US and UK Social Security Benefits

US Social Security and UK State Pension benefits often form a cornerstone of an individual's retirement planning strategy providing a foundational source of income that will supplement other retirement savings. The ability to receive such benefits generally depends on employment and having earned income in the requisite countries for long enough to qualify. Understanding what benefit you may be entitled to and the basic principles of the US Social Security and UK State Pension systems for a US-UK connected individual is a fundamental first step. Once you understand what your benefit entitlement may look like, it can then be important to assess your strategy for collecting your social security income and determine how it will factor into your broader retirement planning.

Social Security Benefit Entitlements in the US and the UK

Under the UK system, anyone who reaches State Pension Age after 6 April 2016 needs to qualify for benefits under the New State Pension rules. Under the New State Pension, an individual needs 10 qualifying years to receive a benefit. A qualifying year is generally one in which you were employed and paying National Insurance Contributions, received National Insurance Credits due to unemployment or illness, or paid voluntary National Insurance Contributions. The full benefit currently (for 2021/22) amounts to £179.60 per week (or £9,339.20 per year) but the ultimate amount you receive is based on your National Insurance record. If you have any gaps in your record, it should be noted that there is currently an opportunity to make voluntary contributions before 5 April 2023 related to gaps in your record between April 2006 and April 2016. You can usually only make any voluntary contributions from the last 6 tax years. This can be a relatively cheap way to pick up an extra retirement benefit entitlement.

For US Social Security, an individual must generally be employed in a job where Social Security tax has been paid in an amount that allows the individual to earn at least 40 credits. A maximum of 4 credits can be earned each year, so this equates to an individual paying Social Security taxes over at least 10 years of employment. The amount of projected benefit entitlement is based on a formula which indexes your earnings during the 35 years in which you had the highest earnings. In the instance that you have less than 35 qualifying years then the projected benefit is based on the number of years between 10 and 35 that you have paid into the program. Unlike the UK system, there is no opportunity to make voluntary contributions to enhance your US Social Security record retrospectively.

How is your benefit entitlement impacted from years working abroad?

Some individuals who spend time working in both the US and the UK may find that they do not meet the minimum requirements to qualify for a Social Security benefit in either the US or the UK. In this instance, you may still be able to obtain a Social Security benefit as there is an agreement in place between the US and the UK called a Totalization Agreement which both eliminates the requirement to pay Social Security tax in both countries on the same income source and provides for a gap fill to benefit entitlement in the situation where individuals have spent part of their career working in the US and part in the UK. In the instance where qualifying time periods of participation in each of the US and UK Social Security system can be combined to then subsequently result in an entitlement, then the US and the UK will each pay their pro-rata share in the benefit entitlement being paid.

Whilst you can be entitled to receive both a US Social Security benefit and a UK State Pension benefit, this does not mean that the projected benefit entitlement outlined on your US Social Security Statement will be the amount you ultimately receive. The Social Security Administration applies something called the Windfall Elimination Provision (WEP) to an individual's US Social Security benefits if they worked in a job where Social Security taxes were not required to be paid and they have also earned a pension from that job. In this instance, the projected benefits can be recalculated and reduced by up to 50% of the pension benefit you earned from income in which you didn't pay Social Security taxes. In 2021, if an individual has 20 years or less of substantial earnings, the benefit reduction will be capped at $498 per month (or $5,976 per year).[1] Once an individual has more than 20 years of substantial earnings where you have paid Social Security taxes, the reduction of benefits becomes smaller and if you have more than 30 years of credits then the WEP doesn't apply.

An example highlights the application of WEP – An individual has 15 years of US substantial earnings towards their Social Security Benefit accrual and is entitled to the maximum UK State Pension benefit of £9,339.20. Let's assume that in US Dollars the UK State Pension benefit is worth $13,075 per year or roughly $1,090 per month. Fifty percent of the UK State Pension benefit would be $545 per month. We know from above that the maximum reduction is currently capped at $498 per month. So, in this instance, the individual's US Social Security benefit entitlement when it commences would be reduced by $498 per month or $5,976 per year.

Some may (wrongly) think it isn't worth collecting on the UK state pension benefit due to the prospect of their US Social Security benefit being reduced. However, when you look at the numbers, due to the fact that any reduction is always capped, it is likely that you would end up better off in total when you collect both entitlement benefits. That being said, it highlights the importance for you to understand how the WEP may impact your total projected benefits especially if the income stream will form part of the income that is relied upon to meet your retirement needs.

When does it makes sense to consider collecting benefit entitlements?

There are decisions as to when it is best to begin collecting Social Security benefits and it is important to think about maximising the benefit for your own individual situation. Some decisions may seem relatively insignificant, but they may cost a material amount over time.

Under current law, the State Pension age in the UK is currently age 66 with it set to increase to age 67 by 2028 and age 68 by 2046. Recent proposals have indicated the desire to bring the date forward to age 68 from 2046 up to 2039.[2] Once you reach State Pension age, you are entitled to collect your full benefit regardless of whether you continue to work and have employment earnings.

It should be noted that you can choose to defer the start of your payments. Your State Pension increases by 1% for every 9 weeks that you defer. This would amount to just under 5.8% for every year that the payments are delayed.[3]

In the US, the current Full Retirement Age (FRA), or age that an individual is entitled to collect full benefits, ranges between age 66 and 67 depending on date of birth. The US does allow benefits to begin to be collected as early as age 62 albeit at a reduced rate of up to 30%.[4]

It should also be noted that if you choose to begin collecting your US Social Security benefit before FRA but you continue to work, your benefit may be reduced based on your earnings until you reach FRA. In 2021, if you earn more than $18,960, $1 is deducted from payment for every $2 that exceeds the earnings limit.[5] Once you reach FRA, your earnings no longer affect your benefits.

Similar to the UK, individuals can also choose to delay their US benefits after FRA until the age of 70. For every year that an individual defers their US Social Security benefit, the monthly benefit will increase by roughly 8%.[6] However, once you reach age 70, benefits will no longer continue to increase.

With all this in mind, you should give some thought as to the underlying purpose that your Social Security income will serve in your retirement and legacy planning. If you are trying to maximise your own income over your lifetime or maximise the income of the family, and you do not require access to income earlier in retirement then choosing to wait until FRA or delay payments past FRA may be beneficial. Alternatively, if your health is poor and you think your life expectancy will be shorter than average, collecting a benefit earlier may be beneficial in terms of the amount of benefit you collect during your lifetime. That being said, for married individuals, you must also keep in mind that any surviving spousal benefit would also be reduced which may impact the surviving spouses financial planning should they have a much longer life expectancy.

Choosing to take benefits early means that you are collecting your benefits over a longer time period. However, the monthly benefit is permanently reduced. Additionally, if you continue to work before reaching FRA, your benefit will be reduced further during the time period before you reach FRA. If you are working or you have other assets or income sources that can plug the gap, delaying your payments can permanently increase your monthly retirement income stream over your lifetime. If your US benefit will be subject to the WEP, delaying the commencement of payment can help make up some of the reduction.

Social Security benefits can be difficult to navigate for expat individuals. You should start planning early to understand what your benefits may look like and how they may be impacted by the time spent in different countries. Reviewing this in the context of your broader Wealth Plan will help ensure that you are being prudent in your planning strategies and maximising any owed benefits. Most importantly, it should prevent any unintended surprises at retirement.

[1] https://www.ssa.gov/benefits/retirement/planner/wep.html
[2] https://www.gov.uk/government/news/proposed-new-timetable-for-state-pension-age-increases
[3] https://www.gov.uk/deferring-state-pension/what-you-get
[4] https://www.ssa.gov/benefits/retirement/planner/agereduction.html
[5] https://www.ssa.gov/benefits/retirement/planner/whileworking.html
[6] https://www.ssa.gov/benefits/retirement/planner/1943-delay.html

enquiries@masecopw.com
+44 (0) 207 043 0455 | +1-888-MASECO1

MASECOPRIVATEWEALTH.COM