

28. Retirement 2: Understanding Social Security

Introduction

For many of the 40 million Americans who are 65 and older, Social Security is the primary source of retirement income. Social Security is the first resource most Americans turn to when saving for retirement; however, most younger Americans, who will not face retirement for many years, might not have access to the benefits of the Social Security program, at least not in its present form. The Social Security Administration has given the following forecast:

Social Security is a compact between generations. For decades, America has kept the promise of security for its workers and their families. Now, however, the Social Security System is facing serious financial problems, and action is needed soon to make sure the system will be sound when today's younger workers are ready for retirement.

Without changes, by 2033 the Social Security Trust Fund will be able to pay only about 77 cents for each dollar of scheduled benefits. We need to resolve these issues soon to make sure Social Security continues to provide a foundation for future generations.¹

It is important for you to understand Social Security, its history, its processes, and its current form. Likewise, it is important for you to understand the challenges related to Social Security. The purpose of this chapter is to help you understand these topics.

Social Security is not an investment. Social Security is a social insurance program that provides not only retirement income but survivors insurance for children and spouses, disability insurance for people who are unable to work, and Medicare insurance for the elderly.

You are eligible to receive Social Security benefits if you have paid money into the Social Security program through your employment. Most experts expect Social Security to replace only about 42 percent of your current average earnings; therefore, although Social Security may be the first resource you turn to for retirement income, it should definitely not be your only source of retirement income.

Objectives

When you have completed this chapter, you should be able to do the following:

- A. Describe how the Social Security program works and the benefits of the Social Security program
- B. Answer frequently asked questions about Social Security and the future of Social Security

C. Understand plans and strategies for Social Security.

Describe How the Social Security Program Works and the Benefits of Social Security

Prior to 1935, retirement assistance was solely the responsibility of the individual, and the government did not provide financial help to retired workers. However, when the stock market crashed in 1929 and the gross domestic product (GDP) of the United States fell 48 percent in five years (from \$105 billion to \$55 billion), many individuals and families were left economically devastated. Millions of Americans were laid off, over 9,000 banks failed, and depositors lost over \$7 billion in assets. In an attempt to ensure that this type of depression did not happen again, Franklin D. Roosevelt signed the Social Security Act in 1935 to aid individuals who were displaced and unemployed.

The Social Security Program

The Social Security program was designed to be a pass-through account. This means that the taxes you pay for Social Security (through the Federal Insurance Contribution Act, or FICA) are used to pay benefits to those who are currently retired, disabled, widowed, or orphaned. Because there are currently more people paying into Social Security than there are people receiving Social Security benefits, the tax reserves are maintained in interest-earning government bonds held by the Social Security Trust Fund. There was no investment or savings component to Social Security when it was originally set up because the government assumed that there would always be enough people in the working generation to pay for the retired generation's benefits. In 1935, there were 17 workers for each retiree who received benefits. Today, it is estimated that there are only 3.4 workers for each retiree who receives benefits.

Financing for Social Security is roughly split evenly between the employee and employer. All employees pay at least 7.65 percent of their wages in FICA taxes, which are used to pay for Social Security and Medicare. This FICA tax comprises a Social Security tax of 6.20 percent and a Medicare tax of 1.45 percent. If your adjusted gross income (AGI) is larger than \$250,000 (Married Filing Jointly), then the taxpayer is required to pay an additional 0.9 percent in Medicare tax. Also any investment income is taxed an additional 3.8 percent. Since 1937, the government has made major changes in the Social Security tax rate. Table 1 shows how the Social Security tax rate has changed from 1937 to 1990.

Table 1. Social Security Tax Rate Changes

<u>Year</u>	<u>Amount</u>
1937	1.0%
1954	2.0%
1960	3.0%
1971	4.7%
1984	5.8%
1990	6.2%

There is a limit on the amount of wages that are subject to Social Security taxes; this limit changes each year. In 2018, the maximum amount of wages subject to the Social Security tax was \$127,200. There is no limit, however, on the amount of earnings that is subject to the Medicare tax. In other words, in 2018, any earnings in excess of \$128,400 are exempt from the Social Security tax but not from the Medicare tax. Table 2 shows a historical perspective on changes to this limit.

Table 2. Maximum Wage Amount Subject to Social Security Taxes

Year	Limit
2014	\$117,000
2015	\$118,500
2016	\$118,500
2017	\$127,200
2018	\$128,400
2019	\$132,900

Employers must provide a dollar-for-dollar match to the funds employees pay in Social Security and Medicare taxes. Self-employed individuals are required to pay both the employee's part of the FICA tax and the employer's part of the FICA tax. This means that self-employed individuals pay 12.4 percent on the first \$128,400 of their net earnings for Social Security and 2.9 percent on all taxable earnings for Medicare (3.8 percent if AGI is higher than \$250,000). However, self-employed individuals may deduct up to half of their Social Security taxes as an adjustment to taxable income on their federal income tax returns.

OASDI-HI, which is the official name of Social Security, stands for "Old Age, Survivors, and Disability Insurance and Hospital Insurance." Individuals must pay Social Security taxes only on taxable wages. Taxable wages include salaries; bonuses; commissions; the value of employer-provided meals and lodging; sick pay during the first six months of illness; employer-paid group life insurance premiums in excess of \$50,000; salary reductions from 401(k), 403(b), and 457 plans; nonqualified deferred compensation that is no longer at risk; nonqualified stock options; vacation pay; and severance pay. Nontaxable wages include sick pay after six months, payments made by an employer for medical or hospital expenses, and employer contributions to qualified retirement plans.

Key Terms

In order to understand Social Security, you should understand a number of key terms:

Average indexed monthly earnings (AIME) is calculated using your top 35 highest earning years. It entails adjusting each year's earnings total for inflation to reflect its value in the year in which eligibility is requested.

Primary insurance amount (PIA): Your primary insurance amount is the basic unit used to express the amount of a worker's benefit at their full retirement age (FRA). The calculation of a

Medicare benefits. These four main types are discussed in detail in the following paragraphs.

1. Retirement Benefits

Retirement benefits are available to four classes of people: workers, spouses, children, and single parents who have a child under the age of 16.

Table 4. Full Retirement Age:

Birth Year	Year at Age 62	Full Retirement Age
1937	1999	65
1938	2000	65 + 2 mo.
1939	2001	65 + 4 mo.
1940	2002	65 + 6 mo.
1941	2003	65 + 8 mo.
1942	2004	65 + 10 mo.
1943–1954	2005–2016	66
1955	2017	66 + 2 mo.
1956	2018	66 + 4 mo.
1957	2019	66 + 6 mo.
1958	2020	66 + 8 mo.
1959	2021	66 + 10 mo.
1960	2022	67
1961 +	2023 +	67

Table 5. Quarters of Coverage

Year	Amount
2014	\$1,200
2015	\$1,220
2016	\$1,260
2017	\$1,300
2018	\$1,320
2019	\$1,360

Worker's benefit: Workers may receive retirement benefits beginning at any month between the time they turn age 62 and the time they reach full retirement age. Benefits received up to 36 months before FRA will be reduced by 5/9 of 1 percent per month for each month you began receiving benefits before your FRA, for a maximum reduction of 20 percent. Additional reductions of 5 percent per year will be effective when the full retirement age exceeds age 65. Note that once you begin receiving benefits, this reduction will remain through the rest of your life.

For example, if your full retirement age is 66, and you begin retirement at age 62, your benefits will be reduced by 20 percent for the first three years and 5 percent for the fourth year; your benefits will be reduced by 25 percent total.

Delaying payment beyond full retirement age results in a benefit increase for each year of delay. You may delay benefits after age 67 up to age 70 and receive credits amounting to a specific percentage increase for each year of delay (see Table 6). For example, if your FRA is 67 and you begin receiving benefits at age 70, your PIA will be increased by 24 percent (three years multiplied by 8 percent).

Table 6. Percentage Increase per Year for Delaying Benefits

Year Born	Percentage Increase
1935-36	6.0%
1937-38	6.5%
1939-40	7.0%
1941-42	7.5%
1943 or later	8.0%

You may work while you are receiving benefits. Earnings you receive during or after the month in which you reach full retirement age will not reduce your Social Security benefits. However, if you choose to continue working while receiving benefits before your full retirement age, your benefits will be reduced. In 2018, earnings you receive in the year you reach your FRA will be reduced by \$1 in benefits for every \$3 you earn above the annual limit of \$45,360; your earnings will only be reduced until the month you reach full retirement age. In the years before you reach full retirement age, your earnings will be reduced by \$1 in benefits for each \$2 you earn above the limit (\$17,640 in 2019). Note that these limits change each year (see Table 7).

Spouse's benefit: The spouse of a fully insured worker is eligible to receive a retirement benefit of 50 percent of the worker's PIA, subject to the family maximum. This benefit is reduced by up to 25 percent for three years if it is received while the spouse has not reached his or her FRA. Once the spouse has reached age 65, a reduction of 5/12 of 1 percent per month, or 5 percent per year, is imposed for each of the remaining months the spouse is below the FRA. Any reductions to the worker's benefit resulting from early retirement will not affect the amount of the spouse's retirement benefit. If a spouse is entitled to benefits from his or her own employment, that spouse will receive 100 percent of his or her own PIA or 50 percent of his or her spouse's PIA, whichever is larger.

Child's benefit: Any child who is under 18 (19, if the child is still in high school), is eligible to receive a benefit of 50 percent of the retired worker's PIA (this amount is subject to a family maximum).

Mother's or father's benefit: The spouse of a fully or currently insured worker is eligible to receive a benefit of 75 percent of the worker's PIA if the spouse is caring for a child under age 16 or a child who was disabled before age 22.

2. Disability Benefits

Worker's Benefits: Workers who qualify for disability benefits are entitled to receive 100 percent

of their PIA until one of the following situations occurs: the disability ends (benefits are terminated in the second month after the end of the disability); the worker dies (benefits are terminated in the month after the worker dies); or the worker attains full retirement age (disability benefits convert to retirement benefits). Note that it is very challenging to qualify for disability benefits.

Table 7. Benefits Withheld for Earnings

Before You Reach Full Retirement Age: One dollar in benefits will be withheld for every \$2 in earnings above the limit:

Year	Benefit Amount
2015	\$15,720
2016	\$15,720
2017	\$16,920
2018	\$17,040
2019	\$17,640

Year You Reach Full Retirement Age: One dollar in benefits will be withheld for every \$3 in earnings above the limit:

Year	Benefit Amount
2015	\$41,880
2016	\$41,880
2017	\$44,880
2018	\$45,360
2019	\$46,920

There is no limit on earnings made during the month when an individual reaches FRA.

Spouse's Benefit: The spouse's disability benefit is either 50 percent of the worker's benefit or the spouse's own Social Security benefit, whichever is larger. Retirement or disability benefits paid to a spouse who is 62 years old will be reduced by a maximum of 25 percent each year. If the worker's benefit is decreased, the benefit paid to the worker's spouse is also decreased.

Child's Benefit: Any child who is under 18 (19 if the child is still in high school), is eligible to receive a benefit of 50 percent of the disabled worker's PIA.

Mother's or Father's Benefit: The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75 percent of the worker's PIA if he or she is caring for a child under age 16 or a child who was disabled before age 22.

Maximum family benefit: When more than one family member is eligible to receive benefits (e.g. the worker, his or her spouse, and children), a family maximum applies. This maximum applies to all benefits paid to the family. For disability benefits, the family maximum is either 150 percent of the worker's disability benefit or 85 percent of the AIME used to calculate the worker's benefit, whichever is smaller. This maximum will not be less than the benefit paid to

the worker.

3. Survivor Benefits

Lump-sum benefit: If the deceased worker was fully insured (40 quarters of credits) or currently insured (6 quarters of credits), a lump-sum survivor benefit will be paid to eligible survivors. A monthly lump sum is available to the surviving resident spouse, nonresident spouse, or eligible children.

Widow(er)'s benefits: A benefit of up to 100 percent of the fully insured, deceased spouse's PIA will be paid to the surviving spouse who is at least age 60 and who was married to the deceased spouse for at least nine months. The surviving spouse is generally eligible if he or she is not remarried and is not entitled to retirement benefits (for his or her covered employment) in at least the amount of the deceased spouse's PIA. If the worker dies before receiving retirement benefits, the surviving spouse of full retirement age is entitled to a benefit of 100 percent of the deceased worker's PIA.

A surviving spouse between the ages of 60 and 65 (below the FRA) would receive reduced benefits of 19 to 40 percent per month each month until the spouse turned 65. If a worker dies after Social Security benefits have begun, the surviving spouse's benefit cannot exceed the amount being paid at the time of death. A widow(er)'s benefit terminates at death or at eligibility for an equal or greater retirement benefit.

Child's benefits: Child's benefits terminate at age 18, at marriage, or at death. The dependent child of a fully or currently insured worker will receive a benefit of 75 percent of the worker's PIA (this amount is subject to the family maximum) under at least one of the following circumstances: if the child is under age 18 (or age 19 if the child is a full-time high school student) and not married, or if the child is over age 18 and has been disabled since before age 22.

Mother's or father's benefit: The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75 percent of the worker's PIA if that surviving spouse is caring for a child who is under age 16 or a child who was disabled before age 22 (the benefit amount is subject to the family maximum). The benefit is paid until the youngest child reaches 16 or marries or until the surviving spouse dies or remarries.

4. Medicare Benefits

The Medicare hospital insurance (HI) portion of Medicare, also known as Part A, is largely funded by the 2.9 percent HI tax on earnings. Part A is compulsory insurance. Part B of the Medicare program, supplemental medical insurance (SMI), is financed by premiums paid by participants and by federal government funding.

Individuals who are at least age 65 and who are eligible for Social Security retirement benefits on their own behalf are entitled to coverage under Medicare Part A. If the individual has applied

for Social Security retirement benefits, no separate application is required. If the individual continues to work after age 65 and is not receiving Social Security benefits, an application must be filed in order for the individual to receive Medicare Part A coverage. Recipients of disability benefits are eligible for Part A coverage after they have been eligible for disability benefits for 24 months.

Survivors and dependents of individuals who are entitled to Part A coverage must be at least 65 years old to be eligible for Part A coverage. U.S. citizens who are not eligible for Part A coverage but who are enrolled in Part B may pay a monthly premium to enroll in Part A. Individuals are automatically enrolled for Part B coverage when they become eligible for Part A coverage. Part B coverage can be waived by completing the necessary forms. Any individual may enroll in Part B coverage if he or she is at least age 65 and has been a citizen or resident for five years.

Answer Frequently Asked Questions about Social Security

There is a great deal of important information about Social Security that may be of interest to you. The following are a few of the more frequently asked questions and their answers.

If I have a full-time job and I have a small business on the side, how much do I pay for Social Security? If you have both a full-time job and you have a small business on the side, no more than \$132,900 of your combined earnings is subject to the FICA tax in 2019. However, any additional wages are subject to the Medicare tax.

How does Social Security account for the increasing cost of living expenses? Benefits are increased annually on January 1 to reflect increases in the cost of living.

Do unearned income and asset ownership affect how much one pays in Social Security? Unearned income, such as interest earned on investments and assets, has no effect on eligibility for Social Security benefits.

How does earned income affect Social Security before age 65? Earned income has an effect on retirement benefits and survivor benefits paid to individuals who are under age 65 if such earnings exceed their earnings limitations. When individuals begin to take advantage of retirement benefits, the earnings limit is applied as a monthly amount in the months preceding the 65th birthday.

How do I qualify for benefits? To qualify for full benefits, you must meet the quarters-of-coverage requirement, which means you must earn at least the required minimum during each calendar quarter (every three months). For 2019, the quarters-of-coverage minimum was \$1,360. You need to meet this minimum for at least 40 quarters to qualify for full benefits; this is equivalent to 10 years of work. Earning beyond 40 quarters will not increase your benefits.

What is an annual Social Security statement, and when will I receive it? An annual Social

Security statement shows your quarters-of-coverage credit, the amount you have paid in Social Security taxes, and the amount of your estimated benefit. You must be at least 18 years old to receive a statement. The statement is sent to you each year three months before your birthday, or may be reviewed online at www.ssa.gov.

How can I apply to receive benefits? You can complete the application process at a Social Security office, over the telephone, or via the Internet. When you apply, you may need to show verification of your age by providing your birth certificate or your Social Security card.

When will I receive my retirement benefits? Benefits are paid once a month on either the second, third, or fourth Wednesday of the month, depending on your birth date. You can choose to receive your payment as a check or through direct deposit.

Do I have to pay federal income taxes on my retirement benefits? About 20 percent of those who receive Social Security benefits must pay some federal taxes on the benefit, when they earn substantial income (including pension and wages) in addition to the Social Security benefit. See an accountant to discuss your personal situation.

Describe the Future of Social Security

The Social Security program is currently collecting more money than it is paying out. In 2012, the program collected \$840.2 bn (versus \$784.9 bn in 2007) and paid out \$785.8 bn in benefits (\$495.7bn in 2007) to 56.8 mn people (54.7mn).³). Note that income is growing 1.4% per year over this period and expenses are growing 9.7% over the same period.

Today, it is estimated that there are 2.8 workers per recipient of Social Security (see Chart 1). However, by the year 2075, it is estimated that there will be only 2.0 workers per recipient of Social Security. Clearly, the program must undergo some changes to accommodate this major shift in demographics.

According to government projections, Social Security benefits can be paid solely from tax revenues until 2015. From 2016 to 2025, Social Security benefits will likely have to be paid with the interest from government bonds. From 2026 to 2033, the Social Security Trust Fund may have to redeem its bonds to pay Social Security benefits. Current projections estimate that Social Security funds will be exhausted in 2033.

Plans and Strategies for Social Security

Following are a few ideas of plans and strategies for Social Security, part of your Retirement Plan. We have developed [Social Security Spreadsheet](#) (LT36) to help as you calculate your Primary Insurance Amount, Family Maximums, Spouse's benefits, Children's benefits, as well as determine your breakeven years for taking different benefit options (see Breakeven tab).

As a starting point, you should have a rough idea of how long are you expecting to live. I recommend you take some life expectancy quizzes to help you in this area. With this information, you would take benefits earlier than later if:

- You do not expect to live to the Social Security determined life expectancy
- You are no longer working and can't make ends meet without benefits
- You are in poor health, and don't expect to live to an average life expectancy
- You are the lower earning spouse and the higher-earning can wait to file for higher benefit.

You would take benefits later than sooner if:

- You are in good health and expect to live longer than the normal social security determined life expectancy
- You are still working and make enough to impact the taxability of benefits (at least wait till FRA so your benefits are not further reduced)
- You are the higher earning spouse and want to be sure your surviving spouse received the highest possible benefit.

Using [Social Security Spreadsheet](#) (LT36), you can determine your breakeven age, the point where it would be more beneficial for you to wait to take benefits, based on your age, full retirement age, and your NPV assumptions including cost of living adjustments and interest rates. Again, this is an approximation only.

Following are Social Security plans and strategies for the accumulation, retirement and distribution stages.

Plans and Strategies

Accumulation

- If health is poor, life expectancy low, or needs are great, begin taking benefits as soon as possible
- Continue to work and contribute to the SS system as benefits are based on top 35 earning years
- If possible, don't take benefits before full retirement age as there is a tax penalty on benefits if your earnings are above a specific amount before FRA
- If needed, you can take benefits up to 5 years before FRA; however, once you start taking benefits you cannot change that choice!

Retirement

- The higher-earning spouse should take retirement as late as possible. This would increase benefit and would maximize the amount the lower-earning spouse would have after the higher-earning spouse passes. Once the higher-earning spouse passes, the remaining spouse receives the higher of their amount or the higher-earning spouses amount

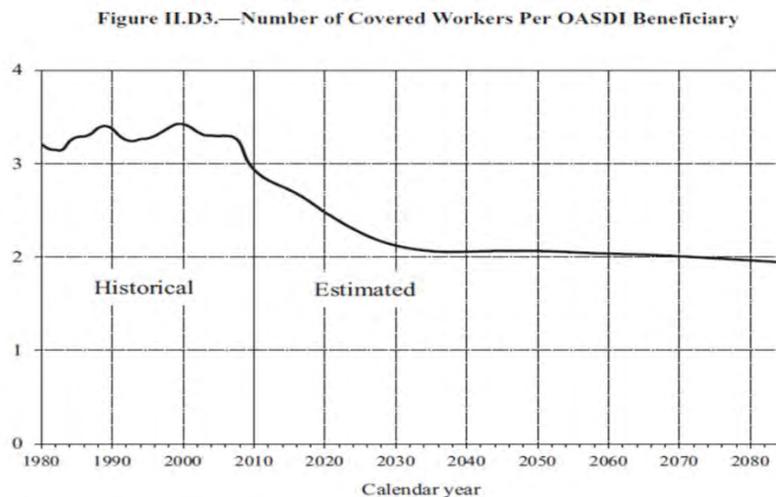
- If possible, don't take benefits before full retirement age as there is a tax penalty on benefits if your earnings are above a specific amount before FRA

Distribution

- Try to defer taking benefits as long as possible, especially if you expect to live longer than the SS system determined average.
- The longer you delay taking benefits, the greater your monthly benefit (up to 3 years beyond FRA)
- If you have extra money left over, roll over excess amounts into a Roth IRA to use later.

Summary

Chart 1: Number of Workers per OASDI Beneficiary⁴



Source: 2011 Social Security Trust Fund Reports, <http://www.ssa.gov/oact/tr/2011/tr2011.pdf>

For many of the 40 million Americans who are 65 and older, Social Security is the primary source of retirement income. However, most young Americans, who will not face retirement for many years, might not have access to the benefits of the Social Security program, at least not in its present form.

The Social Security program was designed to be a pass-through account; this means that the taxes you pay for Social Security (through the Federal Insurance Contribution Act, or FICA) are used to pay benefits to those who are currently retired, disabled, widowed, or orphaned. Because there are currently more people paying into Social Security than there are people receiving Social Security benefits, the tax reserves are maintained in interest-earning government bonds held by the Social Security Trust Fund. There was no investment or savings component to Social

Security when it was originally set up because the government assumed there would always be enough people in the working generation to pay for the retired generation's benefits.

Social Security should be the first component of your retirement plan, but it should not be the only one. To fully understand how Social Security can benefit you, you must understand what Social Security is, what Social Security does, and how your benefits will be calculated. You must also realize that the program is in transition and that you should include other retirement resources in your retirement plan accordingly.

Assignments

Financial Plan Assignments

Your assignment is to learn about the benefits you will receive from Social Security. Get a copy of your Social Security statement benefits by going to www.ssa.gov. Click on *Get a Copy of your Social Security Statement Online* near the middle left of the page, and then click on *Sign in or Create an Account*. Fill out your name, middle initial, last name, social security number, birthday, and other information that is requested. Follow the on screen instructions, and they will send you a copy of your Social Security statement. Use this statement as you work to determine how much you will need for retirement.

Learning Tools

The following learning tools may also be helpful as you prepare your Personal Financial Plan:

[Retirement Planning Needs Spreadsheet](#) (LT06)

This Excel spreadsheet helps you determine how much you must save each month to achieve a specific lifestyle at retirement based on the following estimates: years until retirement, expected return, inflation, and tax rates.

[Retirement Planning Ratio Forecasts](#) (LT25)

This Excel spreadsheet helps you determine where you are in your progress towards achieving your retirement goals. By inputting the relevant information, you can determine whether you are on track for reaching your retirement goals based on your age and your income.

[Social Security Spreadsheet](#) (LT36)

This spreadsheet helps you calculate your Primary Insurance Amount and Maximum Family benefit from your Average Indexed Monthly Earnings, and how much you will receive at various ages. It also shows how the bend points have changed over time.

Review Materials

Terminology Review

Average Indexed Monthly Earnings (AIME). The average lifetime earnings indexed for inflation is your top 35 highest earning years. It entails adjusting each year's earnings total to reflect its value in the year in which eligibility is requested.

Bend Points. Calculating your PIA from AIME is divided into three calculations called "bend points" because the formula, when graphed, appears as a series of line segments joined at these amounts. These bend points change year to year.

Child's Benefit. Any child who is under 18 (19 if still in high school), is eligible for a benefit of 50% of the retired workers PIA, subject to a family maximum. Child's benefits terminate at age 18, marriage, or death. The dependent child of a fully or currently insured worker will receive a benefit of 75% of the worker's PIA (subject to family maximum) if the child is under age 18 (or age 19 is a full-time high school student), or is over age 18 and has been disabled since before age 22, and is not married.

Currently Insured Status. To be "currently insured", you must have at least 6 quarters of coverage in the previous 13 quarter period. Currently insured is adequate for eligibility for survivor benefits paid to children and for a surviving spouse caring for a qualifying child.

Eligibility for other benefits generally requires fully insured status or 40 quarters of coverage

Delayed Retirement Credit. Delaying payment beyond full retirement age results in a benefit increase for each year of delay. With a delay the worker's PIA is not increased and the benefits to family members is not increased.

Disability Benefits. Workers who qualify for disability benefits are entitled to 100% of PIA until the earliest of the following: disability ends: benefits are terminated in the second month after the end of disability, or the workers dies: benefits are terminated in the month prior to the month the worker dies. If the worker attains full retirement age: disability benefits convert to retirement benefits.

Disabled Child. The disable child of a retired or disable worked is entitled to benefits past age 22 if the disability began before age 22.

Full Retirement Age (FRA). This is the age at which a retiree will receive 100% of their entitled benefits. Receiving benefits prior to FRA will result in a reduction in benefits. Receiving benefits after FRA will result in an increase of benefits.

Insured Worker. A worker is only entitled to receive benefits if that worker is fully insured.

Workers are considered fully insured if they have worked forty quarters of work (a quarter is three months) and earned a specific amount of money per quarter.

Low Income Filer. This is a single filer with provisional income below \$25,000 or married filing jointly (MFJ) with income below \$34,000. None of the benefits are taxable.

Lump Sum Benefit. A lump sum of \$255 is available to the surviving spouse, nonresident spouse, or to children eligible for the monthly benefits (for 2018).

Maximum Family Benefit. When benefits are payable to more than one family member, a family maximum applies. This includes all benefits paid to the family. For disability, the family maximum is the lesser of 150% of the workers disability benefit or 85% of the AIME used to calculate the benefit, but is not less than the benefit paid to the worker. When the worker is living, and benefits exceed the family maximum, the worker's benefit is not adjusted; rather, the reduction is made in other beneficiaries' payments.

Medicare Benefits. Medicare hospital insurance (HI) portion of Medicare, also known as Part A, is largely funded by the 2.9% HI tax on earnings. Part A is compulsory. Individuals at least age 65 and eligible for Social Security retirement benefits on their own behalf are entitled to coverage under Medicare Part A. If the individual has applied for Social Security (SS) retirement benefits,

no separate application is required.

Middle Income Filer. This is a single with income from \$25,000 to \$34,000 and MFJ with income from \$32,000 to \$44,000. Up to 50% of social security benefits are taxable.

Mother's or Father's Benefit. The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75% of the worker's PIA if they are caring for a child who is under age 16 or who was disabled before age 22 (subject to family maximum).

OASDI – HI (Old Age, Survivors, and Disability Insurance and Hospital Insurance). This is payment for Social Security and Medicare taxes. The employee and employer each pay (assuming your Adjusted Gross Income (AGI) is less than \$250,000: Social security tax (OASDI) of 6.20%, Medicare tax (HI) of 1.45%, for a total of 7.65% each. Self-employed individuals pay the whole 15.30%. OASDI-HI taxes are on taxable wages including wages, salaries, bonuses, commissions, value of employer provided meals/lodging, sick pay during first 6 months, employer paid group life insurance premiums in excess of \$50,000, salary reduction from 401k, 403b, 457 plans, non-qualified deferred compensation no longer at risk, non-qualified stock options, vacation pay, and severance pay.

Primary Insurance Amount (PIA). Your PIA is the basic unit used to express the amount of a worker's benefit if they received benefits at their full retirement age (FRA). The calculation of PIA is based on the worker's AIME, which is split into three segments and multiplied by specific percentages for each segment and summing the parts.

Retirement Benefits. Retirement benefits can either be reduced or increased depending on your PIA, your FRA and the date when benefits begin. You can begin receiving benefits as early as age 62. Benefits that begin 3 years before FRA will be reduced by a maximum of 20% (or 5/9% of 1% per month for each month benefits begin before FRA or 6.67% per year). Additional reductions of 5% per year are effective when FRA exceeds age 65.

Social Security. Social security is a government provided retirement, survivor, and disability benefits. Franklin D Roosevelt signed the Social Security Act in 1935 to Aid the displaced and out of work. Social Security is a pass-through account, which means that FICA taxes being paid by current workers provided the money for benefit payments to current retirees.

Spouses benefit. A fully insured worker's spouse age 65 (FRA) is eligible to receive a retirement benefit of 50% of the worker's PIA subject to the family maximum. This benefit is reduced by 25/36% of 1% for each of the first 36 months that the spouse is under FRA (25% for 3 years). Once the FRA > 65, a reduction of 5/12 of 1% is imposed for each month beyond 36 months the spouse is under the FRA. The reduction of benefit from early retirement will not affect the amount of the spouses benefit. Disability benefits for spouses are 50% of the worker's PIA, reduced if the spouse is under FRA, subject to a family maximum amount.

Supplemental medical insurance. The SMI portion of the Medicare program (Part B) is financed by premiums paid by participants and by federal government funding. Participation in Part B is voluntary.

Survivor Benefits. Deceased worker must had had fully insured status; other survivor benefit (mother's or fathers' child's lump sum) will be paid to eligible survivors of a fully or currently insured worker

Upper Income Filer. These are singles with income above \$34,000 and MFJ with income above \$44,000. 85% of Social Security benefits are taxable.

Widow(er)'s Benefits. A benefit of up to 100% of the deceased, fully insured PIA will be paid to the surviving spouse who is at least age 60 and who was married to the worker for 9 months. The surviving spouse is generally eligible if he or she is not remarried and is not entitled to retirement benefits (due to his or her covered employment) of at least the amount of the deceased workers

PIA. A widowers benefit terminates at death or at eligibility for an equal or greater retirement benefit.

Review Questions

1. What is the primary source of income for adults 65 and older? Is this a reliable source for the future?
2. What two people/entities finance Social Security and Medicare? What percentage does each pay?
3. What does it take to be fully insured in the Social Security program?
4. To which four classes of people are retirement benefits available?
5. Why is it advantageous to wait until you are 70 before withdrawing money from your social security account?

Case Studies

Case Study 1

Data

Bill was born in 1940. He plans to retire and begin receiving Social Security benefits at age 68 and 6 months. His AIME is \$2,072, his PIA is \$1,200 and he knows that his PIA will be increased by 7% for each year beyond FRA he takes retirement. His FRA is 65 and 6 months.

Calculations

What is his retirement benefit at 3 years beyond FRA?

Case Study 1 Answers

Since Bill was born in 1940, his full retirement age is 65 years and 6 months. At 68 years and 6 months, he would be three years beyond his FRA. He would have a benefit of 7.0 percent per year for waiting beyond his FRA to retire.

His retirement benefit is $3 * 7.0\% = (21\% + 1) * \$1,200 = ?$

He would receive \$1,452 per month for a retirement benefit.

Tax Year				Worker		
2019	FRA	65 + 6 mo.		Age Begin	Monthly	
Birth Year:	1940	Additional %	7.0%	Period:	SS Benefits	Payments
Calc. Spouse's Benefit (50% of workers PIA)			No	FRA - 5	60 + 6 mo.	840
Average Indexed Monthly Earnings (AIME) \$ 2,071.6				FRA - 4	61 + 6 mo.	900
Weights:	SS Limits	Difference	Amounts	FRA - 3	62 + 6 mo.	960
90%	926	926	833.40	FRA - 2	63 + 6 mo.	1,040
32%	5,583	1,146	366.60	FRA - 1	64 + 6 mo.	1,120
15%	-	-	-	FRA	65 + 6 mo.	1,200
Worker's Primary Insur. Amt. (PIA) \$1,200.00				FRA + 1	66 + 6 mo.	1,284
				FRA + 2	67 + 6 mo.	1,368
				FRA + 3	68 + 6 mo.	1,452

Case Study 2

Data:

Steve was born in 1960 and is thinking about perhaps retiring at age 62. He knows that his full retirement age is 67. He also knows that if he begins retirement 3 years before his FRA his AIME will be reduced by 20% and for each year before that, it will be reduced by 5%.

Calculations:

- A. How much in percentage terms would his PIA be reduced if he was to begin receiving Social Security benefits at age 62?
- B. If his AIME was \$2,072 and his PIA was \$1,200, how much would he receive each month if he retired at age 62?

Case Study 2 Answers

Bill's benefits would be reduced by 5/9 percent per month for the first 36 months prior to age 67 (20 percent for three years) and 5/12 percent for each month after those three years (5 percent per year for each year after that).

A. Calculate the benefit Bill would receive if he was to retire at age 62:

$$\begin{aligned}
 5/9 \text{ percent} \times 36 \text{ months} &= 20\% \\
 5/12 \text{ percent} \times 24 \text{ months} &= 10\% \\
 \text{Total reduction in payments} &= 30\%
 \end{aligned}$$

B. Bill would receive $1,200 \times .7$ (1 – 30%) or \$840 each month.

LT36			
Tax Year	2019	FRA	65 + 6 mo.
Birth Year:	1940	Additional %	7.0%
Calc. Spouse's Benefit (50% of workers PIA)	No		
Average Indexed Monthly Earnings (AIME)		\$ 2,071.6	
Weights:	SS Limits	Difference	Amounts
90%	926	926	833.40
32%	5,583	1,146	366.60
15%		-	-
Worker's Primary Insur. Amt. (PIA)		\$ 1,200.00	

Worker	Age Begin	Monthly
Period:	SS Benefits	Payments
FRA - 5	60 + 6 mo.	840
FRA - 4	61 + 6 mo.	900
FRA - 3	62 + 6 mo.	960
FRA - 2	63 + 6 mo.	1,040
FRA - 1	64 + 6 mo.	1,120
FRA	65 + 6 mo.	1,200
FRA + 1	66 + 6 mo.	1,284
FRA + 2	67 + 6 mo.	1,368
FRA + 3	68 + 6 mo.	1,452

Case Study 3

Data

Sam was born in 1955 (FRA is 66 and 2 months), and his wife Ann was born in 1958 (FRA is 66 and 8 months). They plan to both begin receiving Social Security benefits when Ann reaches full retirement age (Sam will be three years beyond FRA; the percentage increase is 8 percent per year beyond FRA).

Calculations

- A. Assuming Sam's PIA is \$1,500, and Ann's PIA, because she has worked in the home, is only \$600, how much would each receive at retirement?
- B. What would be the combined amount they would receive each month?

Case Study 3 Answers

- A. Since Sam was born in 1955, his full retirement age is 66 years and 2 months. At Ann's FRA of 66 and 8 months, Sam would be three years beyond his FRA. He would have a benefit of 8 percent per year of for waiting beyond his FRA for retirement.
His retirement benefit is $3 * 8.0\% = (24\% + 1) * \$1,500 = ?$ or \$1,860 per month.
His wife would receive the higher of half her spouse's PIA (before the increase) of $\$1,500 / 2$ or \$600, whichever was higher, subject to the family maximum. In this case she would take the \$750.
- B. Their combined benefit would be $\$1,860 + \750 , or \$2,610, per month.

Case Study 4

Data

Jenny and Steve were married for 15 years when Steve passed away. They have four children, all under age 12. Steve was a currently insured worker and had an AIME of \$2,072 and a PIA of \$1,200 when he passed away. The family maximum amount was \$1,820.

Calculations

- A. How much would Jenny receive from Social Security survivor benefits to help her raise her children after Steve's death?
- B. How much would the children receive?

Case Study 4 Answers

- A. Since Steve was a currently insured worker, Jenny would receive 75 percent of his PIA regardless of her age as there are children in the home under age 18. Jenny's survivor benefit would be 75 percent of Steve's PIA of \$1,200, or \$900 per month.
- B. The children's benefit would also be 75 percent of Steve's PIA.
However, because Jenny had already received \$900, the four children would only receive together the difference up to the family maximum of \$968 (\$1,868 family maximum less the \$900 for Jenny), rather than 75 percent per child.

LT36			
Tax Year	2019 FRA	65 + 6 mo.	
Birth Year:	1940 Additional %	7.0%	
Calc. Spouse's Benefit (50% of workers PIA)	No		
Average Indexed Monthly Earnings (AIME) \$ 2,071.6			
Weights:	SS Limits	Difference	Amounts
90%	926	926	833.40
32%	5,583	1,146	366.60
15%	-	-	-
Worker's Primary Insur. Amt. (PIA) \$ 1,200.00			
Worker Period:	Age Begin	Monthly SS Benefits	Monthly Payments
FRA - 5	60 + 6 mo.		840
FRA - 4	61 + 6 mo.		900
FRA - 3	62 + 6 mo.		960
FRA - 2	63 + 6 mo.		1,040
FRA - 1	64 + 6 mo.		1,120
FRA	65 + 6 mo.		1,200
FRA + 1	66 + 6 mo.		1,284
FRA + 2	67 + 6 mo.		1,368
FRA + 3	68 + 6 mo.		1,452
Calculating Family Maximum from your PIA - Survivor Benefits Using Bend Points for 2019			
Primary Insurance Amount (PIA) \$ 1,200.00			
Weights:	SS Limits	Difference	Amounts
150%	1,184	1,184	1,776.00
272%	1,708	16	43.52
134%	2,228	-	-
175%	-	-	-
Maximum Family Benefit \$ 1,819.52			
Survivor Benefits:			
- Spouse: 75% of PIA with kids < 18			
- Children: 75% of PIA, subj. to max			
Calculations:			
Spouse's Benefit (75% PI) \$ 900			
Child #1 Benefit (75% PI) 900			
Other Children's Benefit () 20			

Case Study 5

Data

Jenny and Steve are both beyond FRA and received \$11,000 in social Security benefits in 2019. Their AGI (taxable pensions, wages, interest and dividends) was \$22,500. They had \$1,500 in tax-exempt interest income from a mutual fund. (Remember provisional Income (PI) is your AGI (before Social Security) + tax-exempt interest + 50% of your Social Security benefits)

Calculations:

- A. Calculate their provisional income (Married Filing Jointly)
- B. How much of that \$11,000 is taxable?

Case study 5 Answers

Low Income: Benefits not taxable

Single filer with PI < \$25,000 (\$32,000 MFJ)

Middle Income: Up to 50% of benefits taxable

Single filer with PI from \$25,000 to \$34,000 (\$32,000 to \$44,000 MFJ)

Upper Income: 85% of benefits taxable

Single filer with PI > \$34,000 (\$44,000 MFJ)

Their provisional income is $\$22,500 + \$1,500 + (\$11,000/2) = \$29,500$

Since they are married filing jointly, the \$29,500 is less than the \$34,000 base amount.

Therefore, none of the benefits are taxable.

Case Study 6

Data:

Bob has an AIME of \$5,500 per month.

Calculations

- a. Based on 2019 bend points of \$926 and \$5,583, what would Bob’s PIA be (his PIA is calculated from his AIME)? Remember the weights are 90% of the first bend point, 32% of the second and 15% of the remainder.

Case Study 6 Answers

a. Calculating Bob’s PIA from his AIME in 2019 is divided into three calculations called “bend points”

1. 90% of the amount for the first \$926
2. 32% of earnings from \$926 - \$5,583, and
3. 15% of earnings above \$5,583

Since Bob’s AIME was \$5,500 per month, the amount is:

90% of \$926 or \$833.40
 32% of \$5,583 - \$926 (\$4,574) or \$1,463.68
 15% of \$5,500 - \$5,583 (\$0) or \$0.00
 Bob’s total PIA would be \$2,297.08

This is the sum of each of the bend calculations

This is the sum of each of the bend calculations

Tax Year				Worker		
2019 FRA	67	Period:	SS Benefits	Age Begin	Monthly Payments	
Birth Year:	1960 Additional %	8.0%	FRA - 5	62	1,608	
Calc. Spouse's Benefit (50% of workers PIA)	No		FRA - 4	63	1,723	
Average Indexed Monthly Earnings (AIME) \$ 5,500.0				FRA - 3	64	1,838
Weights:	SS Limits	Difference	Amounts	FRA - 2	65	1,991
90%	926	926	833.40	FRA - 1	66	2,144
32%	5,583	4,574	1,463.68	FRA	67	2,297
15%	-	-	-	FRA + 1	68	2,481
Worker's Primary Insur. Amt. (PIA) \$ 2,297.08				FRA + 2	69	2,665
				FRA + 3	70	2,848

Case Study 7

Data:

Bob, born in 1972, has an AIME of \$5,397 and a PIA of \$2,246 per month.

Calculations

- a. Based on 2019 family bend points, what would his family maximum be (the family maximum is calculated based on his PIA)? (For calculating family maximums, the weights are 150% of the first bend point, 272% of the second, 134% of the third, and 175% over the third bend point using the PIA).

Case Study 7 Answers

a. Calculating Bob’s family maximum benefits in 2019 from his PIA is divided into four calculations

1. 150% of the amount for the first \$1,184
2. 272% of earnings from \$1,708 - \$1,184
3. 134% of earnings from \$2,154 - \$1,708, and
4. 175% of earnings over \$2,154

Since Bob’s PIA was \$2,246, the family maximum would be:

150% of \$1,184 or \$1,776.00

272% of \$1,708 - 1,184 (\$524) or \$1,425.28
 134% of \$2,154 - \$1,708 (\$520) or \$696.80
 175% of \$2,246 - \$2,154 (\$36) \$63.21
 His family maximum amount would be \$3,961.29

Calculating Family Maximum from your PIA - Survivor Benefits			
Using Bend Points for 2019			
Primary Insurance Amount (PIA)			\$ 2,264.12
Weights:	SS Limits	Difference	Amounts
150%	1,184	1,184	1,776.00
272%	1,708	524	1,425.28
134%	2,228	520	696.80
175%	2,264	36	63.21
Maximum Family Benefit			\$ 3,961.29

Survivor Benefits:	
- Spouse: 75% of PIA with kids < 18	
- Children: 75% of PIA, subj. to max	

Calculations:	
Spouse's Benefit (75% PIA)	\$ 1,698
Child #1 Benefit (75% PIA)	1,698
Other Children's Benefit ()	565

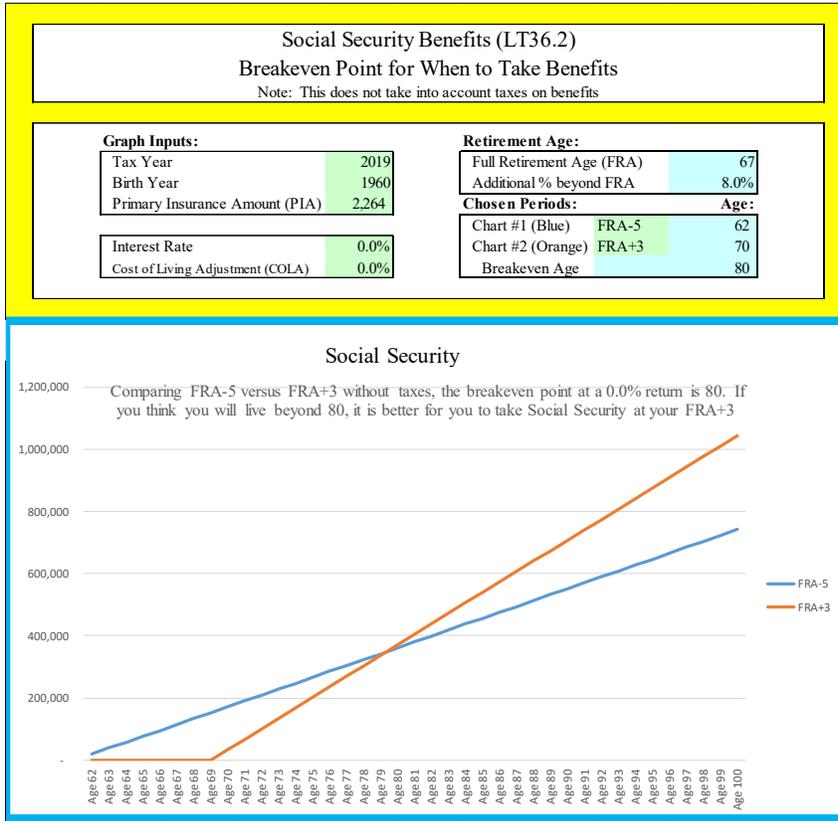
Case Study 8

Data:

Bob was born in 1960, has an AIME of \$5,397 and a PIA of \$2,264 per month. Assuming no time value of money (no interest rate) and no cost of living adjustment (COLA), after what breakeven age would it be more beneficial for Bob to wait for FRA+3 than to retire at his full retirement age.

Hint: Use [Social Security Spreadsheet](#) (LT36)

Chapter 28. Retirement 2: Understanding Social Security



¹ Carolyn Davis, Acting Commissioner, as printed in individual Social Security Statements, January 2, 2014 from <http://www.ssa.gov/myaccount/materials/pdfs/SSA-7005-OL.pdf>

² <http://www.ssa.gov/oact/COLA/bendpoints.html>, August 14, 2014.

³ 2011 Social Security Trust Fund Report of the Social Security Administration, 2011.

⁴ Source: 2011 Social Security Trust Fund Reports, <http://www.ssa.gov/oact/tr/2011/tr2011.pdf>.