Understanding Social Security Retirement Benefits

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Conventional wisdom holds that people should begin to collect Social Security benefits as soon as possible, which is age 62. While this strategy may have been prudent for millions of Americans until now, baby boomers are expected to live longer than any previous generation. The choice of when to begin collecting Social Security benefits will have a significant impact on the overall retirement plans of individuals approaching retirement.

This guide is intended to provide you with a summary of Social Security retirement benefits to assist you in creating an effective strategy for collecting your benefits. Work with your financial professional to ensure your decisions complement your overall retirement plan.

Collecting Retirement Benefits Based on Your Own Work History

Qualifying for Retirement Benefits

When you work and pay Social Security (SS) taxes as mandated by the Federal Insurance Contributions Act (FICA), you earn "credits" toward SS retirement benefits. You earn credits on the basis of your annual earnings and can earn up to four credits per year. Once you have acquired 40 credits (approximately 10 years of employment), you are fully insured and eligible to receive retirement benefits. FICA tax for old-age, survivors and disability insurance (OASDI) is withheld from each paycheck until you have earned up to the taxable earnings base for the year.

2009 FICA Limits	
Taxable Earnings Base	$106,800
FICA Tax Rate (OASDI)	6.2%
Earnings Required to Earn One Credit	$1,090

Determining Benefit Amount

All benefit amounts are derived from your Primary Insurance Amount (PIA). Your PIA is the monthly benefit you become eligible for at your Full Retirement Age (FRA). FRA was originally age 65, but, as a result of longer life expectancies, is gradually increasing to age 67 according to the schedule in the following table.

FRA

Year Born	FRA
1937 or earlier	65
1938-1942	65 + 2 months for every year after 1937 until 1943
1943-1954	66
1955-1959	66 + 2 months for every year after 1954 until 1960
1960 and later	67

To determine your PIA, your Average Indexed Monthly Earnings is calculated using your best 35 years of employment. If you have not worked for 35 years, some of your best years may be zero. For more information, please visit the Social Security Administration's website at www.ssa.gov.

If you continue working after you reach your FRA, the Social Security Administration (SSA) will automatically recalculate your benefit each year you continue to work. If your current income is greater than your previously calculated "best 35 years," your benefit will be automatically adjusted upward. The increase generally will be made in October of the following year, but will be retroactive to January 1.

In addition to any increases from additional years of working, SS retirement benefits are automatically increased each year to reflect Cost of Living Adjustments (COLAs). COLAs are based on the Consumer Price Index for Urban Wage Earners and Clerical Workers and have averaged around 3% over the last 10 years.

Historical Cost of Living Adjustments

Year	COLA (%)	Year	COLA (%)
1999	2.5	2004	2.7
2000	3.5	2005	4.1
2001	2.6	2006	3.3
2002	1.4	2007	2.3
2003	2.1	2008	5.8

Collecting Benefits Early

While your PIA is payable at your FRA, you are entitled to collect benefits as early as age 62. However, if you choose to collect benefits early, you will permanently reduce your benefit. Your benefit will not be adjusted when you attain your FRA. The amount of your reduction will depend on two things—your FRA and the number of months until you attain it. If you commence benefits at age 62, you will receive the maximum reduction, as noted in the table below:

Reduced Benefits at Age 62

FRA	Monthly Benefit Reduction (%)
65	20
66	25
67	30

Your reduction will be prorated for each month delayed after age 62 but prior to reaching your FRA.

Do not forget to consider taxes in addition to reduced or withheld benefits when collecting before your FRA. Always consider the net (after-tax) benefit you will receive. A working spouse can cause more of your benefits to be taxed, and at potentially higher tax rates.

Working While Collecting Benefits Prior to FRA

Since SS is intended to be a supplemental retirement income, the SSA has imposed consequences to collecting your benefit early if you have not actually retired and are still receiving wages or a salary. If you collect benefits prior to FRA, you will be subject to an earnings test every year until you reach FRA. If your earnings exceed certain thresholds, the SSA will withhold part or all of your benefit. The earnings test looks only at salary or wages of the individual collecting early benefits. It does not consider salary or wages of a spouse or any other type of income.

2009 Retirement Earnings Limit	
Under FRA $1 of benefits withheld for every $2 in earnings above the limit	$14,160/year
Year individual reaches FRA $1 of benefits withheld for every $3 in earnings above the limit for months prior to attaining FRA	$37,680/year
Month individual reached FRA and beyond Reduction no longer applies	Unlimited

Withheld Benefits

If benefits are withheld, they will not be refunded. However, your benefit will be adjusted on a go-forward basis when you reach your FRA to account for the benefits that were withheld. For example, if your FRA was 66 and you began collecting benefits at 62, there would have been a 25% reduction applied. Assume you returned to work at 63 and the SSA withheld the equivalent of 2 years' worth of benefits by the time you reached your FRA. The SSA would lessen your deduction of 25% to give you credit for the 2 years of benefit you lost. Your new reduction would be as if you started collecting benefits at age 64 rather than 62.

Delaying Benefits Beyond FRA

If you elect to defer collecting benefits beyond your FRA, the SSA will give you a Delayed Retirement Credit for every year you defer up to age 70. This annual increase will be in addition to the COLA each year. Depending on your year of birth, your annual increase will range from 7% to 8%.

Delayed Retirement Credit	
Year of Birth	**Yearly Increase (%)**
1939–1940	7.0
1941–1942	7.5
1943 or later	8.0

Withdrawal of Application

If you start collecting your benefit and change your mind, you can file a "Request for Withdrawal of Application" form with the SSA, which will review your request. If your Withdrawal of Application request is granted, you need to repay the SSA all of the payments you and anyone else have collected to date based on your benefit. You do not have to pay any penalty or interest on the amount repaid. You can subsequently refile as if it were your first time filing.

If any of the benefit repaid was subject to federal income tax in earlier years (discussed later), you may be entitled to an itemized deduction on your tax return in the year of repayment. If the amount of benefits previously taxed is $3,000 or less, you may be entitled to claim a deduction on Schedule A (Form 1040) line 23, subject to the 2% of adjusted gross income (AGI) limit.

If the amount exceeds $3,000 you may be entitled to claim a deduction on Schedule A, line 28. This is not subject to the 2% of AGI limit. Please refer to IRS publication 915 for other options for calculating your tax when amounts exceed $3,000.

Requests for Withdrawal of Application are intended to be used by individuals who commenced benefits early and returned to work. It is not, however, limited to just these individuals.

Windfall Elimination Provision (WEP)

If you work for an employer who does not withhold SS taxes from your salary, such as a government agency, the pension you receive based on that work may reduce your SS retirement benefits. WEP primarily affects individuals who earned a pension in any job where FICA taxes were not paid and worked in other jobs long enough to qualify for SS retirement benefits.

WEP closed a loophole that enabled people who worked in both covered and noncovered employment from appearing to be low-wage workers and receiving a higher benefit.

Taxation of Benefit

About one-third of people who get SS have to pay income taxes on their benefit. Individuals with high total incomes must include up to 85% of their benefit as income for federal income tax purposes. Special step-rate "thresholds" on provisional income determine the amount on which you may be taxed.

To determine your provisional income for this purpose, you must include all of your earnings (including pensions, dividends and taxable interest from investments and other sources) plus interest on tax-exempt bonds plus 50% of your SS benefits. The thresholds for taxation of your benefits are not currently indexed for inflation.

Provisional Income	
Single or Head of Household	**Married Filing Jointly**
Base amount $25,000 = not taxed	Base amount $32,000 = not taxed
$25,000 – $34,000 = up to 50% taxable	$32,000 – $44,000 = up to 50% taxable
Above $34,000 = up to 85% taxable	Above $44,000 = up to 85% taxable

Distributions from Roth accounts do not currently impact the taxation of SS benefits.

Collecting Retirement Benefits Based on a Family Work History

Beneficiaries Entitled to Collect Off of Your Benefit

If you are entitled to collect retirement benefits, certain other individuals may be entitled to collect benefits based on your work history once you file for yours. If you have been married for at least one year, your spouse may be entitled to collect spousal benefits when he or she reaches age 62, possibly earlier if caring for your child. Additionally, any children you have may be entitled to retirement benefits when you file.

Beneficiaries Entitled to Collect Off of Your Benefit

You	Your Spouse	Your Unmarried Child
Age 62 and over	• Age 62 or over • Any age, if caring for your child who is under 16 or disabled before 22	• Under 18, or up to 19 if in high school • Any age, if disabled before 22

Maximum Family Benefit

The amount of benefits that members of one family may receive on the earnings record of one worker is limited. If the total benefits due to your spouse and children are more than the limit, their benefits will be reduced proportionately to bring the total within the limit. Your benefit will not be affected. Any amount payable to an ex-spouse (addressed later) is not included in the family maximum.

Collecting Benefits as a Spouse

If you are married to an individual who files for SS retirement benefits and you are at least age 62, you may be entitled to collect spousal benefits. Spousal benefits will be equal to 50% of your spouse's PIA (benefit he or she is entitled to at FRA). If you are entitled to your own benefit, your benefit will always be paid first. If your benefit is less than 50% of your spouse's PIA, a spousal benefit will be paid in addition to your own that will bring you to a combined benefit amount equal to 50% of his or her PIA. For example, the husband described in the following chart has a PIA of $2,257. As a spouse, the wife is entitled to 50% of that amount, or $1,129. However, because she is entitled to her own benefit, and has her own PIA of $552, the spousal benefit will be reduced by that amount. The wife will receive a combination of benefits, $552 (own) and an additional $577 (spousal) to equal $1,129.

Wife's Estimated Benefit

Retirement Age	Monthly Benefit ($)
62	416
66 (FRA)	552
70	729

Husband's Estimated Benefit

Retirement Age	Monthly Benefit ($)	Spousal Benefit ($)	Adjusted Spousal Benefit ($)
62	1,614		406
66 (FRA)	2,257	1,129	577
70	3,042		

Collecting Spousal Benefits Early

If you collect spousal benefits prior to your FRA, your adjusted spousal benefit (the amount you would collect in addition to your own benefit) will be reduced. If your spouse collects benefits prior to FRA, it will not reduce the amount you are entitled to receive. Only if you collect early will your spousal benefit be reduced.

Collecting Spousal Benefits Beyond FRA

Unlike your own benefit, spousal benefits will not receive guaranteed annual increases if you defer collecting them beyond FRA. Spousal benefits are at their maximum when you reach FRA, so there would not be any advantage to defer collecting them.

Collecting Survivor (Widower) Benefits

If you have been married for at least 9 months and your spouse passes away, you may be entitled to a survivor benefit based on your spouse's PIA on the date of death.

The amount of your survivor benefit is dependent on when your spouse commenced benefits. If the death occurs prior to your spouse collecting benefits, your survivor benefit would be equal to 100% of your spouse's PIA when you attain your FRA. If your spouse had begun collecting benefits, your survivor benefit would be equal to his or her actual benefit. The only exception is if he or she were collecting a benefit that was reduced more than 17.5%. In that case your survivor benefit will be 82.5% of the decedent's PIA. The survivor benefit will replace your other benefit(s) if higher. The chart below shows the expected survivor benefit for an individual who began collecting benefits at 62, FRA and 70.

Husband's Estimated Benefit		
Retirement Age	Monthly Benefit ($)	Survivor Benefit ($)
62	1,614	1,862
66 (FRA)	2,257	2,257
70	3,042	3,042

You can collect a survivor benefit as young as age 60. If you collect at age 60, your survivor benefit will be reduced by 28.5%. It is possible to collect a reduced survivor benefit at age 60, and than convert to your own unreduced benefit at FRA or later. If you remarry before age 60, survivor benefits will not be paid unless the subsequent marriage ends. Remarriage after attaining age 60 does not prevent or stop entitlement to benefits.

Government Pension Offset

Individuals who receive a pension from a federal, state or local government based on work where SS taxes were not withheld may have their spousal and/or survivor benefit reduced. SS benefits will be reduced by two-thirds of the government pension. Consider the following scenario. The wife will receive a government pension of $1,500 a month, while her husband will receive SS benefits of $2,257. Generally she would be entitled to spousal benefits equal to 50% of her husband's PIA, or $1,129, but because she is covered by a government pension, this benefit will be reduced by two-thirds of her pension, or $1,000. She will receive a spousal benefit of $129. The same $1,000 reduction will also be applied against any survivor benefits she may be entitled to.

Wife's Government Pension	
Monthly Pension	Gov't Pension Offset
$1,500	$1,000

Husband's Social Security				
Age	Monthly Benefit ($)	Spousal Benefit ($)	Adjusted Spousal Benefit ($)	Survivor Benefit ($)
62	1,614			862
66	2,257	1,129	129	1,257
70	3,042		129	2,042

Divorced Individuals

If you are not married but had previously been married to the same individual for at least 10 years, you would be entitled to collect spousal and/or survivor benefits as discussed earlier. As an unmarried divorced spouse, you are entitled to spousal benefits once both you and your ex-spouse reach age 62. You are not required to wait until your ex-spouse files for benefits. Amounts payable to an ex-spouse will not reduce any benefits you or your current spouse is entitled to.

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