What You Need to Know About Social Security

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Social Security is an important piece of many American's retirement income and it was only designed to replace a portion of your income and survivor needs. Your decision to claim benefits early, on time or delay will be one of the most important financial decisions you make when approaching retirement. The decision is complex and there are many variables to consider such as your survivor needs, spousal benefits, continued employment, other assets and income needs. Before applying for Social Security benefits, you should consult with your financial professional to review your financial plan . They can help you determine the best claiming strategy and the associated solutions to help you make that decision.

This paper is designed to provide you with an overview of some key concepts you need to know in order to make educated decisions about Social Security. It also gives you a well-rounded look at the retirement benefits and discusses opportunities to optimize benefits given your specific situation.

As you think about Social Security, it will be helpful to keep the following in mind:

Key Insights

- **Predetermined amount of income.** Your Social Security income is tied to your earnings history. The exact amount of your benefit is based on a mathematical formula and when you apply for benefits.
- **Spousal Benefits**. In order to receive a spousal benefit based on your spouse's work record, your spouse must have filed for benefits.
- **File and Suspend**. "File and Suspend" allows a spouse to receive spousal benefits based on the worker's record, while the worker accrues delayed retirement credits. Both spouses must have reached full retirement age to use this strategy.
- **Inflation-adjusted income.** Social Security benefits can be increased each year, based on increases to the Consumer Price Index. These cost of living adjustments help retirees keep pace with the rising cost of living.
- **Survivor Benefits**. While your Social Security checks will be issued for your lifetime only, benefits are also paid to surviving spouses and dependents. Regardless of which spouse dies first, the smaller benefit is eliminated and the larger benefit continues.
- **Social Security benefits may be taxable.** Depending on your total annual income in retirement, a portion of Social Security benefits - or those of your spouse, if filing jointly - may be subject to income tax.

Social Security Benefits

On August 14, 1935 President Roosevelt signed the Social Security Act, which created the Social Security Board. The Board was tasked with old age insurance, unemployment compensation, and public assistance titles of the Social Security Act. In 1946, the Board became the Social Security Administration.

Today, Social Security Administration handles many citizen benefits. These include retirement benefits, disability benefits, Medicare, survivor benefits, supplemental security income, and benefits for those caring for minors.

The average monthly benefit for Social Security in January 2014 was $535.23, and represents 8.3 million people, of which 6.1 million are receiving federal payments only. [1]

Earnings Record

The retirement benefits you're entitled to are based on your earnings record, or the record of your current spouse or ex-spouse. Social Security Administration records the amounts you have paid to the system throughout your earning years and represent the "credits" you have earned. When you've earned 40 credits, you are eligible for retirement benefits on your own.

Social Security benefits use an "average indexed monthly earnings." This AIME is computed by indexing the earnings by general wage levels for that year. "Such indexation ensures that a worker's future benefits reflect the general rise in the standard of living that occurred during his or her working lifetime." [1]

This average summarizes up to 35 years of a worker's indexed earnings. This creates the Primary Insurance Amount ("PIA") that you see on your statements. The PIA is the basis for the benefits that are paid to an individual.

"After we determine the *number* of years, we choose those years with the highest indexed earnings, sum such indexed earnings, and divide the total amount by the total number of months in those years. We then round the resulting average amount down to the next lower dollar amount. The result is the *AIME*." [1]

The Social Security wage base is the maximum amount each year that you are taxed for Social Security. In 2014, the wage base is $117,000. If your wages exceed this amount, then you have contributed the full amount to Social Security for the year. The wage base has changed throughout the years. From 1968 to 1971 it was $7,800 and by 1980 it had risen to $25,900. Fast forward to 2000 and the wage base had moved to $76,200 and it rose to $90,000 in 2005.

You can earn up to 4 credits per year. You earn 1 credit for every $1,200 in earnings. (Social Security Administration, 2014)

[1]Social Security Administration, 2014 (www.ssa.gov)

The Social Security Statement

The Social Security statement shows an estimated PIA ,and assumes that the person earned the past year's wage up until each of the retirement dates (62, 67, and 70). Therefore, the Social Security statement may overestimate the PIA amount, depending on when the wage earner actually stops working or has a change in his or employment status.

Primary Insurance Amount (PIA)

The Social Security benefit an individual receives at his or her Full Retirement Age.

For illustration purposes, let's review a hypothetical wage earner named Pat, who has a PIA of $2,400. If Pat decides to stop working at 60, then this amount will change. The Social Security web site has calculators available to create a more accurate PIA by entering actual future working years and wages. If we know that Pat will stop working at 60, then we would add zero for wage income for the years 61 to 67. This would provide a more accurate estimate for Pat when the time comes to apply for benefits.

Full Retirement Age

The Social Security Administration has determined the age you will be eligible to receive your full, regular retirement benefit, known as your full retirement age ("FRA") based on the year you were born. For today's retirees, full retirement age ranges from 65 – 67. Due to greater life expectancies, full retirement age is gradually increasing. FRA is currently 66 for those born between 1943 and 1954, at which point a retiree is entitled to his or her PIA.

Full Retirement Age

Year of Birth*	Full Retirement Age
1943 - 1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

*If you were born on January 1st of any year, you should refer to the previous year. (If you were born on the 1st of the month, we figure your benefit (and your full retirement age) as if your birthday was in the previous month.)

http://www.ssa.gov/retire2/retirechart.htm0

Full Retirement Age (FRA)

The age at which a person may first become entitled to full or unreduced retirement benefits.

Early Retirement

An individual is eligible to start collecting Social Security as early as age 62; however, this locks in a reduced benefit for the rest of the retiree's life. This reduction is based on the following calculation:

In the case of early retirement, a benefit is reduced 5/9 of one percent for each month before normal retirement age, up to 36 months. If the number of months exceeds 36, then the benefit is further reduced 5/12 of one percent per month. [2]

Primary and Spousal Benefits at Age 62 (Benefits based on a $1,000 PIA)			
		Percent Reduction	Percent Reduction
Year of Birth*	FRA	Primary	Spouse
1943 - 1954	66	25.00%	30.00%
1955	66 & 2 months	25.83%	30.83%
1956	66 & 4 months	26.76%	31.67%
1957	66 & 6 months	27.50%	32.50%
1958	66 & 8 months	28.33%	33.33%
1959	66 & 10 months	29.17%	34.17%
1960 and later	67	30.00%	35.00%

http://www.socialsecurity.gov/OACT/quickcalc/earlyretire.html

- If you are born on January 1, use the prior year of birth
- Applies only if you are born on the 2nd of the month; otherwise the number of reduction months is one less than the number shown.
- Reduction applied to primary insurance amount ($1,000 in this example). The percentage reduction is 5/9 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.
- Reduction applied to $500, which is 50% of the primary insurance amount in this example. The percentage reduction is 25/36 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.

Delayed Retirement Credits

For each year a retiree delays the start of Social Security beyond their full retirement age, their benefit will increase by 8%, up to age 70. For example, a retiree who starts to receive retirement benefits at age 68 would see a PIA increase by a multiplier of 1.16 as seen in the chart below.

Factor Applied to Annual Social Security Income Based on Age[3]									
Claiming Age	62	63	64	65	66	67	68	69	70
Multiplier	0.75	0.82	0.87	0.93	1	1.08	1.16	1.24	1.32

Reductions Scale varies slightly based on year of birth. This example reflects Full Retirement Age at 66.

[2] Social Security Administration, 2014 (www.ssa.gov)
[3] For a detailed chart showing how a retiree's benefits are reduced by claiming early, see SOC.SEC.ADMIN., Full Retirement Age: If You Were Born Between 1943 and 1954, available at http://www.ssa.gov/retirement/1943.html. For a detailed chart showing a retiree's yearly rate of increase for delayed retirement, see SOC.SEC.ADMIN., Retirement Planner: Delayed Retirement Credits, available at http://www.ssa.gov/retire2/delayret.html.

Spousal Benefits

When you start collecting Social Security benefits, other members of your family may also be eligible to receive a monthly benefit of up to fifty percent of your benefit amount. Spousal benefits provide an opportunity to maximize your household's monthly Social Security income, but the rules are complex and must be carefully followed.

"If your spouse is under full retirement age and qualifies on his or her own record, we will pay that amount first. But if he or she also qualifies for a higher amount as a spouse, they'll get a combination of benefits that equals that higher amount. If he or she begins receiving benefits between age 62 and their full retirement age, the amount will be permanently reduced by a percentage based on the number of months up to his or her full retirement age." [4]

> ***When will Social Security begin paying benefits to same-sex married couples and surviving spouses?***
>
> *Social Security is now processing some retirement, surviving spouse and lump-sum death payment claims for same-sex couples and paying benefits where they are due. It is also are considering same-sex marriages when processing some claims for Supplemental Security Income (SSI).*

Let's review a few examples.

Assuming Pat is the higher wage earner and has a PIA of $2,400:

Example #1

If Pat, the higher wage earner, applies for benefits at age 67 (FRA):

- Chris may be entitled to 50% of Pat's PIA at Chris's FRA.
- Pat must file for her worker benefit in order for Chris to apply for a spousal benefit. In this scenario, Chris would have a spousal benefit of $1,200.
- Chris also has the option to apply for spousal benefits at age 62, however this would create a reduction in spousal benefits.

Example #2

- If Pat, the higher wage earner, applies for benefits at age 62:
- Pat will have a reduction of benefits of 30%, or a $720 reduction, for a PIA of $1,680.
- Pat can also decide to wait to Full Retirement Age (67) for the full retirement benefit.
- Pat can also wait until age 70 and gain the full delayed credits available.
  - The delayed credits are a way to increase the PIA by up to 8% per year. The increases are based on a per month basis, so any amount of time that Pat waits, up until age 70 is a benefit to her.

Spousal Benefits		
Age	**Spousal Benefits**	**Percentage of Benefit**
62	Claim own benefit Claim spousal benefit	70% of PIA 35% of spousal PIA
Full Retirement Age	Claim own benefit Claim spousal benefit	100% of PIA 50% of spousal PIA
70	Claim own benefit Claim spousal benefit	124-135% of PIA depending on year born No additional increase after FRA

> *This chart illustrates the results of a spouse claiming spousal benefits at age 62, full retirement age, and age 70.*

[4]Social Security Administration, 2014 (www.ssa.gov)

Divorced Spouses

Your ex-spouse can receive benefits based on your record (even if you have remarried) providing:

- Your marriage lasted 10 years or longer;
- Your ex-spouse is unmarried;
- Your ex-spouse is age 62 or older;
- The benefit that your ex-spouse is entitled to receive based on his or her own work is less than the benefit he or she would receive based on your work; and
- You are entitled to Social Security retirement or disability benefits.

For further information on Social Security rules on divorced spouses, please contact the Social Security Administration.

Claiming Strategies for Married Couples

There are a number of ways for married couples to optimize Social Security Benefits. We have already reviewed spousal benefits. Now we'll review file and suspend and multiple claiming strategies.

File and Suspend

"File and Suspend" allows a spouse to begin receiving spousal benefits based on the worker's record, while the worker continues to accrue delayed retirement credits. Using our sample couple, Pat could apply for and then immediately suspend her benefits at FRA. By suspending benefits, Pat can now gain delayed credits. Every year delayed is an increase of about 8% to the PIA. Chris can then begin receiving spousal benefits based on Pat's record. The planning opportunity here is the ability to create additional cash flow to the household as well as increasing the higher wage earner's PIA.

Year of Birth	Yearly Rate of Increase	Monthly Rate of Increase
1933-1934	5.50%	11/24 of 1%
1935-1936	6.00%	1/2 of 1%
1937-1938	6.50%	13/24 of 1%
1939-1940	7.00%	7/12 of 1%
1941-1942	7.50%	5/8 of 1%
1943 or later	8.00%	2/3 of 1%

Note: If you were born on January 1st, you should refer to the rate of increase for the previous year

Multiple Claiming Strategy

A multiple claiming strategy or "claim twice" as it is has been referred to in some publications, is a way to optimize one's household retirement income from Social Security. This strategy maximizes lifetime benefits and not necessarily monthly benefits.

This strategy works best:

- For married couples in which each spouse worked and qualify for their own Social Security benefits;
- One or both of the spouses must be at full retirement age, or older;
- When the older spouse is the higher earner.

Example #3

This strategy works best when both spouses are similar ages. In this scenario, Pat and Chris both turned 66 last month. Pat has a PIA of $2,400 and Chris has a PIA of $2,000.

The first set of claims happen at full retirement age, and the second set of claims happen at age 70.

Claim One

- Chris, the lower wage owner would apply for benefits at FRA.
- Pat, the higher wage earner would apply for spousal benefits at FRA.

This creates a household income of $36,000 for the first year. For simplicity, we will not include the Social Security cost-of-living adjustment (COLA).

	Chris	Pat	Household	Yearly Income
Claim #1	$2,000.00	$1,000.00	$3,000.00	$36,000

Claim Two

- At age 70, Pat, the higher earner would move from spousal benefits to her own record, now with delayed credits (132% of PIA).
- Chris, the lower earner keeps 100% of his PIA or 50% of Pat's PIA, whichever is greater.
    - If Chris decided to claim 50% of Pat's PIA at age 70, he would have to re-file for spousal benefits.

	Chris	Pat	Household	Yearly Income
Claim #2	$2,000.00	$2,976.00	$4,976.00	$59,712

Hypothetical example for illustrative purposes only. Data not based on actual individuals or work history.

At age 70, the household income moved to $59,712 a year assuming Chris kept 100% of his PIA.

Considerations

Before a person files for Social Security benefits there are a several issues to consider. These include continuing to work while applying for retirement benefits, the taxes you will pay, the windfall elimination, and the pension offset.

Working and Benefits

If a person applies for Social Security benefits before their FRA and continues working, there is a reduction in the benefits paid. The income that is considered as “working income" by SSA rules is wage income, or if self-employed, your net earnings. Gross wages are considered in the wage calculation, so any before-tax savings programs will also be included. Think gross wages if you work for someone else. Wage income is also considered at the time it is earned, not when it is paid. So if a person receives a bonus, commissions, vacation pay that is paid the next year, for Social Security it is counted as income in the year it is earned. Other income, such as government pensions or benefits, investment earnings, interest, annuity income, or capital gains, does not count as working for Social Security.

> *The reduction in all years prior to full retirement age is $1 for every $2 earned over $15,480.00. The year of FRA the reduction is $1 for every $3 earned over $41,400, until the month of Full retirement age.*

The reduction in all years prior to full retirement age is $1 for every $2 earned over $15,480.

Let's consider another hypothetical example, that of George. On his 62nd birthday George decides he can use a few extra dollars each month. He is still working and making $55,000 and files for Social Security. His FRA is 66 and his PIA is $2,200.

- $55,000 - $15,480= $39,520.
- George’s benefit is then reduced $1 for every $2 and the annual reduction is $19,760.
- This effectively creates a $533.00 PIA

If George waits to the year he turns 66, then the rule changes.

- The reduction is $1 for every $3 earned over $41,400, until the month George turns 66 or FRA.

The same example would be this:

- George turns 66 in July 2014.
- In January 2014, George’s benefit reduction changes to **$1 for every $3 earned**. He is still working and making $55,000. His FRA is 66, and his PIA is $2,200.
- $55,000 - $41,400= $13,600
- George’s benefit is then reduced $1 for every $3, for an annual reduction of $4,534.
- This effectively creates a $1,822 PIA.
- After July (the month of FRA), there are no benefit reductions. He can make as much as he wants and his Social Security benefit will not be impacted based on wage income.

“It is important to note, though, that these benefit reductions are not truly lost. Your benefit will be increased at your full retirement age to account for benefits withheld due to earlier earnings. After you reach full retirement age, we recalculate your benefit amount to leave out the months when we reduced or withheld benefits due to your excess earnings. [5]

Special Rule for the First Year of Retirement:

If you attain retirement age in the middle of the year and you decide to apply for Social Security benefits, you can still receive a full payment even if you have been working. The special rule will look at the income made in the months after FRA. In 2014, a person under FRA is considered retired if monthly earning are $1,290 or less. So let’s say Pat decides to retire at age 62 on July 30, 2014. Pat had been making $50,000 so far, but moved to $1,000 a month part time schedule in August. Pat would receive the full PIA for August through December 2014.[2]

Income Tax Consequences

A person may have to pay taxes on the Social Security benefit he or she receives.

- A person may have to pay federal taxes on their Social Security benefits if they file a federal tax return as an individual and their total income is more than $25,000.
- If they file as an individual and their modified adjusted gross income is between $25,000 and $34,000, they may have to pay income tax on up to 50% of their benefits.
- This would create their combined income.

A person may also have to pay federal taxes if they file a joint return. For example, if they file a joint return and the total combined income is greater than $44,000, then:

- 85% of the benefit may be taxable.

Windfall Elimination and Pension Offset

The windfall elimination was designed to reduce a person's Social Security benefit if he or she also worked for an employer that did not withhold Social Security taxes from wages and he or she is receiving a pension. The windfall elimination will impact how the benefit is calculated. Basically, if the person worked for an employer that did not take Social Security taxes out of their wages, then the benefit will be reduced.

The windfall elimination may apply if:

- He or she reached 62 after 1985.
- He or she became disabled after 1985, and
- He or she first became eligible for a monthly pension based on work where he or she did not pay Social Security taxes after 1985, even he or she us still working.

Your adjusted gross income
+ Nontaxable interest
+ ½ of your Social Security benefits
= Your "combined income"

[5]Source: Social Security Administration, 2014 (www.ssa.gov)

The windfall elimination provision was enacted by Congress to remove an advantage by some workers who were receiving a benefit and a pension from a job that did not pay into Social Security.

Social Security benefits are based on a workers average monthly earning adjusted for inflation.

SSA separates these earnings into three amounts for windfall consideration.

- In 2014, the first $816 of average monthly earnings is multiplied by a factor (90%);
- The next $4,101 by 32%,;and
- The remainder by 15%.
- The sum of these three parts equals the total monthly amount. These factors can also be reduced depending on a workers income.

The windfall elimination is applying to fewer workers as time goes on. If you were a federal worker hired after December 31, 1983, your pension is based on railroad employment, or you have 30 or more years of substantial earnings under Social Security, this most likely does not apply to you.

Pension Offset

The pension offset may impact your spouse or widow. This applies to workers that receive a pension from a state, federal, or local government based on work where he or she did not pay Social Security tax.

- The Social Security benefits will be reduced by two-thirds of his or her government pension.
- In other words, if he or she receives a monthly civil service pension of $600, two-thirds of that, or $400, must be deducted from his or her Social Security benefits.
- For example, if a person is eligible for a $500 spouse's, widow's or widower's benefit from Social Security, he or she will receive $100 per month from Social Security ($500 – $400 = $100).

If he or she takes the government pension annuity in a lump sum, Social Security still will calculate the reduction as if the person chooses to get monthly benefit payments from government work. (Social Security Administration, 2014)

The offset only applies to the Social Security benefits of a person's spouse, widow, or widower. His or her own benefits are not impacted by the pension offset. However, if the pension offset is impacting one's spouse, then the windfall elimination may apply.

If your spouse will receive a pension for work not covered by Social Security such as government or foreign employment, the amount of his or her Social Security benefits on your record may be reduced. (Social Security Administration, 2014)

Work with Your Financial Professional

Social Security is the most popular government program in the United States, making up close to 40% of the average American's retirement income. The rules around Social Security benefits can be complicated and making the wrong decision can be detrimental to your retirement goals. Maximizing Social Security benefits can help secure a sound retirement and applying creative claiming strategies may lead to a substantial increase in retirement income over your lifetime.

According to the Social Security Administration;[6]

- An estimated 165 million workers are covered under Social Security.
    - 51% of the workforce has no private pension coverage.
    - 34% of the workforce has no savings set aside specifically for retirement.
- In 1940, the life expectancy of a 65 year old was almost 14 years; today it is about 20 years.
- By 2033, the number of older Americans will increase from 46.6 million today to over 77 million.

With that in mind, deciding when and how to claim Social Security benefits should fit within the context of your overall retirement income plan. Your financial professional has the expertise, knowledge, and resources to ensure that the decisions you make about Social Security fit within your financial goals and retirement needs.

[6]Source: Social Security Administration, 2014 (www.ssa.gov)