Episode 233: Should You Worry About Social Security Running Out?

Tue, Jun 16, 2026 3:27PM • 30:45

SUMMARY KEYWORDS
Retirement income, Social Security, primary insurance amount, survivor benefit, taxable account, Roth conversions, variable annuity, asset allocation, tax planning, payroll taxes, benefit cuts, financial personality, retirement planning, income gap, guaranteed lifetime withdrawal benefit.

SPEAKERS
Briana Corbin, Alex Murguia, Wade Pfau

Briana Corbin 00:00
The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to retirewithstyle.com/style and sign up to take the industry's first financial personality tool for retirement planning. Should you worry that social security won't be there when you retire? Should you keep reinvesting dividends in a taxable account? And what exactly does it mean to harvest a loss? Wade and Alex covered all in part two of the live Q and A. Let's get into it.

Wade Pfau 00:57
Retirement,

Alex Murguia 01:01
okay, uh this is another question here, and it's wow, this is a poo is a hardcore because it's usually the other way that we hear this question, but is there a way to get a more detailed version of Wade's book, the older version? So I suspect they like that, you know, how you always, you know, with a new book in the podcast series, you were saying how you've like reduced, I don't know, 150 pages of it to get a little bit more to the meat of the sandwich of the story. Who likes the details, and I'm sure many folks do. Could they have access to, is there still a way to access the older versions, editions of your book.

Wade Pfau 01:42
Yeah, so the third edition of the Retirement Planning Guidebook came out the start of this year, and it's 100 pages shorter than the 2025 update from the second edition, but I really didn't cut out any significant details. Although, if you're really, if you still want to see the 2025 update to the second edition and the first edition, they're all available on Amazon still, if you just search for Wade Pfau Retirement Planning Guidebook. Hopefully, the third edition shows up first, and we've gone in past issue of people accidentally buying an older edition, but if you just scroll down through the options, you should still find the second and first editions available for sale at a discounted price. You can still get access to those older books. It's not hard to do that. I just

don't want anyone to accidentally buy one of those older editions, because I do think the third edition is much better.

Alex Murguia 02:33
Alrighty, looking for thoughts on younger spouses, five years differences with similar but higher PIA and SS and social security claiming strategies. Oh, you better say it again.

Wade Pfau 02:49
You better define PIA. Let's see if you can do it.

Alex Murguia 02:52
You're gonna put me on the spot like that.

Wade Pfau 02:54
Go ahead. Oh, sorry, you should finish the question.

Alex Murguia 03:00
Hang on, let me Google this real quick, real quick, real quick. No, hang on, remember, where's the question?

Wade Pfau 03:08
Yeah, looking for thoughts on younger spouses with a.. so there's a five year age difference, but they have similar primary insurance amounts, their PIA, PIA,

Alex Murguia 03:16
better

Wade Pfau 03:18
social security claiming strategies. Has this

Alex Murguia 03:21
been addressed on any specific episode? We have tons of episodes on on this, but Wade, go ahead.

Wade Pfau 03:27
Yeah, yeah. So, the scenario again, it's they have about the same primary insurance amounts, so when we don't really talk about one of them as a high earner and the other is a low earner, they have about the same primary insurance amounts. The issue here is one spouse is five years younger than the other, and so, yeah, we can talk about that. I actually ran it through open,

Alex Murguia 03:47
just because PA is still not even obvious what that means. That's just like the monthly benefit you're going to get.

Wade Pfau 03:53
Yeah, if you, if you claim at your full retirement, you'll get your primary insurance amount as your monthly benefit at full retirement age. If you delay past full retirement age, you'll get credits

to increase, so your benefit at age 70. If your full retirement age is 67 you'll get 1.24 times your primary insurance amount. If you claimed at 62 you'd get 70% of your primary insurance amount. Okay, so they have about the same primary insurance amount, but one spouse is five years older. So I ran a scenario like that through Open Social security.com software that is software freely available to consumers. Mike Piper developed that. It's a great resource, and yeah, basically the story here is the older person should still think about claiming at 70 because their benefits, the most likely to become the survivor benefit, when which would allow that higher age 70 benefit to apply for the joint lifetime of the individuals. The younger person has more flexibility if they're not as worried about. Longevity risk, and so forth, because the younger person's benefit - well, they have the same primary insurance amount, but one of them, whoever dies first, the person who delayed till 70, that benefit becomes available to them both. So that younger person, their benefit may not last for as long, since eventually they could gain access to the survivor benefit from the older spouse, so the older spouse delayed a 70, the younger spouse is more options, more flexibility. If they're not as worried about longevity, they could claim as early as 62 but if they're worried, they might both live to an advanced age, like they might both might live into their 90s, the possibility they might both delay to age 70. It's just the older person, pretty strong case, delay to 70. The younger person has more flexibility, anywhere from 62 to 70. It's just the longer they both live, the more benefit there would be from them both waiting till closer to age 70.

Alex Murguia 06:01
Okay. Okay, I am 39 years old. This one's from Timothy. I am 39 years old. When I lay out my balance sheet of assets and liabilities with regards to the future, I feel scared, including the estimated benefits of Social Security from my annual statement. I worry that social security will become unreliable and possibly not even exist by retirement age in 25 to 30 years. You discussed the timetable of partial insolvency in the past and how it needs adjustment to its formulas, or else it will fail to 70 to 80% fund it. Can you please comment on how certain a young or middle-aged person can feel about social security actually being enforced and reliable three day kids in the future. How can we safely factor estimated social security benefits into an asset liability matching in 20 to 30 years? Thank you.

Wade Pfau 06:58
Okay, yeah, and so the issue is there's currently a trust fund for Social Security, because of demographics. Social Security was pay as you go, which just meant the incoming payroll taxes from current workers cover the benefits to current beneficiaries, retirees, and any other beneficiaries, but because people are living longer, and the baby boomer generation is creating a lot of retirees, and their fertility rates are down, so there's fewer workers in the future to pay payroll taxes. There's a trust fund developed to help anticipate that that trust fund is expected to deplete in the early 2030s It adjusts each year based on the new Social Security trustees report, and when the depletion happens, the projection is that payroll taxes from workers will cover over the long term, you know, 75 to 80% of the promised benefits. So, if Congress does not take any sort of action, the worst case kind of scenario we're looking at is they'd have to take some action, but if they legislate a 20 to 25% benefit cut as a way to get social security into balance, you would be looking at a lower social security benefit. So, the question is kind of like, you know, how worried should I be about that? I think it's reasonable to build that sort of analysis into your planning, but I would also note, like, if you're 39 years old, your social security statement that's telling you what your primary insurance amount is might really already reflect the reductions, because the social security statements assume future inflation is zero and it

assumes future real wage, well, future wage growth is zero, so you're kind of locked into prices and wages staying the same in the future, historically, and it seems reasonably reasonable to expect in the future wages grow about 1% faster than inflation every year, and that matters up until your early 60s, so if you just think you know you've got another 20 years where if wages exceed inflation by 1% a year, your real benefit will be about 20 to 25% larger than what your social security statement shows. So then, if you take a 25% 20 to 25% haircut on that, actually the primary insurance amount on your social security statement is like the reduced number, if they actually reduce benefits in the future, so you may not really need to make any haircuts to what you see on your social security statement, and hopefully that will help you feel better about the situation. You don't necessarily have to take a haircut off of what the social security statement shows, that would just be as you get closer to your early 60s, you might have to take a haircut off of what your statement shows, because you have less time for real wage growth to make up any difference in the cut,

Alex Murguia 09:48
so in essence, what you're saying is yes, this is a real concern that there's potential reductions in social security benefits in the future, but if you're young right now, you don't really have. To worry about it, because the estimate you're getting on your payouts for Social Security when you retire are severely understated, because it's taken into account zero inflation and the

Wade Pfau 10:12
zero wage growth. Yeah, zero

Alex Murguia 10:15
wage growth. So

Wade Pfau 10:17
your benefits are adjusted, your average index monthly earnings, they adjust for the wage growth, and so if real wage growth is positive, you see a real growth in your future benefit above inflation, and that's what could offset any benefit reduction with respect to what you see on your statement,

Alex Murguia 10:36
but if you're older, it's a different kettle of fish, and I'll add, and you said it, but I'll bring in that other question that we had, that was similar, since we're on this vein, that you can then address, which is my question concerns planning assumptions around future social security benefits, since social security trust fund will be depleted within the next few years. In our particular situation, my spouse will claim social security benefits at full retirement age at six of 67 in 2030 so he'll get a PIA out of that right way. I was the higher earner, I will claim at 70 in 2035 For planning purposes, I am assuming that both of our benefits will be cut by 25% when the social security trust fund runs out. I'll also mention that our projected future benefits in parentheses without any cuts are on the high side most likely in the 90th percentile. To my mind this means we might be subject to a larger reduction than people with lower benefits, depending on how Congress decides to adjust the funding gap. My goal in planning is to be reasonably conservative, but not too conservative. What are your thoughts? Goldilocks.

Wade Pfau 11:54

Yeah, so this is talking about the cutting 25% when the trust fund runs out, and I think that's a reasonably conservative assumption for them to use. They're making, yeah, a couple further points that it's your earnings stop getting indexed for the wage growth after age. I'm pretty sure it's 60, but it might possibly be 62 and if someone's going to definitely correct either 60 or 62 they stop indexing the wages for wage growth, so that's where this issue I was talking about. If you're 40, your benefit might be a lot larger than what the statement shows, but if you're already like 60, that's not going to be the case. So that's where you would want to actually apply a benefit reduction if you're going to want to plan for that scenario, and so I think a 25% reduction is reasonable. They're also hinting at they're on the higher side of earnings, and they're worried maybe the benefit cuts. We have no idea what this reform will eventually look like, but if it becomes a progressive type of benefit cut, the higher wage earners benefits could be cut by more than the lower wage earners benefits, just with the way they adjust the formulas for calculating that, so they, you might worry that if you're very high benefits, they could be cut by more than 25% I don't know that I necessarily would want to build that into my assumptions, so I do think 25% seems like a reasonably conservative assumption for them, for them to use in their scenario that they described.

Alex Murguia 13:31
Okay, let me go to the next one. Here in episode 207 a commenter asked about Roth conversions in the situation where RMDs or not, they would remain in the 22nd percent tax bracket. I am in a similar situation, however, that pushed me into the Roth conversion side. However, what, oh, what pushed me into the Roth conversion side was when I did future modeling with me passing away at age 80 rather than both of us passing away at 100 as a single person having to make those RMD distributions, it really made a difference. You often talk about thinking about a surviving spouse when it comes to delaying Social Security, a similar issue, at least for taxes, occurs for Roth conversions.

Wade Pfau 14:25
Yes, this is known as the widow's penalty, and it's definitely a consideration for tax planning. The widow's penalty is the idea that single filers get hit a lot harder with the retirement taxation than those who are married filing jointly, so when you're still married filing jointly, you know at some point when somebody passes away the following year that surviving widow, widower has to start filing as a single filer, and their tax bills could go up because a lot of the tax bracket, well, their first like the. Their investment income is not really going to change just because somebody passed away. They're still going to have pretty comparable required minimum distributions, the investment income being kicked off of the portfolio, and so forth. They may lose a social security benefit and other pensions, so they may have less income. Their expenses might drop a little bit, but their taxable income is probably not going to change all that much, and it, but the tax brackets applied to it are likely to be cut in half, the Medicare Irma surcharge thresholds get cut in half, the odds of having to face that Social Security tax torpedo when you're already in the 22% income tax bracket go up the tax bill for a single filer could be higher than the tax bill for married filing jointly, and for that reason, this is one of the things we talk about, where if it's kind of, it's not clear whether or not to do Roth conversions. Well, there's a few reasons why you might want to consider doing Roth conversions anyway. One is to help protect that surviving spouse. Another is, if you're worried tax rates could increase in the future, and there were some other questions we got about that idea as well. Yeah, if you're worried tax rates might go up in the future, tax rates are relatively low from a historical perspective. Now you might want to take advantage of that, and I feel like there was some other reason too, but at

least the surviving spouse and the potential for future tax rate increases in the future are both reasons why you might want to go ahead and think about things like Roth conversions, even if, as married filing jointly, you might not really expect a lower tax rate being applied to your situation in the future,

Briana Corbin 16:41
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Alex Murguia 17:08
Okay, wait, and William had commented on the social security stuff, and you may want to people always are asking what can be done, so I'll put it up here. Oh, sorry, wrong one. Let me show this one instead. The current social security actual IRA deficit is about 4% of taxable payroll. Congress has many options to address this deficit,

Wade Pfau 17:33
right? Just

Alex Murguia 17:34
your.. what's your hot take on that? I agree with him, but you know you're the star. One

Wade Pfau 17:40
way to address the deficit is to have an immediate payrolling tax increase of about 4% Yeah, and ultimately we're just talking about, like, kind of worst-case scenario from the perspective of benefits. If all the reform goes into benefit cuts, you're looking at 20 to 20-5% but if ultimately the reform package is a mix of tax increases and benefit cuts, which historically has been the case. The benefit cuts may be nowhere near 25% maybe they're just slight reductions, or maybe for the higher income folks there is that larger reduction, but then there's very little to no reduction for lower income type individuals. But yeah, payroll taxes could go up, they could raise the cap on taxable earnings, there's all kinds of different reform options available, and it wasn't really intending to address them all, but just trying to answer the earlier question, but yeah, that 25% benefit cut is like, if kind of the extreme case, if all the reform goes into reducing benefits rather than raising taxes. Is

Alex Murguia 18:43
okay, and we have here Beach Girl with another question. I'll put it up,

Wade Pfau 18:53
and that's only the first half of the question.

Alex Murguia 18:55
Yeah, we were sold a variable annuity when we were 30, now it's we're 62 we it appreciated from 100 Let me do it again, from 100 to 340 Fees are three and a half percent. Expenses fully covered by rental income, pension at 68 Social Security, thinking of a drawing from barrel variable annuity as a bridge to Social Security, all traditional accounts already covered, converted to Roth.

Wade Pfau 19:29
Okay, and yeah, with you being on the line here, that I'm, if the fees are three and a half percent, I hope that includes a guaranteed lifetime withdrawal benefit as part of that, in which case, you might want to think about whether it's worthwhile to turn on the guaranteed lifetime withdrawal benefit. If the fees are that high without any guaranteed lifetime withdrawal benefit, you probably do want to think about kind of reducing the role of that variable annuity in your plan, whether that. Means to use it as the income bridge for Social Security, as you're, you're stating, yeah, that could be an option, or if so, you mentioned having the pension and the Social Security. This gets kind of the whole conversation around if you have a retirement income style that's looking for reliable income to cover your basic expenses. Do you have an income gap after the pension and social security? If there's still an income gap, you might want to add reliable income, and there you do have the option. What are the annuitization features of that variable annuity? Does that variable annuity have a guaranteed lifetime withdrawal benefit? And then, if so, comparing that to other annuities available on the market, and yes, you could do a 1035 exchange, not just to another variable annuity, to real, but to really any, any type of annuity, and if you're looking for like the highest guaranteed lifetime income at this point, you're more likely to find that on the fixed annuity side than the variable annuity side, but yeah, it's if you want more reliable income, don't just immediately think you have to get out of that variable annuity. Looking at the conversion options as a possibility, if you don't necessarily need more reliable lifetime income, then building that social security delay bridge with it does seem like a reasonable option as well. Oh, and so Beach Girls following up, it does include a G A W A. So, guarantee is that an accumulation? I don't know that I've specifically seen the G A W A acronym before, but that's probably a variation of something I don't know if that's an accumulation benefit that will guarantee, like the principal or some growth of the account, in which case the fact that it's appreciated from 100,000 to 340,000 means you probably don't need to pay for the GA, well, for an accumulation benefit anymore. You're probably so much higher than the what the accumulation benefit guarantees that you're very likely to fall below that, and no income gap after pensions of Social Security. So, yeah, I guess

Alex Murguia 22:16
guaranteed on, oh, so it is. Wade, you're right, or

Wade Pfau 22:20
that's a guaranteed annual withdrawal amount, that may not be so. Now we, I need to see fine print about what that means. Is that it for an annuitization table, or it may not be a guaranteed lifetime withdrawal benefit. Have to look at the details of the contract, but yeah, I mean, I think you're.. we can't say a whole lot specifically, other than I think you're kind of thinking about it the right way here. If you don't need more reliable income, potentially using that to build a social security labor age does sound like a reasonable option.

Alex Murguia 22:59
Okay, next one here is here. I'll do it here. IRS refunded me $8,600 for overpayment for tax of taxes. I paid the exact amount using IRS Direct Pay for a Roth conversion. I use TurboTax online for my 2025 taxes. How do I find out if IRS made an error?

Wade Pfau 23:32

Yeah, you may want to actually speak to, like, an accountant, because we're not going to be able to really speculate. There's not any way for us to figure out with these details if where the problem came into play, but yeah, if the IRS thinks you overpaid on taxes and you think you didn't overpay on taxes, you wouldn't want that to come back and haunt you later, so probably going beyond just the do-it-yourself tools you have with the TurboTax, and so forth. Speaking to an accountant is probably a better option than just figuring it out on your own. At this point, it's possible the IRS made in there, but they might have - maybe they're doing it right. I can't, can't say too much about that particular issue.

Alex Murguia 24:23
Yeah, but what are the odds the government institution actually makes errors and stuff,

Wade Pfau 24:29
especially when it comes to thinking someone overpaid their taxes. All

Alex Murguia 24:35
right, this is a general question of I'll start off, how do you think about what to sell in a taxable account? Well, rule number one is you sell what is going to go down next, you know,

Wade Pfau 24:52
right goes down

Alex Murguia 24:54
right before it goes down. Wait, anything to add to that? No, I. Like other than, you know, anything that has to do with forecasting what you think is going to happen next, and that's what you sell, like, you know, things are over or frothy, or whatever. I would try to disabuse yourself from that, because I think that's a tough game to play. I would really take it down to basics, from the standpoint of what is your asset allocation, and with regards to that, what is overweight and underweight, and adjust accordingly. I wouldn't let the taxes, the tax tail wag the dog here from that perspective. I would keep things in line with what the allocation is, and make sure that it's maintaining that that discipline, simply because the financial plan is based from that, and don't forget what Wade said about allocation differences, in terms of 3565 versus 7525 you know, things like that. It doesn't make a whole hell of a lot of difference once you're taking withdrawals, not necessarily from the standpoint of overall growth and the like, but if you're already taking distributions, which is the purpose of the portfolio, I feel, and I say I in quotations, you should probably be less concerned about what's going to be the one that's going to be the highest performing, as opposed to which is the one that's going to maintain my distribution, and really it's a matter of maintaining the asset allocation within that account, and that's how I would go about doing it as strategically and robotically as possible.

Wade Pfau 26:32
And Michael added that the asset allocation is on target, so that does then speak to just the tax considerations, and that's kind of getting into the tax map calculator, like, if, if you can realize capital gains at a 0% effective marginal rate, because you don't have a lot of other ordinary income, and you don't have a lot of long-term capital gains yet, you might want to sell some of the shares with a lower basis to generate more long-term capital gains, but if you are at a point where you do need to work to keep taxes lower, then you're looking at shares with a higher cost basis to generate less capital gains for taxation purposes.

Alex Murguia 27:12
Now, if this person is asking the question from the standpoint of which asset class to sell, irregardless of that, like, I want to sell, should I sell the REITs instead of the small cap value. I don't, I don't have a particular opinion on that. Do you?

Wade Pfau 27:32
What can you say that again? I was reading one of the other questions. Oh,

Alex Murguia 27:35
maybe this person is asking too, from the Michael is asking from the point of view of, okay, I get all of that, but should I sell once I determine I need to sell something? Should I sell REITs versus small cap value? You know that kind, and getting into the asset allocation minutia of which won't.

Wade Pfau 27:53
Yeah, for that you could just do kind of proportionally to keep your targeted asset allocation. The selling decision can be part of the rebalancing. What do I need to do to rebalance, and then selling shares to move to the right asset allocation, but if you're already at the right asset allocation and there's no tax considerations, yeah, it would just be selling proportionally from different asset classes to maintain your targeted asset allocation,

Alex Murguia 28:18
which is what he was saying, because he followed it up by Michael, followed it up by saying that allocation is our target, but something must be sold, anything sold will be at 15% tax rate, I assume,

Wade Pfau 28:30
but, but that's only for the gains, not the basis, so yeah,

Alex Murguia 28:34
that's a good point that you said earlier, yeah, so that's which individual stocks or stock funds, I look,

Wade Pfau 28:41
but you're saying you're already out of the 0% threshold, so

Alex Murguia 28:44
yeah. And again, Wade, my take would be I don't think it matters. The absent of forecasting, which we don't do, like I can't tell you, hey, Nvidia's been on a tear, and so why don't you sell that one now? If you're looking for that answer, that's just not something we do, where we're sort of agnostic to that type of forecast, and I would say proportionally as best you can, going back to Wade's last response,

Briana Corbin 29:20
and that's a wrap on this part of the conversation. Wade and Alex will pick right back up next episode, so make sure you're subscribed, so you can catch the rest next time. Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC

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