$45,000	+ \$70,000
<b>Total pre-tax income</b>	<b>= \$90,000</b>	<b>= \$90,000</b>
<hr/>		
AGI	\$45,000	\$20,000
Plus tax exempt income	+ \$0	+ \$0
<b>Modified AGI</b>	<b>= \$45,000</b>	<b>= \$20,000</b>
<hr/>		
Social Security benefits	\$45,000	\$70,000
<hr/>		
<b>Test 1</b> 85% of Social Security benefits (Total test 1)	\$38,250	\$59,500
<hr/>		
<b>Test 2</b> A) One-half of Social Security benefits	\$22,500	\$35,000
B) Combined income (aka provisional income)	\$67,500	\$55,000
C) Less second threshold	\$44,000	\$44,000
D) Excess above second threshold (B-C)	\$23,500	\$11,000
F) 85% of excess (D x 85%)	\$19,975	\$9,350
<b>Total test 2 (A + F)</b>	<b>\$42,475</b>	<b>\$44,350</b>
<hr/>		
<b>Test 3</b> B) Combined income (aka provisional income)	\$67,500	\$55,000
G) Less first threshold	\$32,000	\$32,000
H) Excess above first threshold (B-G)	\$35,500	\$23,000
I) 50% of excess above first threshold (H x 50%)	\$17,750	\$11,500
J) 35% of excess over second threshold (D x 35%)	\$8,225	\$3,850
<b>Total test 3 (I + J)</b>	<b>\$25,975</b>	<b>\$15,350</b>
<hr/>		
Amount includable in gross income (Least of the three tests)	\$25,975	\$15,350
<hr/>		
Taxable income	\$70,975	\$35,350
<hr/>		
Difference		-\$35,625
Percentage of income removed from AGI due to trade of IRA income to Social Security		142.50%
% Drop in AGI caused by switch of IRA to Social Security		50.19%

The tax advantages of taking more of your retirement income as Social Security are substantial for many individuals. Conventional wisdom on the “take-up” discussion has overlooked these tax advantages and must be revisited.

What matters is what the retiree puts in his or her pocket. Higher income in the retiree’s pocket results in a higher quality of retirement and more financial security. If the retiree already has what is deemed as sufficient after-tax income already in his/her pocket, the retiree could consider converting other IRA assets into Roth IRA assets.

This can be done over a number of years and the taxes due would be at a lower rate than if they had been taking reduced Social Security and high IRA withdrawals. The conversion of regular IRA assets to Roth income eliminates the need for those assets to be distributed as Required Minimum Distributions down the road. Retirees can then draw down the converted Roth IRA assets much later in retirement without causing further taxation of their Social Security assets. Or, retirees can earmark these Roth IRA assets as a legacy bequest and the beneficiaries can then take tax-free income over their own life expectancies under what is known as the stretch IRA concept. Note: if you delay Social Security, Required Minimum Distribution amounts are likely to be taxed at a much lower level.

**Is it possible that there is a change in the way Social Security is taxed? Yes, but look at the options:**

- 1) All (or more of) Social Security becomes taxable. Under this option, many retirees who are just making ends meet and currently enjoy tax-free Social Security get hurt.
- 2) All Social Security becomes tax-free. This would benefit many who delayed Social Security but is unlikely to occur due to the funding issues that Social Security already faces. In fact, this legislation has been proposed before by some who dislike the Tax Torpedo, but gets dismissed every time due to the Social Security funding issues.



# How to bridge the income gap until higher Social Security benefits can begin

As you can see, there is tremendous potential, tax, income, and spousal protection from delaying Social Security benefits.

But delaying collecting Social Security doesn't mean you have to delay receiving retirement income. Individuals can tap their IRAs, 401(k)s or other investments first to provide bridge income from the point that they retire until the time that their higher Social Security benefits kick in. Period certain immediate annuities can provide a consistent cash flow. Also, deferred variable annuities with automatic withdrawal features work well in providing income streams and often provide more flexibility than immediate annuities. Many 401(k) plans now allow for similar automatic withdrawal capabilities.

Keep in mind that cash flow needs will often change for married couples as a spouse may start his/her benefit at age 62, step up to a higher spousal benefit at age 66, then inherit an even higher survivor benefit when his/her spouse dies. Cash flow needs may also change if one spouse is changing jobs or stopping and/or starting jobs.

If you do decide to delay Social Security benefits, make sure to properly plan by:

- Filing for Medicare when you initially become eligible at 65.
- Remembering to maximize possible spousal benefits. If applicable, file and suspend benefits when the primary worker hits Full Retirement Age. (Since this information is not widely known, interested readers can find more information in the Social Security procedures manual known as the Program Operations Manual System [POMS] under section GN 02409.100 and GN 02409.110. The public version of this information is available on the Internet at <https://secure.ssa.gov/apps10/poms.nsf>).

- Comparing possible Social Security start ages on an "apples to apples" basis and treat inflation-adjustments fairly. Consider that your annual Social Security statement shows starting amounts at different ages in "today's dollars" while almost all financial planning is done in "future dollars" as retirees plan on drawing down income over time.
- Planning on the higher Social Security benefit "living on" when the first spouse in a married couple dies. No matter which spouse passes away, the smaller benefit will be eliminated.

Note: If the reader would like to read a more detailed analysis of the subject presented, including an advanced discussion of the taxation of Social Security benefits, a research paper written by the authors titled "Rethinking Social Security Claiming in a 401(k) World" is available at The Pension Research Council website.

### Another new wrinkle for married couples

In an article titled “The Baby Boomer’s Guide to Social Security,” *The Wall Street Journal* reported on November 17, 2007 that individuals may have another option to maximize Social Security benefits between spouses.<sup>6</sup> The article mentions that when the higher earning spouse is delaying Social Security, once Full Retirement Age is reached, he or she may still be able to claim spousal Social Security benefits (based on the earnings of the lower earning spouse—if that spouse has already started her/his own Social Security benefit).

This strategy is unique since historically, the higher earning spouse may not have been thinking about claiming spousal benefits. Once Full Retirement Age is reached, the individual is no longer deemed to be filing for both worker and spousal benefits once he/she files for benefits. And thus, the worker can choose to file only for spousal benefits at his/her Full Retirement Age (or later) and allow his/her own worker benefits to continue to grow via Delayed Retirement Credits. Once that higher benefit is claimed based on his/her own earnings history, the spousal benefits being paid to the higher earning spouse would cease.

The key to understanding this option is based on understanding the difference between being “eligible” for a Social Security benefit and being “entitled.” For example, an individual may be “eligible” for full retirement benefits at age 66. But he/she only becomes “entitled” to those benefits once they have filed for those benefits.

And thus, if an individual does not file for Social Security benefits based on his/her own earnings, he/she is not “entitled” to those earnings. And thus, the individual may become “entitled” to spousal benefits (if their spouse has filed for benefits based on their work record and is past Full Retirement Age) since he/she is not yet “entitled” to benefits based on his/her own work record.

See Social Security POMS references RS 00202.025 and RS 00202.020 using the same URL address mentioned on previous page.



The safety and comfort that guaranteed lifetime benefits provided by traditional Defined Benefit pensions may be fading away, but new retirees can use the flexibility of their 401(k) and IRA balances to help optimize and maximize the guaranteed benefits of Social Security. In fact, many future retirees may find even greater advantages than if they had a traditional pension due to the tax advantages of higher Social Security benefits, as their traditional pension income would have subjected them to the Tax Torpedo.

It truly has become a “Do-It-Yourself” retirement world. But retirees who embrace a strategy that can withstand the risks they’ll face, will have a better chance of enjoying a happier and healthier retirement. It is all about choices. And those who understand how to evaluate their choices and optimize their decisions will be the ones to enjoy a more secure retirement. A larger amount of Social Security within a retirement income strategy may, indeed, be the golden ticket to the golden years.

### About the authors

As defined benefit pension benefits fade away, the authors have spent the last four years researching how individuals with 401(k) assets and Social Security can maximize after-tax income and reduce the risks that they will face in generating retirement income. A research paper, “Rethinking Social Security Claiming in a 401(k) World” was presented at The Pension Research Council’s annual symposium in April 2007. The authors’ work has also been featured in *The Wall Street Journal*, *Kiplinger’s*, and *Retirement Weekly*.

**James Mahaney** has over 20 years of experience in the Financial Services industry and holds a Master’s Degree in the Science of Financial Services. He is a Certified Pension Consultant. Lately, he has been a frequent speaker about how Social Security can efficiently integrate with personal retirement savings. He currently has three patents pending in the U.S. patent office.

**Peter Carlson**, a Wharton graduate is a Chartered Financial Analyst and earned his Fellowship of the Society of Actuaries in 2007.

The authors are currently at work developing a new generation of 401(k) products and services, which they hope will better prepare individuals for retirement and help them achieve a secure retirement.

### Notes

1. “Social Security is Chief Factor in Improved Retirement Wealth Picture,” Economic Policy Institute, 2005.
2. “Social Security as a Retirement Resource for Near-Retirees,” Benjamin Bridges and Sharmila Choudhury, May 2005.
3. “Why Do Women Claim Social Security Benefits So Early?” Alicia Munnell and Mauricio Soto, *Center for Retirement Research Issue Brief*, October 2005.
4. “Torpedo Tax Can Cause a Sinking Feeling,” *The Dallas Morning News*, February 11, 2003.
5. “Another Retirement Option: New Roth 401(k),” *The Dallas Morning News*, March 28, 2005.
6. “The Baby Boomer’s Guide to Social Security,” *The Wall Street Journal*, November 17, 2007.



280 Trumbull Street  
Hartford, CT 06103  
[www.prudential.com](http://www.prudential.com)

Since individual circumstances may vary, you should consult your own legal, tax, accounting, and/or investment advisors if you have questions on the tax treatment of the products described. Prudential is not a tax or legal advisor.

Prudential Retirement, Prudential Financial, PRU, Prudential and the Rock logo are registered service marks of The Prudential Insurance Company of America, Newark, NJ and its affiliates.