Social Security fundamentals

Guidelines for making well-informed decisions

Table of contents

When it comes to thinking about the part Social Security plays in your retirement plan, most of your concerns probably relate to two main questions:

1. How much can I expect to receive? (determining amount of benefit)
2. What is the best age for me to begin? (determining timing of benefit)

Unfortunately, the only simple answer to most Social Security questions is, "It depends." The benefit each person receives is relative to both his or her earnings history and the choice he or she makes about the age at which benefits begin. Throw in the fact each person approaches Social Security with a different set of financial circumstances, tax issues and other considerations, and you really have a lot to think about.

This "relative" nature of Social Security makes your decision about Social Security a complex one. However, this complexity can be seen as a positive instead of a negative. The good news is, if you understand some key concepts, you can make well-informed decisions to help you optimize both the amount and the timing of your benefit.

A good source of information about the Social Security benefit you personally may receive is the Social Security Statement mailed to you by the Social Security Administration each year for workers age 60 and older. For U.S. workers between the ages of 25 and 60, you will receive a paper statement in the mail every 5 years. If you are between these ages you can access your statement online at www.ssa.gov by creating your own Social Security account. We also recommend verifying your Earnings History annually, as your retirement benefit will be based on this record.

There are approximately 2,800 rules governing the Social Security program. To make it easier, we have isolated 10 key concepts we feel are most important to understand. The rest of this white paper provides an overview of these key concepts in order for you to make well-informed decisions about Social Security. If you have any questions about this material or want help making decisions about Social Security, your financial advisor can talk to you about the role Social Security plays in your retirement plan.

Key concept #1

Social Security will be around into the foreseeable future

One of the most common questions we receive is whether Social Security should be considered in a client's broader retirement income plan. Many people have concerns about the future viability of the program.

Future payment of benefits

According to government reports, unless changes are made the Social Security Trust Fund will be exhausted by 2034. At that time, there will be sufficient income coming in to pay 79 percent of scheduled benefits *(as of June 23, 2016 report)*.

Some solutions that have been proposed to help keep Social Security solvent:

- Raise the current payroll tax
- Raise the current ceiling on wages currently subject to the payroll tax
- Raise the retirement age beyond age 67
- Reduce future benefits, especially for wealthy retirees
- Tie increases to a more modest price index instead of the current wage index
- Allow individuals to invest some of their current Social Security taxes in "personal retirement accounts"
- Allow the Social Security program itself to invest in assets other than government bonds

Key take away — Depending on your age and when you plan to retire, you will receive benefits but based on future estimates and assuming Congress makes no further changes, the worst case scenario is currently predicted to be a cut in benefits of 19%.

Key concept #2

How benefits are calculated

Determining your benefit

Current Social Security law uses a special formula to calculate benefits. First, it indexes your average earnings from the highest 35 years of your working life, so the value of each year's earnings is adjusted for inflation and changes in average wages to be expressed in current dollars. Then it uses your average indexed monthly earnings to determine your basic benefit, or "primary insurance amount", based on the age at which you decide to begin benefits.

A number of factors go into determining your benefit. For a quick and easy estimate, look at your annual Social Security Statement, either the hard copy or online at www.SSA.gov.

Funding your benefits

Reduced to its basics, Social Security is a trust administered by the federal government through which current workers and their employers fund benefits paid to current retirees. The money you and your employer pay into Social Security is used now to provide benefits. It is not set aside in an account waiting for you. As a corollary, the benefits you may receive upon retirement are funded by workers and employers paying into the trust after you stop working.

Key takeaway — Social Security is a "pay as you go" system.

Contribution and benefit caps

Social Security law authorizes the federal government to tax workers 6.20% on earnings up to $127,200 for 2017. Earnings above $127,200 are not subject to Social Security tax. The maximum monthly Social Security benefit at full retirement age is $2,687 per month, or $32,244 annually for 2017.

Key take away — There is an upper limit on both what you are expected to contribute and what you can expect to receive in benefits.

Qualifying for benefits

You must be insured under the Social Security program to receive benefits. Your insurance status is determined by the number of Quarters of Coverage (also called "credits") you have earned for meeting the minimum work requirements defined by Social Security law. You may earn up to four credits per year, and you need to earn 40 credits (10 years) to qualify for retirement benefits.

Key take away — You need the equivalent of ten full years of a minimum level of employment as defined by Social Security law to qualify for benefits.

Key concept #3

Full retirement age (FRA) varies depending on your year of birth

Early retirement

You become eligible for Social Security benefits beginning at age 62. However, if you elect to take early retirement, your monthly benefit will be lower than if you had waited until your normal (full) retirement age, because the lifetime benefit is spread over more time. See the chart below to determine how much your monthly benefit is reduced if you elect to take early retirement.

Key take away — You can begin receiving benefits at 62, however they will be permanently lower than if you had waited until your normal retirement age to begin. For example, if your monthly benefit at age 66 is $2,000 and you decide to start at age 62, your benefit would be reduced to $1,500.

Normal (or full) retirement age

The age at which you can begin receiving your full Social Security benefit ranges from 66 to 67, depending on the year you were born. See the chart below to determine the age at which you can begin receiving full Social Security benefits.

Key take away — Normal retirement age depends on the year you were born.

Normal retirement ages and early retirement reductions

Year of birth[1]	Normal (full) retirement age	Early retirement reduction, months (age 62)	Monthly % reduction[2]	Total % reduction[2]	Age in 2017
1943-1954	66	48	0.520%	25.00%	63-74
1955	66 and 2 months	50	0.516%	25.84%	62
1956	66 and 4 months	52	0.512%	26.66%	61
1957	66 and 6 months	54	0.509%	27.50%	60
1958	66 and 8 months	56	0.505%	28.33%	59
1959	66 and 10 months	58	0.502%	29.17%	58
1960 and later	67	60	0.500%	30.00%	57

1. If you were born on January 1, you should refer to the previous year.
2. Monthly and total percentage reductions are approximate due to rounding. The actual reductions for the worker are 0.555 or 5/9 of 1% per month the first 36 months and 0.416 or 5/12 of 1% for subsequent months.

Source: www.ssa.gov

Delayed retirement credit

You will receive an 8% credit for each year past full retirement age that claim benefits are delayed. Delayed retirement credits given for retirement after your full retirement age can increase your benefits. To receive full credit, you must be insured at your normal retirement age. No credit is given after age 69, so the largest benefit you can expect to receive is for retirement at 70.

Key take away — Postponing retirement until after your normal retirement age increases your benefit. For example, if your full retirement age is 66 and your monthly benefit is $2,000, waiting until age 70 to retire would increase your benefit to $2,640.

Key concept #4

Benefit estimates on Social Security statements assume you continue to work until you begin collecting

You continue working up until the age of that benefit (62, FRA, 70).

- For example…If you stop working at age 62 and wait until FRA to collect, your benefit may be lower than the estimate shown on your current statement.

You continue earning the same amount from now until you claim at that particular age (62, FRA, 70).

- Earning more or less in the future may increase or decrease your benefit estimate.

Estimates are shown in today's dollars.

- Important to get the most recent statement before running analysis
- Whether the income changed (up or down)
- Updated benefit including the most recent cost of living adjustments

Key take away — The Social Security Administration can't provide your actual benefit amount until you apply for benefits and the final benefit determination considers your complete earnings history.

Key concept #5

Claiming benefits before FRA and continuing to work

Benefit reduction for earned income

If you retire before your normal retirement age and receive earned income, your benefit will be reduced by $1 for every $2 of earned income above $16,920 for 2017.

For the purposes of this penalty, earned income is defined as wages earned for work done for others and/or net earnings from self-employment. Income from other government benefits, investment earnings, interest, certain pensions, annuities and capital gains do not count.

Furthermore, if you earn wages, you must count the income in the year it is earned (income from accumulated sick or vacation pay, bonuses, etc., should not be counted in the following year, if that is when it is paid to you). And if you are self-employed, you must count income in the year it is received — unless this would delay payment on early retirement earnings until after you qualify for normal retirement benefits, in which case you would need to count the self-employment income in the year it was earned. Deferred compensation is also included in the year it is earned, not in the year it is later received.

This earned income penalty does not apply once you achieve full retirement age.

However, you don't lose these benefits forever, they are merely deferred. SSA will recalculate the benefits at FRA based on the equivalent months of forfeited benefits.

- For example: If you claimed benefits at age 62 and forfeited equivalent 24 months of benefits; upon reaching FRA your benefit would be recalculated as if you had claimed at age 64

Benefit reduction for earned income in early retirement

	Age 62 to normal retirement age	Year of reaching full retirement age – months prior to attaining normal retirement age	Month attaining full retirement age and greater
Earned income	› $16,920	$44,880	No limit
Reduction in benefit	$1.00 for every $2.00 earned	$1.00 for every $3.00 earned	Not applicable

Does not include pension, annuity, taxable interest or dividend income

Key take away — If you claim benefits before your normal retirement age and receive earned income above $16,920, your benefit may be reduced until you reach full retirement age.

Key concept #6

Social security benefits are not tax-free

Income tax consequences

Your Social Security benefit may be taxable, based on your combined income. Your combined income is determined by adding your adjusted gross income, your non-taxable interest and one-half of your Social Security benefit. See the following table to determine how much of your Social Security benefit may be subject to income tax.

Key take away — Depending on how you file and your combined income, 50% to 85% of your benefit may be subject to federal income tax at your marginal tax rate.

Amount of benefit subject to federal income tax (2017)		
	50% of benefit subject to federal income tax *	85% of benefit subject to federal income tax *
Filing individually	Combined income of $25,000 to $34,000	Combined income more than $34,000
Filing jointly	Combined income of $32,000 to $44,000	Combined income more than $44,000

*At marginal tax rate

Combined Income = Adjusted Gross Income + Non-Taxable Interest + 50% of Social Security Benefits

Key concept #7

Spousal, survivor & ex-spouse (divorce) benefits

Spouse

Is eligible to receive the higher of either the benefits he/she may have earned on his/her own record or half (50%) of spouse's primary insurance amount, at full retirement age (FRA)

Spouse cannot collect on your record until you file for benefits and spouse must be at least age 62. If taken prior to the spouse's FRA, the benefit will be reduced

Survivor

A surviving spouse will generally receive 100% of the deceased's benefit or benefits on their own record at FRA but will not receive both.

- Reduced benefits can begin as early as age 60, but would be reduced by 28.50%

Ex-spouse (divorce)

If married for at least 10 years and divorced for at least two years, an ex-spouse can get Social Security benefits based on the other ex-spouse's record

- Both ex-spouses must be 62 or older and cannot remarry or benefits are forfeited
- A divorced spouse can receive benefits even if other ex-spouse is not retired and these benefits received have no effect on either the primary earner or their current spouse

Key take away — There are many ways and strategies you can claim benefits from a current or previous marriage.

Key concept #8

Filing strategies and rule changes contained in the Bipartisan Budget Act of 2015

There are basically 3 ways to claim benefits:

1. File

- You just file and claim your own benefit

2. Suspend (rules changed with Bipartisan Budget Act of 2015)

- Allowing your spouse to receive (spousal) benefit on your record

3. Restrict (rules changed with Bipartisan Budget Act of 2015)

- Allowing you to claim a benefit on your spouse's record
  - Spouse collects their benefit and you claim a spousal benefit at FRA

The Bipartisan Budget Act of 2015 signed into law by President Obama on November 2, 2015 included impactful changes to how retirees may elect to receive Social Security benefits. While the effective date of the legislation began for some provisions on November 2, it is important to know how the remaining provisions will impact you as they are phased in. Different rules will apply depending on your age.

"Filing restricted application" strategy

If you were age 62 or older as of January 1, 2016 you may continue to elect to file a restricted application for spousal benefits once you reach your full retirement age. This means you will retain the right to collect just spousal benefits starting at full retirement age (66), assuming your spouse has already claimed retirement benefits or has requested to file and suspend their benefits within six months after enactment of the law.

If you were younger than age 62 on January 1, 2016 you will no longer be able to elect restricted filing as a strategy, as the "deemed filing" rules are extended to age 70 for your age group. If you are entitled to two Social Security benefits (on your own record and as a spouse) you will be required to file for all benefits at once and will be able to collect only on the higher amount. You will not be able to claim a spousal benefit first as under current law and then switch to your own retirement benefit at a later time.

People who reached age 62 by January 1, 2016 (born January 1, 1954 or earlier)

- Will still be able to file and restrict their application to spousal benefit when they reach full retirement age.

Anyone younger than age 62 on January 1, 2016 (born January 2, 1954 and later)

- Lost the ability to file and restrict.
- "Deemed filing" rules were extended to age 70.

"File and Suspend" strategy

As of 180 days from the enactment of the act, file and suspend will no longer be an effective strategy for married couples. After that date, once a benefit has been suspended any benefits tied to that record (spousal, child, etc.) will also be suspended until the primary benefit record owner starts receiving benefit payments.

If you have already filed and suspended benefits (or file and suspend within 180 days of enactment) you may continue to operate under the rules related to file and suspend that existed prior to this budget act.

File and suspend was available as a viable strategy through April 29, 2016.

- Must be age 66 or older by April 30, 2016

After April 29, 2016, once a benefit was suspended

- Any benefits tied to that record (spousal, child, etc.) will also be suspended until the primary benefit owner begins receiving benefits again.

If you have already filed and suspended

- You may continue to operate under the rules related to file and suspend that existed prior to this Act.

Lump sum retroactive benefits

If you have currently suspended benefits (or plan to suspend benefits as of 180 days from the enactment of the act) and intend to receive a lump sum retroactive benefit at a later time (sometimes called a "reinstatement of previously suspended benefits"), the ability to receive this payment will still be available after implementation of the Bipartisan Budget Act of 2015. Anyone that suspended benefits after 180 days from the enactment will no longer be able to claim a lump sum reinstatement of previously suspended benefits.

Previously, if you had suspended benefit payments

- You could apply for a lump sum reinstatement of previously suspended benefits.
- This ability went away for anyone who suspends benefits after April 29, 2016.

Anyone suspending prior to that is grandfathered and will still have that ability (unless changed in a subsequent patch).

Divorce (ex-spouse) benefits

If you are divorced, suspension of benefits by an ex-spouse will not affect the party receiving spousal benefits. This operates the same as it does today as there is no requirement the ex-spouse needs to file to trigger spousal benefits for the other party. The restricted application elimination applies for ex-spouse benefits if you were under age 62 as of January 1, 2016. If you are 62 or older by this date, you may still restrict your application to receive only benefits related to the ex-spouse's earnings record once you reach full retirement age. Younger divorced spouses will not have that option.

Restricted application for spousal benefits

- Will follow the same age based rules as regular retirement benefits (must have reached age 62 by January 1, 2016).

File and suspend does not come into play

- As there was no previous requirement the ex-spouse needed to file to trigger spousal benefits for the other party.

Survivor benefits

Survivor benefits are not affected by either of these provisions. Filing a restricted application for survivor benefits will continue to be an available option for widow(er)s after the act goes into effect.

Summary of changes for married couples

	Strategy	File and suspend	Filing restricted application
Age 62 by January 1, 2016	**Birthdates April 30, 1950 through January 1, 1954**	No longer allowed	Still available at client's FRA, if eligible for Spousal Benefits
Under Age 62 by January 1, 2016	**Birthdates January 2, 1954 and later**		No longer allowed

Key concept #9

The "do-over"

If you claim Social Security benefits and decide later you wanted to wait:

- You can have a **complete Do-Over within 12 months** of claiming
- Need to pay back all the benefits you received
- If it's **after 12 months** of claiming benefits
- You can voluntarily suspend your benefits at FRA
- You can't pay back and re-do, but every year you wait, you will receive benefits at 8% higher than when you suspended.

On the flip-side…if after FRA you didn't claim and wanted to *(didn't file & suspend)*

- **You can only get 6 months of retroactive benefits.**
- i.e. Someone whose FRA is age 66 and is now age 67 could request a lump sum payout of six months of benefits, but not the entire year.

Key concept #10

Windfall Elimination Provision (WEP) & Government Pension Offset (GPO)

Windfall Elimination Provision (WEP)

Is only applicable if you qualify for a public pension (non-covered pension) that did not pay into the Social Security system and Social Security. The formula for calculating the reduction in benefits is:

- **90% of the first $826 is reduced to 40%** if you worked in a Social Security-covered employment for **less than 20 years**
- The reduction in Social Security benefits **cannot exceed 50%**

Government Pension Offset (GPO)

A non-covered pension *could* reduce spousal or survivor benefits you are eligible for based on your spouse or ex-spouse's earnings record. If you receive pensions from a federal, state, or local government based on work where you did not pay Social Security, your spouses' or widows'(ers') Social Security benefits may be reduced by two-thirds of your government pension amount. This can reduce benefits all the way to zero in the case of a larger pension amount.

In closing...

It's a critical decision to get professional assistance.

Making well-informed decisions about when to begin Social Security (and how much benefit you may receive) depends on a number of factors, including:

- Your current health/overall life expectancy
- Your other sources of income in retirement
- Your tax situation in retirement

Ask your financial advisor how Social Security fits into your retirement income plan. He or she can help you explore your options, recommend strategies and make sure the decisions you make about Social Security are appropriate for both your needs and your financial situation in retirement.

Sources:

Social Security Administration website: www.ssa.gov

The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds

SSA Publication No. 13-11727 Released April 2010

 6892 (01/17)