

## **A Social Security Primer for Boomers**

### **The Birth of Social Security**

Due to the substantial number of recent client inquiries concerning the rules and elections relating to Social Security retirement benefits, this quarter we are departing somewhat from our traditional market/economic newsletter in order to provide a brief history of Social Security and to answer some of the most frequently posed questions. For Boomers fast approaching or already facing these decisions, we hope this information will prove helpful. Alternatively, for those looking forward to next quarter's return to an investment topic, we assure you that your review of the Social Security rules will prove the equal of Tylenol PM.

In 1935, Congress passed and President Franklin D. Roosevelt signed into law the "Social Security Act" creating "a system of Federal old-age benefits" for workers and their families. **The 1935 Act set the wage threshold at \$3,000**, with income earned above this amount not subject to Social Security taxes. Additionally, **the original Act set the Social Security Tax Rate at 2%; 1% each for the employee and employer** with specified increases that would bring the rate to 6% by 1949 (the 6% rate was ultimately delayed until 1960).

### **Status Check**

The following statement, currently issued by the Social Security Administration to all participants, has largely been ignored:

"Social Security is the largest source of income for most elderly Americans today, but **Social Security was never intended to be your only source of income when you retire.** You also will need other savings, investments, pensions or retirement accounts to make sure you have enough money to live comfortably when you retire."

Fast forward and let's see how well Americans are planning for retirement and what role Social Security actually plays. **In 2007, the average annual U.S. savings rate was \$158.23 per person** or .5% of disposable personal income. At the same time, **Social Security benefits comprised 50% or more of the income for 63% of elderly beneficiaries and 90% or more of the income for one-third of elderly beneficiaries.** As of 2008, Social Security is paying an average of \$12,948/year to individual retired workers receiving old-age benefits and \$21,132/year to couples receiving benefits.

Contributions are also far higher than the \$30 collected from employees in 1935. For 2010, the wage threshold is \$106,800 and the Social Security and Medicare tax rates for employer and employee are 6.2% and 1.45% each (a total of 15.3% for self-employed, though one-half can be deducted for purposes of the income tax calculation).

### **The Inverting Pyramid**

**In 1945, the ratio of people paying taxes to people receiving benefits was 41.9:1; in 2007 the ratio was 3.3:1; in 2030, the ratio is projected to be 2.2:1.** From the inception of the Social Security program through 2002, the retirement age was not changed. A law passed in 1983 requires that it be increased from 65 to 67 (in stages) by the year 2027.

When Social Security began paying benefits **in 1940, the life expectancies for the average 65 year-old male and female were 11.9 and 13.4 additional years.** According to the 2006 Social Security tables, those same **life expectancies have risen to 17 and 19.7 years, increases of 43% and 47%.** And while benefits and taxes are automatically indexed on an annual basis to

compensate for inflation and wage growth, the retirement age is not indexed to compensate for increased life expectancy.

The baby boom generation was born between the late 1940's and early 1960's. The average birth rate per woman was 3.6 vs. 2.05 in 2004. Around 2010, the baby boom generation will begin to retire. **Between 2010 and 2030, it is projected that the number of people eligible for old-age benefits will increase by roughly 66%. During the same timeframe, the number of people paying Social Security taxes will increase by about 10.2%.**

### Washington . . . We (Still) Have a Problem

The Social Security program has an independent budget that is separate from the rest of the federal government. Since 1982, Social Security has had surpluses and, by law, these surpluses have been "loaned" to the federal government, which is obligated to pay the money back with interest. **Paradoxically referred to as the "Social Security Trust Fund," this account showed a balance of \$2.2 trillion at the end of 2007.**

Here comes the rub. Following are projections extrapolated from "The 2008 Annual Report of the Board of Trustees of The Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds." Social Security is projected to continue having annual surpluses until 2017 at which point the federal government will owe \$3.5 trillion to the Social Security program. In 2017, the Social Security program is projected to start having annual deficits that will be covered by collecting on the money it has loaned to the federal government. **By 2041, it is projected that all of this money will be paid back and the Trust Fund will be exhausted.**

After 2041, Social Security is projected to have deficits every year into the foreseeable future. **To cover the shortfalls through 2082 (the "75-year unfunded obligation"), payroll taxes would need to be increased by 28% starting in 2041, rising to a 34% increase by 2082. This shortfall could also be covered by reducing benefits by 21% starting in 2041, increasing to a 24% reduction by 2082.**

As if these projections are not shocking enough, consider the following statement taken from the Clinton administration's 2000 budget: **"Social Security Trust Funds do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures."** A decade later, nothing has changed.

### In the Meantime – A Basic Q & A Are You Eligible?

Eligibility to receive Social Security retirement benefits requires both reaching a certain age and earning Social Security "credits." For those born in 1929 or later, you need 40 credits to qualify. Before 1978, employers reported earnings every 3 months and workers earned a "quarter of coverage" if they earned at least \$50 in a 3-month calendar quarter. After 1978, employers started reporting earnings just once a year so that credits are now earned based on "covered earnings." **To earn one Social Security credit in 2010 requires \$1,120 in covered earnings with a maximum of four credits earned per year. Thus, four credits can be earned during a single quarter of employment.**

Until the 1983 Social Security Amendments, the full retirement age had been 65. However, **as a result of the '83**

**Amendment, full retirement age or “normal retirement age” was adjusted for persons born in 1938 or later and now gradually increases until it reaches age 67 for people born after 1959.** Individuals can still elect to begin receiving Social Security retirement benefits at age 62 although the benefits are reduced. (See: How Much Will You Get?)

### **Spouses, Former Spouses and Widows**

Your spouse can collect Social Security benefits even if he or she never worked. The rules generally follow “covered” workers, in that a spouse can begin collecting at age 62 although the amount will be permanently reduced. **At full retirement age, a spouse can receive a benefit equal to one-half your full retirement amount.**

If you or your spouse is full retirement age, the options begin to get more complex. If you are full retirement age, you can apply for retirement benefits and then elect to have payments suspended. This election allows your spouse to receive a spouse’s benefit and you can continue to earn delayed retirement credits until age 70. **If your spouse has reached full retirement age and is eligible for both spouse’s benefit and his or her own retirement benefit, he or she has a choice.** For example, your spouse could choose to receive the larger of the two. Alternatively, he or she can choose to receive only the spouse’s benefit currently and delay receiving retirement benefits until a later date, thus continuing to earn delayed retirement credits. The only “right” alternative is to know the options and do the math.

**Ex-spouses can also receive benefits based on their spouse’s record if the marriage lasted 10 years or longer, the ex-spouse is unmarried and the ex-spouse is 62 or older.** Additionally, the benefit that the ex-spouse is entitled to receive based on his or her own work record

must be less than the benefit based on the spouse’s record and the spouse must be entitled to retirement benefits. If the spouse qualifies for but has not applied for benefits, the ex-spouse can claim benefits on the spouse’s record if they have been divorced for at least two years. By remarrying, the ex-spouse generally loses the right to claim benefits on his or her former spouse’s record.

**If you are the widow or widower of a person who worked long enough under Social Security, you can receive full benefits at full retirement age or reduced benefits as early as age 60.** Note that if the person who died was receiving reduced benefits (early retirement), the survivor’s benefit will be based on that amount.

### **How Much Will You Get?**

The amount of benefits to which you are entitled is not related to financial need, but is based on the income you have earned through years of working, both through jobs and self-employment. Social Security keeps a record of these earnings over your working lifetime and pays benefits based on the average of the highest 35 years of each worker’s covered earnings, known as his Primary Insurance Amount, or PIA. For those interested in the details of the benefit calculation, you may go to [www.socialsecurity.gov](http://www.socialsecurity.gov) and reference “Social Security Retirement Benefit Calculation” or, for those who prefer to retain their sanity, they can **use the “Retirement Estimator” which will access your earnings record and generate an estimate of your retirement benefits** comparable to the annual Social Security Statement you should already receive approximately three months before each birthday.

If you elect to begin collecting benefits at age 62 (assuming a year of birth between 1943 and 1954), the reduction from your full retirement benefit will be 25%. For those

born between 1955 and 1960, the reduction ranges from 25.8% (1955) to 30% (1960 and later). Conversely, benefits will increase automatically if you defer receiving benefits beyond your full retirement age. For example, if you were born in 1943 or later, benefits will increase by 8 percent per year for each year that you delay signing up for Social Security beyond your full retirement age, up to age 70.

### So When Should I Start Collecting?

Given the reduction in benefits for collecting early and the increases available for waiting until age 70, it might seem that everyone should wait until they can collect the maximum. Why, then, do the majority choose to begin collecting early? And what is the right choice? **Among the many factors to consider are when you will stop working, how much you have in savings, whether you are healthy, whether you are married or single and whether your spouse earns more or less.**

On a pure “break even” basis, it generally takes approximately 12 years, or until age 78, for someone deferring until full retirement age (66) to collect as much as if they had started getting checks at age 62. Thus, if you are in good health and expect to live to 78 or longer, the advantage goes to the person who waits.

However, **if the alternative to collecting early is incurring debt, depleting other savings, or being forced to sell a home or other asset, accelerating to age 62 may be the better choice.**

The decision-making process can be complicated with a large number of alternatives. **Critical to a sound choice is reviewing all the options and then**

**applying your personal facts and circumstances.**

### Can You Work and Collect Benefits?

For those who have reached full retirement age, they are entitled to receive all of their benefits, with no limit on earnings. However, **for those who are receiving Social Security benefits who have not reached full retirement age, there are two levels of earnings limits.** Up until the year you reach full retirement age, the earnings limit is \$14,160 with \$1 withheld from benefits for every \$2 earned above the limit. In the year you reach full retirement age, the limit is increased to \$37,680 with \$1 withheld from benefits for every \$3 over the limit until the month you reach full retirement age.

### Taxation of Social Security Benefits

Taxation of Social Security Benefits is implemented at two levels. Generally, 50% of benefits are taxable for single taxpayers with incomes over \$25,000 and joint filers with incomes over \$32,000. Legislation enacted in 1993 extended the taxable percentage from 50% to 85% for single taxpayers with incomes over \$34,000 and joint filers with incomes over \$44,000.

### GGM Provides a Helping Hand

The Q & A provided above answers only the most basic and frequently asked questions. Recognizing that unique personal circumstances often make these decisions seem overwhelming, **we at Grant/GrossMendelsohn stand ready to assist you in evaluating all the alternatives and integrating Social Security benefits into a comprehensive retirement plan.**

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