Social Security Workshop

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The information contained in this presentation is as of May 20, 2015 (unless otherwise noted) and is subject to change without notice. The information presented is the most current available. There is no guarantee the outcomes mentioned within this presentation will be realized.

Please see last slide for important information

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Agenda

The story of Social Security

1 **Quick history of Social Security**

2 **How Social Security works**

3 **Benefits: Ins and outs**
- The break-even question
- Taxation of benefits
- Spousal benefits

The story of Social Security

Industrial Revolution reduced family farms, which supported elderly family members, as people moved to cities to work

US had no government-mandated disability insurance, retirement savings or health insurance for the elderly, so end of work due to injury or old age meant end of income.

1935	Social Security Act signed into law — Created Old Age Survivor Disability Insurance (OASDI) benefit
1939	Benefits extended to workers’ dependents and survivors
1950	First cost of living adjustment (COLA) issued
1972	Automatic COLA enacted by Congress, increasing benefits annually
1983	Recommendations to strengthen Social Security signed into law by President Reagan

Source: whitehouse.gov

Current state of Social Security

2010	Government tapped bond interest from trust fund to cover cost of benefits
2020	Government will start selling bonds from trust fund to cover cost of benefits
2033	Trust fund will be depleted
2034	Payroll and Social Security taxes will cover only approximately 75% of benefits

There is no guarantee that the expected outcomes will be realized.
Source: Social Security and Medicare Boards of Trustees, "Status of the Social Security and Medicare Programs, A Summary of the 2014 Annual Reports," 2014

How Social Security works

Four basic benefits

Designed to provide four basic benefits

- For eligible workers:
  1. Retirement benefits
  2. Disability benefits

- For the eligible workers' families:
  3. Dependent benefits
  4. Survivor benefits

Source: ssa.gov

Funding Social Security

Federal Insurance Contributions Act (FICA) created a federal payroll tax to fund Social Security and Medicare.

- Employees pay 6.2%, and employers pay 6.2%.
  - The self-employed pay 12.4%.
- Earnings are taxed up to a maximum earnings cap.
  - For 2015, the cap is $118,500.

Source: ssa.gov

Retirement benefits

Eligibility for Social Security retirement benefits

- Must earn at least 40 work credits
  - Social Security credits = "quarters of coverage"
  - Earn one quarter of coverage for $1,220 earned (2015); $4,880 of annual earned income = four work credits

Social Security retirement benefit

- Based on two components
  - Primary insurance amount (PIA) — Earnings history
  - Age retirement benefits start compared to full retirement age (FRA)

Source: ssa.gov

Determining PIA

1. Take all taxed Social Security earnings.

2. Adjust each year for inflation.

3. From step two, pick the 35 highest-earning years.

4. Add those 35 years and divide by 420 (number of months), which equals the average indexed monthly earnings (AIME).

5. Apply benefit formula, which is designed to give a higher percentage of earnings for lower-wage earners (based on “bend points”).

    90% of AIME up to the first bend point, $826

    \+ 32% of AIME up to the second bend point, $4,980

    \+ 15% above second bend point

    Total of all three is PIA

Source: ssa.gov

FRA

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

Born 1943–1954	
Start payout at age:	Benefit as a % of FRA payout
62	75%
63	80%
64	86.70%
65	93.30%
66	100%
67	108%
70	132%

Delayed Retirement Credits

Source: ssa.gov

Early retirement

- If a participant chooses to receive benefits earlier than FRA, benefits are reduced for the rest of his life.
- Benefits can begin as early as age 62.
- Benefits are reduced by ±0.5% for each month benefits received before FRA.
- If a participant takes early retirement at 62, he will experience these approximate reductions as the FRA becomes later:
  - Age 65 — about a 20% reduction
  - Age 66 — about a 25% reduction
  - Age 67 — about a 30% reduction

Source: ssa.gov

Late retirement

- Delaying benefits means an automatic increase or delayed retirement credits (DRC).
- Increase is based on length of time from FRA until benefits begin or until age 70, whichever comes first.

DRC Example: Born 1943–1954			
Start payout at age:		Benefit as a % of FRA payout	
66	FRA	100%	
67		108%	Delayed Retirement Credits (DRC)
70		132%	

Source: ssa.gov

COLAs

- The purpose is to ensure that the purchasing power of Social Security benefits is not eroded by inflation.
- They are based on the percentage increase of Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).
- If there is no increase, there can be no COLA.

COLAs
2004 – 2.1%
2005 – 2.7%
2006 – 4.1%
2007 – 3.3%
2008 – 2.3%
2009 – 5.8%
2010 – 0.0%
2011 – 0.0%
2012 – 3.6%
2013 – 1.7%
2014 – 1.5%
2015 – 1.7%

Source: ssa.gov

Reducing Social Security's projected deficit

Some proposed ideas to reduce projected deficit:

- Raise retirement age; index FRA to longevity.
- Increase FICA and/or raise earnings cap above $118,500.
- Phase in reduced benefits; exempt low earners.
- Calculate benefits on 40 working years rather than current 35 years to raise the average and lower the benefit.
- Decrease COLAs.
- Gradually lower maximum spousal benefit.
- Include workers, such as state and local government workers, who participate in alternative retirement systems.
- Diversify investments of the trust fund.

Source: "Social Security Modernization: Options to Address Solvency and Benefit Adequacy," Report of the Special Committee on Aging; US Senate, May 2010

Benefits: Ins and outs

1 **The break-even question**

2 **Working while receiving benefits**

3 **Coordinating spousal benefits**

4 **Taxation of benefits**

The break-even question

Example:

John's benefit at age 62 is $1,320 a month; at 66 it is $1,810 a month.

- John's break-even age is 76 years and six months. He would have received the same total amount in benefits either way by that point.
- The probability of John at age 66 reaching the break-even age is 73.8%.
- This example doesn't include COLAs or taxation of benefits.

The Retirement Estimator on ssa.gov allows participants to estimate their projected retirement benefits based on work history.

Other considerations (beyond the break-even age):

- The health of John (and spouse) may prevent delaying retirement.
- John may need to continue working to get 35 years of earnings.
- Working during early retirement may be beneficial.

This hypothetical example is for illustrative purposes only.

Sources: investmentnews.com, "When should you take Social Security?," Rande Spiegelman, Feb, 21, 2007; ssa.gov, "Period Life Table," 2007; ssa.gov

Maximum Social Security earnings

John, born 1954

Monthly benefit at age 62[1]	$2,426
Monthly benefit at age 66 (FRA) but worked until age 62	$3,401
Monthly benefit at age 66 but worked until age 66	$3,445
Monthly benefit at age 70 but worked until age 62	$5,014
Monthly benefit at age 70 but worked until age 66	$5,078
Monthly benefit at age 70 but worked until age 70	$5,187

1 Assume 2.8% annual COLAs
This hypothetical example is for illustrative purposes only.
Source: ssa.gov

Working while receiving early retirement benefits

- If a working participant begins receiving benefits before FRA, benefits are reduced up until FRA.
  - Only individual wages are considered; spouse's wages are not.

Age	2015 Limit
Under FRA $1 of benefits withheld for every $2 in earnings above limit	$15,720 a year
Year of FRA (for the months prior to FRA) $1 of benefits withheld for every $3 in earnings above limit	$41,880 a year
FRA and beyond	Unlimited

Source: ssa.gov
This hypothetical example is for illustrative purposes only.

Coordinating Social Security benefits

This is a complex area of Social Security planning.
Should be done on individual basis using actual ages and benefits

- Spouses have **dual entitlements** to benefits.
  - **Larger** of 100% of participant's PIA **or** up to 50% of spouse's PIA
- Primary worker must apply for benefits but can suspend them.
  - File and suspend: Primary worker files for benefits but immediately suspends receipt; allows his spouse to claim a spousal benefit, while primary worker lets own benefits grow
    - No DRCs on spousal benefits after FRA

Source: ssa.gov

Limits on claim and repay

- Effective Dec. 8, 2010, the SSA changed the rule allowing clients to claim benefits and then repay them (without interest) to reapply for higher benefits.
- Revised rule allows claimants to:
  - Reverse their decision to take a check within 12 months.
  - Reverse only once in their lifetime.
- DRCs are disallowed for months in which claimant received benefits.

Source: ssa.gov

Benefits for divorced spouses

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A divorced spouse can apply for benefits on an ex-spouse's work record if:

- He or she had been married to the worker for at least 10 years.
- He or she had been divorced for at least two years.
- He or she is age 62 or older.

A divorced spouse does not have to wait for the ex-spouse to file.

- A divorced spouse collecting benefits does not preclude his/her ex-spouse's new spouse from collecting spousal benefits.
- If a divorced spouse remarries, he/she collects benefits from the new spouse's work record.

Source: ssa.gov

Divorce case study

Sally and Jim get a divorce. Sally may be eligible to receive benefits based on Jim's work history (or vice versa) if:

- ✓ They were married at least 10 years.
- ✓ They have been divorced at least two years (unless Jim is currently receiving benefits).
- ✓ Sally and Jim are at least 62 years old.
- ✓ Sally is not currently married.
- ✓ Sally is not be eligible for an equal or higher benefit based on her own or someone else's work history.

Source: ssa.gov
This hypothetical example is for illustrative purposes only.

Survivor benefits eligibility

- Spouse age 60 or over (50 or over if disabled)
  - Spouse any age, if caring for child under age 16 or disabled (if disabled before age 22)
- Ex-spouse age 60 or over (50 or over if disabled) married 10 years
  - Ex-spouse any age, if caring for child under age 16 or disabled (if disabled before age 22)
- The deceased’s unmarried children under 18
  - Under 19, if still attending high school
  - Disabled child (if disabled before age 22)
- The deceased’s dependent parents age 62 or older

Source: ssa.gov

Survivor benefits amount

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- One-time $255 lump-sum death benefit is paid upon death to surviving spouse; if none, to eligible child; if none, not paid.
- Spouse or ex-spouse receives 100% of worker's benefit at FRA.
  - If taken at age 60, benefit reduced to 71.5% of FRA benefit.
  - Children receive 75% of benefit up to family maximum.
  - If ex-spouse remarries before age 60, benefit is lost.
- Spouses under age 50 with a child under age 16 can receive 75% up to family maximum.
  - Parents receive 75%; two receive parents 82.5%.
  - Family maximum is 150% to 180%.
- Spouse may claim survivor benefit at age 60, then his/her own benefit at age 62 to 70 without reduction.

Source: ssa.gov

Taxation of Social Security benefits

Taxation depends on:

- Worker's filing status
- Provisional income (adjusted gross income [AGI], plus any nontaxable interest income, plus half of worker's Social Security benefits)

Single	Married Filing Jointly
Base amount $25,000	Base amount $32,000
$25,000 – $34,000 = up to 50% taxable	$32,000 – $44,000 = up to 50% taxable
$34,000+ = up to 85% taxable	$44,000+ = up to 85% taxable

Source: ssa.gov

Windfall reduction/government pension offsets

The Windfall Elimination Provision

- If you worked for an employer who does not withhold Social Security taxes, such as a government agency or an employer in another country, any pension based on that work may reduce your Social Security benefits.
- A modified formula is used to calculate your benefit amount, resulting in a lower Social Security benefit.

- If you receive a pension from a federal, state or local government based on work where you did not pay Social Security taxes, your Social Security spousal or widow(-er) benefits may be reduced by two-thirds of your government pension.
  - **Example:** Suppose you get a monthly civil service pension of $600 and you are also eligible for a $500 widow(-er)'s benefit from Social Security. Two-thirds of your government pension, or $400, will be subtracted from the widow(-er's) benefit and you will receive only $100 from Social Security.
- Even if you take a lump sum, Social Security will still calculate the reduction as if you chose to get monthly benefit payments.

Source: ssa.gov

Case studies

Case study 1 — claim now, claim more later (Part I)

Joe is 65 and currently receiving a monthly benefit of $1,500.

Karen, Joe’s wife, is 63 and wants to apply for a dependent benefit while her own retirement benefit accrues and gets DRCs until age 70.

Is this allowed?

This hypothetical example is for illustrative purposes only.

Case study 1 — claim now, claim more later (Part I) (continued)

Joe is 65 and currently receiving a monthly benefit of $1,500. Karen, Joe's wife, is 63 and wants to apply for a dependent benefit while her own retirement benefit accrues and gets DRCs until age 70. Is this allowed?

Answer:

No. If Karen files for a dependent benefit before her FRA, benefits are **permanently reduced** and **DRCs are no longer allowed**. If she waits until FRA and restricts her application to her spousal benefit, then this will work.

This hypothetical example is for illustrative purposes only.

Case study 2 — claim now, claim more later (Part II)

Before they were divorced, Jane and Bob were married for more than 10 years.

At her FRA, Jane has not remarried and wants to file for ex-spouse dependent benefits based on Bob’s Social Security benefits while she continues working and gets DRCs until age 70. At that point, she will file for her own Social Security benefits.

Is this allowed?

This hypothetical example is for illustrative purposes only.

Case study 2 — claim now, claim more later (Part II) (continued)

Before they were divorced, Jane and Bob were married for more than 10 years. At her FRA, Jane has not remarried and wants to file for ex-spouse dependent benefits based on Bob's Social Security benefits while she continues working and gets DRCs until age 70. At that point, she will file for her own Social Security benefits. Is this allowed?

Answer:

Yes. If Jane restricts her application to her ex-spousal benefit at FRA, this will work.

Note: If the divorce took place more than two years ago, Jane may file for divorced-spouse benefits even if Bob has not filed for benefits; however, Bob must be age 62 or older.

This hypothetical example is for illustrative purposes only.

Case study 3 — file and suspend

Harry and Esther are married and are at their FRA.

Esther has not accrued a Social Security retirement benefit as a stay-at-home mom but would like to begin receiving her dependent benefits.

Harry wants to get the maximum benefit at age 70 with DRCs and does not want to retire.

Since Esther cannot begin her benefit until Harry files, **is there any way to accomplish both objectives?**

This hypothetical example is for illustrative purposes only.

Case study 3 — file and suspend (continued)

Harry and Esther are married and are at their FRA. Esther has not accrued a Social Security retirement benefit as a stay-at-home mom but would like to begin receiving her dependent benefits. Harry wants to get the maximum benefit at age 70 with DRCs and does not want to retire. Since Esther cannot begin her benefit until Harry files, is there any way to accomplish both objectives?

Answer:

Yes. Harry files and suspends his benefit to allow Esther's dependent benefit. He should be sure not to do this until he reaches FRA.

This hypothetical example is for illustrative purposes only.

Important information

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