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Adviser's guide to social security : unlocking the mystery of retirement planning

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Elaine Floyd

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THE ADVISER'S GUIDE TO

SOCIAL SECURITY

UNLOCKING THE MYSTERY OF RETIREMENT PLANNING

Second Edition

AICPA®

Theodore J. Sarenski, CPA, PFS, CFP®
Elaine Floyd, CFP®

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About the AICPA Personal Financial Planning Division

The AICPA Personal Financial Planning (PFP) Division supports both the PFP Section and the Personal Financial Specialist (PFS) credential.

The PFP Section is the premier provider of information, tools, advocacy, and guidance for CPAs who specialize in providing estate, tax, retirement, risk management, and investment planning advice to individuals and closely held entities. The primary objective of the PFP Section is to support its members by providing resources that enable them to perform valuable personal financial planning services in the highest professional manner. PFP Section members broaden their technical expertise, improve their professional competence, and receive resources to deliver high-quality, profitable PFP services.

The PFS credential is the only comprehensive financial planning credential that is exclusive to CPAs. Whether a CPA specializes in personal financial planning with his or her clients or interacts with other financial planning professionals, the PFS credential adds credibility. The PFS credential allows CPAs to demonstrate the powerful combination of extensive tax expertise and comprehensive knowledge of financial planning. PFS credential holders have a specific experience, education, and examination requirement that sets them apart from other CPAs and financial planners.

AICPA PFP Executive Committee

The PFP Executive Committee supports the AICPA by providing its members with information, advocacy, and leadership to enable them to perform valuable PFP services in the highest professional manner. It strives to gain recognition by the public as the premier providers of PFP services. The committee also assists in developing public statements made by AICPA in the PFP area. It determines AICPA technical policies regarding PFP, and it serves as the AICPA's official voice on those matters.

For more information and education on many of the topics covered in this publication, visit the following online resources:

- PFP Web seminar archive, www.aicpa.org/InterestAreas/PersonalFinancialPlanning/CPEAndEvents/Pages/PFPWebArchivedSeminars.aspx
- Forefield Advisor http://www.aicpa.org/InterestAreas/PersonalFinancialPlanning/Resources/PracticeCenter/ForefieldAdvisor/Pages/ForefieldAdvisor.aspx
- Advanced PFP conference recordings, www.aicpa.org/InterestAreas/PersonalFinancialPlanning/CPEAndEvents/Pages/Upcoming percent20PFP percent20Conferences.aspx
- AICPA PFP Section, www.aicpa.org/InterestAreas/PersonalFinancialPlanning/Pages/default.aspx

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Theodore J. Sarenski, CPA/PFS, CFP®

Ted is the principal author of this guide. He is the president and CEO of Blue Ocean Strategic Capital, LLC (http://boscllc.com/). More than 30 years as a CPA and more than 20 years as a financial planner, plus extensive experience in individual taxation and estate planning, enable him to bring a dimension to wealth management not often found. In addition to working directly with clients, Ted is recognized locally and nationally as a financial planning expert. He speaks regularly at conferences across the country and appears weekly on local television. He serves as chair of AICPA's PFP Executive Committee Elder Planning Task Force and also is active in the New York State Society of CPAs. The AICPA PFP Division nominated him for the 2010 Distinguished Service Award for contributions to the profession. Ted feels strongly about the need for planning on elder related issues such as Social Security, end-of-life planning, and retirement income strategies. Contact Ted at http://boscllc.com.

Elaine Floyd, CFP®

Actual client concerns and adviser responses included throughout this guide are provided by Elaine Floyd, director of retirement and life planning for Horsesmouth, LLC (www.horsesmouth.com/), a New York–based company that provides training and professional development services for financial advisers. Previously, she was a financial adviser for a major wire house, having obtained

her CFP designation in 1986. More than 20 years ago, she began studying the Social Security system to unravel some of the mysteries of how benefits are calculated. Her findings have been compiled into the comprehensive package "Savvy Social Security Planning for Boomers," which includes a 190-page guide for financial advisers, a client seminar and script, and Microsoft Excel–based calculators that enable advisers to do Social Security scenario planning for clients. In addition to speaking and consulting on Social Security planning, she writes articles on financial planning for an audience of some 20,000 financial advisers. She has written several books and many articles on baby boomer retirement and has been quoted in the *Wall Street Journal*. Contact Elaine at www.horsesmouth.com.

AICPA PFP Executive Committee Elder Planning Task Force

The PFP Executive Committee Elder Planning Task Force provided the technical review of this guide. The task force is committed to identifying and educating CPA financial planners on the issues and decisions that face the aging public. Special thanks goes to the following task force members:

Dianne Odom – Michael Schulman – Reina Schlager – Ted Sarenski – Ralph Rolfe

AICPA Private Company Practice Section

AICPA Private Company Practice Section (PCPS) assisted with the editing for this guide. PCPS is a venue for CPA firms to harness business opportunities and overcome challenges in their firms. It provides a rich array of valuable information and resources for firms of all sizes in the area of practice management. PCPS members include more than 6,500 leading local and regional CPA firms across the country. Backed by this strength and influence, PCPS reaches out to ensure that its members' interests are taken into account by the profession, its regulators, and standards setters and, in turn, provides its members with practical guidance and quick access to critical information on issues that affect their firms' quality, professionalism, and profitability.

Preface

This guide is designed by CPAs for CPAs. Although many resources provide Social Security facts or advice, including those from the Social Security Administration (SSA), few are oriented towards professionals seeking to offer guidance to clients. As a CPA trusted adviser, you are in a unique position to assist clients with Social Security and other retirement benefit issues because of your unique understanding of a range of personal financial planning concerns, including taxation. Many clients of the Baby Boom generation will be retiring during the next 20 years and will be looking to their CPAs to assist them in optimizing their retirement financing. This guide should serve as a valuable tool to use in giving advice on Social Security benefits to clients who intend to collect Social Security benefits. Although some of the examples in this guide address concerns for people over age 60, it is best for clients to begin planning for retirement as soon as possible, regardless of their age.

How to Use This Guide

This guide is meant to be a practical resource that blends information and planning guidance in a way that allows you to "hear" clients asking relevant questions. Actual client questions and their respective responses were provided by advisers consulting with Elaine Floyd at Horsesmouth, LLC. You will also find plainly stated information, with references to specific SSA publications that can provide you with more in-depth details. The icon indicates important planning tips that will help you incorporate information from this guide into practice.

Please e-mail the AICPA Personal Financial Planning Division at financialplanning@aicpa.org with any questions, comments, or suggestions regarding this guide. Updates and additional content will be added as deemed necessary.

1

Background and Basics

General Statistics

According to a report by the Trustees of the Social Security program issued in 2012, 55 million people received some type of Social Security benefit in 2011, totaling $726 billion.

According to the Employee Benefit Research Institute, Social Security retirement benefits represent 40 percent of the income of all elderly people in the United States.

The poverty rate for those age 65 and older was 35 percent in 1960 and 9 percent in 2010. Without Social Security retirement benefits, the poverty rate for people age 65 and older in 2010 would have been 45 percent, according to the AARP Public Policy Institute.

Obviously, Social Security retirement benefits have become an integral financial consideration for most Americans. To effectively counsel clients, advisers must be aware of what the Social Security program can and cannot do. This chapter will provide some basic background information that will come in handy as you move into subsequent chapters on client planning concerns. Throughout the book, we'll frame many sections around questions that a client might ask, so that practitioners can easily find the answers to common concerns.

Should I Include Social Security in My Retirement Planning?

You must approach this question on a client-by-client basis. The continued viability of the Social Security program is a topic that has been and will continue to be discussed by politicians and regulators. Although an ideal retirement scenario would not *depend* on Social Security, based on the statistics, it should not be ignored. The authors of this guide cannot predict what the future holds, but the Social Security program is likely to continue as a source of some retirement income for baby boomers. From a planning perspective, any assumptions made about the impact of Social Security retirement benefits on when a client can retire should be conservative.

Every year, the government-appointed Social Security Board of Trustees releases a report on the financial outlook for the Social Security and Medicare trust funds. The *2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, available at www.socialsecurity.gov/OACT/TR/2012/tr2012.pdf, was released on April 25, 2012 and announced the following facts:

- The projected point at which the combined trust funds will be exhausted comes in 2033—three years earlier than the estimate in last year's report. At that time, there will be sufficient tax revenue to pay about 76 percent of benefits.
- The annual program cost is expected to exceed non-interest income in 2012, as it did in the two prior years, and remain higher thereafter. However, total income, including interest earnings on trust fund assets, is projected to be sufficient to cover annual cost until 2020.

There is no correct answer on how to include Social Security retirement benefits in planning. Ultimately clients must each make their own retirement planning decisions based on the level of comfort with the risks.

> **PLANNING TIP:** In retirement planning, consider including 100% of the calculated benefit for workers over the age of 55, 75% for those under 55, and possibly decreasing the percentage further for younger workers.

How Do I Apply for Social Security Retirement Benefits?

Clients can apply for Social Security retirement benefits online at www.ssa.gov by clicking on the button titled "Apply Online for Retirement Benefits" and following the instructions. You should let clients know that they cannot apply online more than four months prior to their 62nd birthday; that is, they cannot apply too far in advance. The following information appears on the application website:

You can file online if you:

- are at least 61 years and 9 months old;
- live in the United States, Puerto Rico, the U.S. Virgin Islands, Guam, the Northern Mariana Islands or American Samoa;

- are **not** currently receiving benefits on your own Social Security record;
- have not already applied for retirement benefits; **and**
- want your benefits to start no more than 4 months in the future.

Note: We cannot process your application if you file more than four months in advance.

It normally takes three to four months to begin receiving benefits after an application is made. If a client has a special consideration (that is, making a name change, applying for benefits on someone else's record, or using some of the strategies outlined in this manual), go to www.ssa.gov and click on "Social Security Office Locator." After entering his or her zip code, the client will be given the address, office hours, general directions, and a map to his or her nearest Social Security office.

Social Security Administration (SSA) Publication No. 05-10522, *Retire Online—It's So Easy*, available at http://ssa.gov/pubs/10522.html, is a helpful resource for clients. Local SSA offices are placing significant emphasis on online enrollment.

How Much of My Pre-Retirement Earnings Are Subject to Social Security Tax?

The maximum earnings subject to the Social Security program for 2013 is $113,700. The following chart displays the maximum taxable earnings from 1937–2013.

Maximum Taxable Earnings Each Year							
1937–50	$ 3,000	1978	$17,700	1990	$51,300	2002	$84,900
1951–54	3,600	1979	22,900	1991	53,400	2003	87,000
1955–58	4,200	1980	25,900	1992	55,500	2004	87,900
1959–65	4,800	1981	29,700	1993	57,600	2005	90,000
1966–67	6,600	1982	32,400	1994	60,600	2006	94,200
1968–71	7,800	1983	35,700	1995	61,200	2007	97,500
1972	9,000	1984	37,800	1996	62,700	2008	102,000
1973	10,800	1985	39,600	1997	65,400	2009	106,800
1974	13,200	1986	42,000	1998	68,400	2010	106,800
1975	14,100	1987	43,800	1999	72,600	2011	106,800
1976	15,300	1988	45,000	2000	76,200	2012	110,100
1977	16,500	1989	48,000	2001	80,400	2013	113,700

Source: www.socialsecurity.gov/planners/maxtax.htm.

The current Social Security tax rate (6.2 percent in 2013) is applied each year to the maximum earnings subject to the Social Security program. If a client has one employer, Social Security tax is withheld up to the maximum limit, and no tax is applied to or withheld for any additional income. In some cases, clients with multiple employers may have tax withheld up to the maximum from more than one job. The client would then apply for a refund of the overpaid Social Security tax on his or her personal income tax return filed the following year.

The Medicare portion of the Social Security payroll tax (1.45 percent in 2013) is applied to all wages. There is no maximum wage limit for this tax. An employer matches both the Social Security tax of 6.2 percent and the Medicare portion of 1.45 percent on each employee's wage. A self-employed person pays both the employee and the employer portion of these taxes. Their effective rates are 12.4 percent and 2.9 percent for the Social Security tax and Medicare tax, respectively. Beginning in 2013, the Patient Protection and Affordable Care Act imposes an additional 9 percent Medicare tax on single earned income in excess of $200,000 and joint earned income in excess of $250,000.

Special Consideration for 2011 and 2012

There was a 2 year, 2-percentage-point reduction in the employee portion of the Social Security tax in effect for 2011 and 2012. An employee's Social Security tax withholding was 4.2 percent, and a self-employed person paid 10.4 percent for these 2 years. The employer's match did not change and remained 6.2 percent. This reduction expired on December 31, 2012, at which time rates returned to 6.2 percent for employees and 12.4 percent for self-employed persons.

What Qualifies as Full Retirement Age

A client's full retirement age (FRA) is the age at which he or she qualifies to receive the entire or "full" Social Security retirement benefit based on his or her earnings history. This age varies based on when the client was born (see the following chart). Everyone who is qualified to receive Social Security retirement benefits can begin taking them as early as age 62 or delay up to age 70.

Clients beginning retirement benefits after age 62 but before FRA receive a reduced benefit computed as a percentage of what they would receive at FRA. The reduction is calculated by multiplying 0.55 percent by the number of months before FRA up to 36 months, plus 0.42 percent multiplied by the number of months before FRA for additional months beyond 36.

Clients who delay beginning Social Security retirement benefits beyond FRA earn delayed retirement credits (DRC) up to age 70. No additional credits are added after age 70. The DRC for those born after 1943 is 2/3 of 1 percent per month, or 8 percent per year, multiplied by the FRA benefit. The DRC is not compounded nor is DRC adjusted for the cost-of-living adjustment (COLA) between the ages of 66 and 70.

The following chart displays the FRA for various birth years.

Age to Receive Full Social Security Benefits	
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

Note: People who were born on January 1 of any year should refer to the previous year.
Source: www.ssa.gov/pubs/10035.html.

Is There a Limit on What I Can Earn Between Age 62 and FRA?

If a client has earned income between age 62 and FRA, he or she will be subject to an earnings test that may cause his or her Social Security retirement benefits to be reduced. If this happens, when the client reaches FRA, his or her Social Security retirement benefit will be recalculated upward to account for those months in which benefits are withheld.

For this purpose, earned income includes any wages from the client's employer and net earnings from self-employment. Other earnings such as pensions, annuities, or investment income do not affect the client's Social Security retirement benefits.

General Earnings Test

In 2013, a client who begins collecting Social Security retirement benefits after age 62 and before FRA may have earned income up to $15,120 without experiencing any reduction in benefits. His or her Social Security retirement benefits are reduced by $1 for every $2 of earned income beyond $15,120.

Earnings Test During the First Partial Year

Earned income prior to collecting benefits is not counted, and the earnings test is applied on a monthly basis ($1,260 per month) for the remainder of the first year.

Earnings Test in the Year FRA Is Reached

The earnings limit is increased to $40,080 before a reduction applies, and the reduction is $1 of Social Security retirement benefit for every $3 of earned income over the limit. The limit applies only to the months before reaching FRA. Starting with the month FRA is reached, the client can have unlimited earned income and still receive his or her full Social Security retirement benefits.

See SSA Publication No. 05-10003, *Update 2013*, available at www.ssa.gov/pubs/10003.html, for annual changes in the earnings limit.

ACTUAL CLIENT CONCERN: I am age 62 1⁄2 and will retire in a few months and begin receiving Social Security retirement benefits. I have an opportunity to do some independent contracting work for my former employer. My independent contractor income will be about $2,200 per month for the remainder of the year (4 months). I have been told that there is a Social Security monthly earnings test that allows maximum monthly earnings of $1,260 ($15,120/12). Will my Social Security retirement benefits be reduced because my monthly post-retirement self-employment income will be greater than $1,260 per month? Is the yearly maximum broken down to a monthly maximum? And will my earnings before retirement be counted toward the yearly maximum?

ADVISER RESPONSE: I'll answer your last question first. Under a special rule for the first year of retirement, the regular pre-retirement wages you earned before beginning to collect Social Security retirement benefits would not count in the earnings test. Now let's turn to the question of self-employment income. Once you begin collecting Social Security income, the earnings test is applied on a monthly basis at the rate of $1,260 per month. If your monthly earnings after retirement are $2,200 over 4 months, that adds up to $8,800. The monthly earnings maximum for four months adds up to $5,040 ($1,260 × 4). That means you are a total of $3,760 over the limit. The SSA would withhold one-half of that from your benefit ($1 for every $2 you earn). When you reach FRA, the benefit will be recomputed to remove the actuarial reduction for those 4 months. For more information on working in retirement, see SSA Publication No. 05-10069, *How Work Affects Your Benefits*, available at www.socialsecurity.gov/pubs/10069.html.

ACTUAL CLIENT CONCERN: How can the government take $1 for every $2 earned over my maximum earned income before FRA?

ADVISER RESPONSE: The earnings test assumes that people who earn a high income and aren't really "retired" don't need as much Social Security income. To discourage them from claiming early benefits, part of their benefits are withheld if they earn more than the earnings test amount. The earnings test used to apply to everyone under age 70 (with a higher amount after FRA). In response to complaints that it discouraged older people from working, the Senior Citizens' Freedom to Work Act in 2000 eliminated the earnings test for anyone over FRA.

How does it work? The SSA first asks people under FRA who are receiving benefits to estimate their earned income for the year. Let's say a person who is receiving $1,500 in Social Security retirement benefits plans to earn $30,000 this year. Subtract $15,120, which is the 2013 annual earnings limit, from the $30,000 anticipated earnings and you get $14,880 in excess compensation for the year. Divide $14,880 by 2 and you get $7,440 in withheld benefits. Rather than withholding the benefits proportionally each month, the SSA does not pay benefits for as many months as it takes to make up the $7,440. Dividing $7,440 by $1,500, you get 4.96. This means 5 months of benefits would be withheld, with the extra partial-month amount paid back the following January. After the year is over and actual earnings have been reported, any necessary adjustments will be made.

How Does the COLA Work?

The SSA's COLA is computed each year based on the Consumer Price Index for Urban Wage Earners and Clerical Workers from the third quarter of the prior year to the third quarter of the current year. This formula has been used since 1982. The COLA is then applied to Social Security benefits beginning in the next calendar year. The following chart shows the annual COLA adjustments for the past 37 years.

Automatic Cost-of-Living Adjustments			
July 1976	6.4%	January 1996	2.6%
July 1977	5.9%	January 1997	2.9%
July 1978	6.5%	January 1998	2.1%
July 1979	9.9%	January 1999	1.3%
July 1980	14.3%	January 2000	2.5%
July 1981	11.2%	January 2001	3.5%
July 1982	7.4%	January 2002	2.6%
January 1984	3.5%	January 2003	1.4%
January 1985	3.5%	January 2004	2.1%
January 1986	3.1%	January 2005	2.7%
January 1987	1.3%	January 2006	4.1%
January 1988	4.2%	January 2007	3.3%
January 1989	4.0%	January 2008	2.3%
January 1990	4.7%	January 2009	5.8%
January 1991	5.4%	January 2010	0.0%
January 1992	3.7%	January 2011	0.0%
January 1993	3.0%	January 2012	3.6%
January 1994	2.6%	January 2013	1.7%
January 1995	2.8%		

Source: www.socialsecurity.gov/cola/automatic-cola.htm.

2

Social Security Retirement Benefits

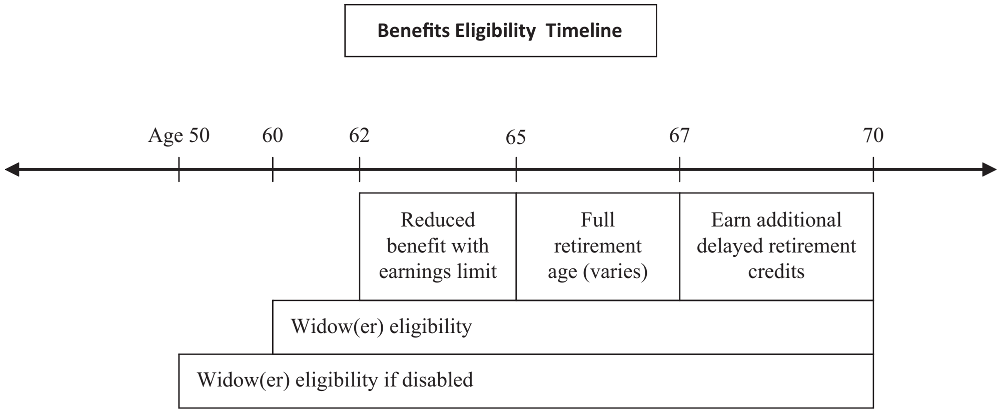
How Can I Qualify to Collect Social Security Benefits?

A client must have 40 quarters of coverage (QC) to fully qualify for Social Security retirement benefits. (It is possible to qualify with fewer QC if death or disability benefits are involved. To qualify for a QC in 2013, a client must earn $1,160 in the quarter. It is not possible to earn more than 4 QC in any one calendar year no matter how much the client earns in that year. Therefore, a client must earn at least $4,640 each year for 10 years to fully qualify at retirement for Social Security retirement benefits. The dollar amount of a QC is recalculated in October each year based on a set formula.

> **PLANNING TIP:** A client must have 40 QC to be fully insured for Medicare benefits as well. For some clients, qualifying for Medicare may be more important than qualifying for Social Security retirement benefits. For example, if the amount of the Social Security retirement benefits is fairly low, the client may be more concerned about qualifying for Medicare.

At What Age Can I Begin Collecting Social Security Benefits?

The following timeline illustrates when a client can become eligible for his or her Social Security retirement benefits.



The following chart displays the age, based on birth year, when a client can receive full Social Security retirement benefits. It also shows the reduction from full benefits at each age if the client starts benefits at age 62.

Year of Birth	Full Retirement Age	Payment Reduction % at Age 62
1937 or earlier	65	80.0%
1938	65 + 2 months	79.2%
1939	65 + 4 months	78.3%
1940	65 + 6 months	77.5%
1941	65 + 8 months	76.7%
1942	65 + 10 months	75.8%
1943–1954	66	75.0%
1955	66 + 2 months	74.2%
1956	66 + 4 months	73.3%
1957	66 + 6 months	72.5%
1958	66 + 8 months	71.7%
1959	66 + 10 months	70.8%
1960 and later	67	70.0%

PLANNING TIP: These reduction percentages apply to both the wage earner's benefit and the spousal benefit.

A widow or widower can begin collecting Social Security retirement benefits at any age if he or she is taking care of a deceased worker's child who is eligible for the children's benefit and is under age 16 or disabled. If the deceased worker does not have any children under age 16, then his or her widow or widower can begin benefits at age 60, or age 50 if the widow or widower is disabled. These same benefits are allowed to a divorced spouse if his or her marriage to the deceased worker lasted for at least 10 years and the divorced spouse did not remarry before age 60. (See section titled "Divorce" in this chapter and chapter 4, "Social Security Survivors Benefits," in this guide.)

> **PLANNING TIP:** Love may be in the air, but divorced clients who wish to remarry should consider how close they are to age 60 before tying the knot.

Unmarried children under age 18 who are in high school can receive Social Security retirement benefits on a deceased or disabled worker's retirement benefits. Children who are disabled before age 22 and will remain disabled can receive the worker's retirement benefits effective immediately and for the remainder of their lives. Also, dependent parents age 62 or older can receive Social Security retirement benefits on a disabled or deceased wage earner's record.

See chapter 3, "Social Security Disability Benefits," in this guide for a complete discussion of the benefit requirements for a disabled worker.

How Are Social Security Benefits Taxed?

According to Social Security Administration (SSA) Publication No. 05-10035, *Retirement Benefits*, available at www.ssa.gov/pubs/10035.html, about one-third of those who collect Social Security retirement benefits pay income taxes on them. To see if a client is subject to taxation, you must first determine his or her *combined income*, defined as adjusted gross income plus tax-exempt interest plus one-half of his or her Social Security retirement benefits. If that total combined income exceeds the amounts in the following chart, the portion of the client's Social Security retirement benefits will be taxable as shown in the following table.

	Percentage of Taxable Benefits	
Taxpayer who is …	*50%*	*85%*
Single or head-of-household	Over \$25,000	Over \$34,000
Married filing jointly	Over \$32,000	Over \$44,000

For those who are married and filing separately, 85 percent of the Social Security retirement benefits are fully taxable at any income level.

> **PLANNING TIP:** Remember that earnings on tax-exempt investments must be included in the calculation to determine the taxability of Social Security retirement benefits. Since that possibly makes them effectively taxable (to the extent they cause tax on Social Security retirement benefits), you may need to reconsider how a client should incorporate them in his or her portfolio. If the client uses them in his or her investment allocation, for example, you may need to recategorize these investments as taxable rather than tax free or even consider recommending that the client change investments.

How Can I Lower or Avoid Taxation of My Social Security Retirement Benefits?

The following suggestions focus solely on the taxation of Social Security retirement benefits. They should be considered in the context of the client's entire financial situation and may not be advisable given other factors in a client's personal income tax situation.

You should be aware that advance planning will help clients minimize taxation of their Social Security retirement benefits. It is best, in other words, not to put off planning until the client is at or near retirement so that you can employ the best possible strategies, including the following:

1. Delay receiving Social Security retirement benefits until age 70 and begin drawing from taxable individual retirement account (IRA) accounts or taxable annuities after age 59½.

   Benefit: Clients who wait past full retirement age (FRA) until age 70 to receive Social Security retirement benefits get an additional 8 percent per year in projected benefits (not indexed for inflation nor compounded). Drawing from a taxable IRA or taxable annuity as soon as possible can potentially help average out distributions to lower tax brackets before age 70 and will reduce the taxable IRA required minimum distribution (RMD) amount that begins at age 70½, thereby reducing the potential Social Security taxation.

2. Convert taxable IRAs to Roth IRAs before beginning to collect Social Security retirement benefits.

   Benefit: Conversion of taxable IRAs to Roth IRAs is now allowed for anyone at any income level. Converting to a Roth IRA will eliminate or reduce the RMD from taxable IRAs. Roth IRAs have no RMD requirement (nor are they taxable), which reduces potential Social Security taxation.

3. As an asset allocation strategy, consider investing a portion of taxable IRAs in fixed-income instruments and a portion of after-tax investments in equities.

   Benefit: This can reduce current taxable income (and thereby reduce potential taxation of Social Security benefits) because dividend yields are normally less than interest rates earned on fixed-income investments. The gains on equity investments held for a long term are only taxable once the investment is sold. In addition, equity investments qualify for a step-up in basis on death, which can mean avoiding capital gains tax altogether.
4. Sell significantly appreciated property before beginning to collect Social Security benefits (the property can be immediately repurchased if the client wants to retain it as the wash sale rule does not apply to gains).

   Benefit: An individual who would be liquidating assets in retirement anyway to supplement his or her income will reduce future taxable income and thus lower taxes on his or her Social Security benefits.
5. For longer-term non-IRA investments with taxable earnings that are being reinvested, consider using tax-deferred annuities, whether variable or fixed, to defer current taxability of the investment.

   Benefit: This suggestion also has a two-fold tax benefit. The growth in the annuity is tax-deferred, and the client can determine when withdrawals are made and taxes paid. This makes it possible to manage income in any given year and to minimize the amount of Social Security benefits subject to taxation.
6. Consider including tax preference items in the investment portfolio.

   Benefit: Real estate investment trusts, annuitizations, and hybrid annuitizations all feature cash flow that is only partially taxed. Depending on the investment, 60 percent to 80 percent of the distribution would be nontaxable because a portion of the income is a return of capital.

How Can I Find Out What My Social Security Benefit Will Be?

The SSA's Retirement Estimator, available at www.socialsecurity.gov/estimator/, is a benefits calculator that can be used to estimate a client's Social Security benefit. The estimator uses the client's actual Social Security earnings record, and it can be used as long as the client has the 40 QC and is not already receiving Social Security retirement benefits under his or her own or someone else's record or if he or she is subject to the Windfall Elimination Provision

(WEP). (See the section titled "Windfall Elimination Provision," in this chapter for more information on the reduction of benefits using the WEP.)

Until recently, the SSA sent statements to workers every year showing the benefits they would receive for retirement, death, or disability based on individual earnings history and projected future earnings. The statement also showed a worker's earnings record from his or her first employment to his or her most recently filed income tax return earnings.

This information is now available at www.ssa.gov/myaccount. Once users create a "my Social Security" account, they can view their personal Social Security statement at any time.

> **PLANNING TIP:** Mistakes in the earnings record are best corrected as soon as possible. Clients can use their earnings statements to verify the need for adjustments. If the earnings record is not verified periodically, suggest that clients keep Form W-2 or other earnings records (such as Schedule K-1) for the length of their work life so they can verify earnings history should questions arise when they apply for Social Security benefits.

How Are My Social Security Benefits Calculated?

Although the SSA is responsible for calculating benefits, it is helpful for you to know the basics of how the calculation works to understand how an additional year of earnings will affect a client's projected benefit. Also, certain income allocation situations exist in which this background knowledge could be helpful.

The actual computation to determine a client's Social Security retirement benefits involves a two-step process. First, you must compute the average indexed monthly earnings (AIME). Then, you can compute the primary insurance amount (PIA) based on the AIME.

How Are AIME Determined?

For each year in which a person has taxed Social Security earnings, those earnings are indexed to bring each of those prior year's earnings to near-current wage levels (basically adjusting for inflation). Each prior year's index is different and is computed by dividing the national average wage index for the year the client attains age 60 by the average wage index for each prior year. The index used for the year a person attains age 60 and each year after is 1.0. The resulting index factor is then multiplied by the person's actual earnings for that particular year to bring earnings up to the indexed earnings amount. For example, based on the following table, if a client's earnings record for 1984 showed $15,610 of taxed Social Security earnings, an index factor of 2.6637 would be used to calculate an inflation-adjusted earnings amount of $41,581 ($15,610 × 2.6637) in 2013. This same calculation is done for each prior year.

The highest 35 years indexed earnings are then added together and divided by 420, the number of months in a 35-year period, to arrive at AIME. If a person has less than a 35-year history when he or she reaches age 60, the indexing is calculated as described in the previous paragraph, added together, and then divided by the months in the number of years in the calculation.

The following is an example from the SSA website that computes the AIME for two different people.

Earnings Before and After Indexing						
	Case A, born in 1950			*Case B, born in 1946*		
Year	*Nominal Earnings*	*Indexing Factor*	*Indexed Earnings*	*Nominal Earnings*	*Indexing Factor*	*Indexed Earnings*
1973	$7,087	5.6700	$40,183*	$10,800	5.3304	$57,569*
1974	7,532	5.3519	40,310*	13,200	5.0313	66,414*
1975	8,121	4.9797	40,440*	14,100	4.6815	66,009*
1976	8,708	4.6583	40,564*	15,300	4.3793	67,003*
1977	9,259	4.3949	40,692*	16,500	4.1317	68,173
1978	10,026	4.0716	40,822	17,700	3.8277	67,751*
1979	10,936	3.7440	40,945	22,900	3.5198	80,604
1980	11,958	3.4347	41,072	25,900	3.2290	83,630
1981	13,203	3.1205	41,201	29,700	2.9337	87,129
1982	13,972	2.9577	41,325	32,400	2.7806	90,091
1983	14,698	2.8203	41,453	35,700	2.6514	94,655
1984	15,610	2.6637	41,581	37,800	2.5042	94,659
1985	16,324	2.5549	41,706	39,600	2.4019	95,114
1986	16,860	2.4812	41,834	42,000	2.3326	97,971
1987	17,989	2.3325	41,959	43,800	2.1928	96,044
1988	18,932	2.2230	42,086	45,000	2.0899	94,044
1989	19,741	2.1383	42,213	48,000	2.0103	96,493
1990	20,715	2.0439	42,340	51,300	1.9215	98,573
1991	21,552	1.9705	42,468	53,400	1.8525	98,922
1992	22,730	1.8739	42,595	55,500	1.7617	97,775
1993	22,993	1.8580	42,720	57,600	1.7467	100,609

(*Continued*)

Earnings Before and After Indexing						
	Case A, born in 1950			Case B, born in 1946		
Year	Nominal Earnings	Indexing Factor	Indexed Earnings	Nominal Earnings	Indexing Factor	Indexed Earnings
1994	23,680	1.8094	42,847	60,600	1.7010	103,082
1995	24,702	1.7397	42,973	61,200	1.6355	100,091
1996	25,987	1.6586	43,101	62,700	1.5592	97,763
1997	27,584	1.5671	43,227	65,400	1.4733	96,351
1998	29,113	1.5671	43,354	68,400	1.4000	95,759
1999	30,825	1.4106	43,481	72,600	1.3261	96,273
2000	32,625	1.3366	43,608	76,200	1.2566	95,752
2001	33,500	1.3055	43,734	80,400	1.2273	98,676
2002	33,934	1.2925	43,861	84,900	1.2151	103,164
2003	34,864	1.2617	43,988	87,000	1.1861	103,193
2004	36,590	1.2056	44,115	87,900	1.1334	99,629
2005	38,038	1.1631	44,242	90,000	1.0934	98,409
2006	39,900	1.1120	44,368	94,200	1.0454	98,475
2007	41,830	1.0637	44,495	97,500	1.0000	97,500
2008	42,914	1.0398	44,621	102,000	1.0000	102,000
2009	42,387	1.0557	44,748	106,800	1.0000	106,800
2010	43,512	1.0313	44,875	106,800	1.0000	106,800
2011	45,002	1.0000	45,002	106,800	1.0000	106,800
2012	46,876	1.0000	46,876	110,100	1.0000	110,100
		Highest-35 total	1,505,835		Highest-35 total	3,391,104
		AIME	**3,585**		**AIME**	**8,074**

Source: www.ssa.gov/oact/progdata/retirebenefit1.html

* The indexed earnings with an asterisk are the five lowest years in the last forty that are dropped when using the top 35 years.

Note: Nominal earnings for case B are limited by the contribution and benefit base for all years (see www.socialsecurity.gov/OACT/COLA/cbb.html). Case B is an example of a person who has earned at or above the maximum taxable amount in each year.

What Is the PIA?

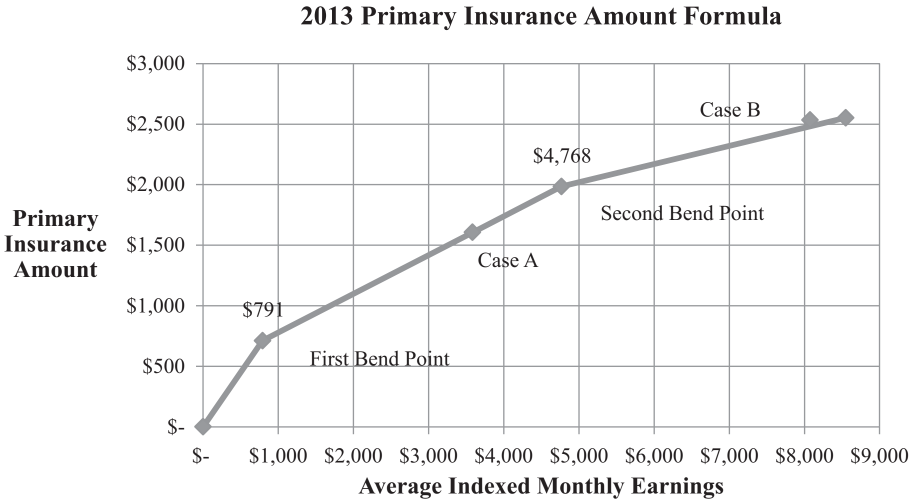
The PIA is the monthly benefit a person would begin receiving at FRA. The benefits formula has three tiers, separated by two "bend points" whose levels are determined for the year in which a person attains age 62. They are called bend points because a graph of the benefits calculation would have a bend in the line at these two points as subsequently shown. Each year, the bend points are adjusted based on average wage indices.

The three-tiered PIA formula is illustrated as follows.

Primary Insurance Amount (PIA) Calculation	Examples From Previous Average Indexed Monthly Earnings (AIME) Table			
	Case A		Case B	
	2013 Bend Points	PIA	2009* Bend Points	PIA
90% of AIME amount up to the first bend	$ 791	$ 712	$ 744	$ 670
First bend	$ 791		$ 744	
32% of AIME amount between the two bends	$3,977	$ 894	$3,739	$ 1,196
Second bend	$4,624		$4,288	
15% of AIME amount over the second bend	n/a	—	Excess over $4,483	$ 539
Calculated PIA		$1,606		$2,405†
AIME amounts	$3,585		$8,074	
PIA as % of AIME		44.8%		29.8%

* Bend points used in the PIA calculations are from the year of initial eligibility.

† Final PIA is $2,533 (31.3 percent of AIME) after adjustment for cost-of-living adjustments between 2009 and 2013.



Using the AIME from the SSA website for Case A and Case B, the resulting PIA would be $1,606 and $2,533, respectively. The maximum monthly benefit for a person at FRA in 2013 is $2,533. As this example illustrates, lower earners receive a greater percentage of their pre-retirement income than higher earners. The computed benefit as a percentage of the AIME for the lower earner (Case A) is 44.8 percent, while the higher earner (Case B) receives only 31.3 percent of the AIME as a monthly benefit. This illustrates that for higher wage earners, particularly those over the Social Security wage base, Social Security benefits will replace a much smaller percentage of wages.

The PIA is indexed for inflation between the time a person reaches age 62 and the time he or she reaches FRA. If the person works past age 62 and earns more than he or she did in any one of his or her earlier top 35 years of earnings, his or her PIA will go up. If the person earned less than any of the top 35 years, the PIA would not decline.

PLANNING TIP: Spouses who have the flexibility to allocate income between them, such as self-employed couples or those involved in a closely held business, can use the bend points in the PIA formula and the AIME to determine the best allocation of income between them to maximize their benefit as a percentage of income. For example, they could choose to maximize one spouse's income at the Social Security wage base, or alternatively, equalize both spouses under the wage base to get the highest percentage of income replaced by the Social Security retirement benefit.

Example

Assume a couple operates a small business with a bottom line profit of $120,000, and the husband and wife can allocate that income any way they wish between each other. The following two scenarios illustrate their options.

1. Maximize one spouse at $113,700 each year, and give the other spouse a wage of $6,300.

	Spouse 1	*Spouse 2*	*Total*
$6,300 *salary results in* average indexed monthly earnings (AIME) of $525 with a primary insurance amount (PIA) of ...	$ 473		
$113,700 salary results in AIME of $9,475 with a PIA of $2,691, but in 2013 is maxed at...		$2,533	
Total Social Security Retirement benefit	**$ 473**	**$ 2,533**	**$ 3,066**
Social Security Retirement benefit using spousal benefit	**$1,267**	**$ 2,533**	**$ 3,800**

2. Equalize each spouse at $60,000 of salary each.

	Spouse 1	*Spouse 2*	*Total*
$60,000 *salary results in* average indexed monthly earnings of $3,685 with a primary insurance amount of ...	**$1,638**	**$1,638**	**$3,276**

Based on each spouse's own Social Security benefit, it would appear the second scenario is better. However, if the lower earning spouse in the first scenario elects a spousal benefit, then the first scenario looks much better if both spouses live happily into old age. The second scenario would be better for a young couple if one spouse became disabled or died. Survivors benefits would be much larger with the second scenario compared with the first scenario.

The resulting conclusion is that no one right answer exists and each situation needs to be examined independently to determine the best outcome.

ACTUAL CLIENT CONCERN: What happens if I retire and start collecting Social Security retirement benefits but then go back to work later on? Can I stop taking benefits, then collect again when I am finished with the second career? Would my benefits increase because of my additional years worked or is my payment fixed (plus the cost-of-living adjustment [COLA]) once I start collecting the first time?

ADVISER RESPONSE: The answer depends on whether you are under or over your FRA. If you are under FRA and collecting reduced benefits, you don't need to do anything. Your benefit would be withheld as appropriate, and when you reach FRA, your benefit would automatically be recomputed to remove the actuarial reduction from those withheld months (due to excess earnings before FRA).

If you are over FRA when you initially apply, you may at any time ask to have your benefits suspended. Why would you want to do this? Even though you are not subject to the earnings test and therefore would not have any benefits withheld, you may want to earn delayed retirement credits (DRCs). Suspending your benefits would enable you to earn 8 percent DRCs up to age 70. The option to voluntarily suspend benefits in order to earn DRCs was authorized by the Senior Citizens' Freedom to Work Act of 2000 and is described in the Social Security Program Operations Manual System (POMS) section GN 02409.100, "Voluntary Suspension," available at https://secure.ssa.gov/apps10/poms.nsf/lnx/0202409100!opendocument.

It is also possible to increase your benefit by improving your earnings record, even after you've started receiving your benefit (or if you are delaying). You'll remember that the benefit is based on the highest 35 years of earnings. If you earn enough to knock off one of your zero- or low-earning years, your benefit may go up by a few dollars.

ACTUAL CLIENT CONCERN: I am a retiree who plans to start collecting benefits at age 62. I will then do some consulting work for about $40,000 a year, which I know would reduce my benefits on the amount in excess of the $15,120. How do the benefits reductions that are credited back to my Social Security retirement benefits actually affect my income when I finally do retire? What factors should be most important in this decision?

ADVISER RESPONSE: Let's review the mechanics of how the earnings test works. First, if you start collecting benefits at 62, your benefit will be reduced by 25 percent. Let's say the PIA is $2,000, so the benefit will be $1,500. When you apply, and each year thereafter (until FRA), you will be asked if you plan to work and how much you intend to earn. If you plan to earn more than the earnings test amount ($15,120 in 2013), the reduction will be $1 in benefits for every $2 earned over the threshold. So if you plan to earn $40,000, the SSA would subtract $15,120 and divide by 2 to get $12,440. Dividing $12,440 by $1,500, you find that your benefit would be withheld for 9 months. If this went on for the 4 years from age 62 to 66, your benefit would be recomputed at age 66 to credit back those months in which you did not receive a check, approximately 36 out of the 48 months in this case. That would raise your benefit to about 93 percent of the PIA, or $1,860, not counting COLAs.

The formula for your Social Security retirement benefit does not discourage you from working because the re-computation at FRA restores part or even all of your benefit. You are not penalized for earning $40,000 after retiring; rather, it's as if you had waited until close to FRA to initially apply for benefits. However, the one thing you miss is the opportunity to earn delayed retirement credits. The only way to earn DRCs is to apply at FRA or later. If you have already applied for early retirement benefits, you can withdraw the application within 12 months from the month when benefits were first received, repay the benefits you have received during that time (which wouldn't amount to very much, since so much was withheld), and reapply for benefits later.

For more information, see SSA Publication No. 05-10069, *How Work Affects Your Benefits*, available at www.ssa.gov/pubs/10069.html.

PLANNING TIP: Don't let clients lose out on delayed retirement credits. The bottom line for anyone who would have all or most of his or her benefits withheld due to the earnings test is that it is easier to wait until FRA or later to apply. For married workers, waiting also increases survivors benefits, so even if the worker dies before collecting the increased benefit, his or her spouse will receive a higher benefit.

Client Planning Ideas

Timing of Application for Social Security Benefits

Clients should apply at least four months before the date they wish to begin receiving Social Security benefits. The SSA will only pay six months in arrears on benefits claims.

Strategies on When to Begin Social Security Retirement Benefits

Social Security retirement benefit strategies are based on statistics, averages, life expectancy tables, and return assumptions. Each client's individual circumstances must be taken into account when offering advice or suggesting a particular strategy. Other factors to consider not included in this guide are the client's health, family health history, financial need, earnings potential from age 62 to FRA, marital status, and other retirement assets or income sources.

Decisions for Individuals

Should I start collecting benefits at age 62 or wait until FRA (assuming age 66)? A client who begins Social Security benefits at age 62 will receive 75 percent of the projected benefit he or she would receive at FRA. The difference in benefit is permanent. The breakeven point, where the total dollars received by waiting to age 66 begin to exceed total dollars received by beginning at age 62, is approximately age 77. Life expectancy tables show that a person who has attained age 62 will live to be 85.5, and a person who has attained age 66 will live to be 86.2. Keep in mind, also, the difference in benefits is also compounded because future benefits grow by the COLA. That means that a client beginning Social Security benefits at age 62 is also giving up COLA increases on the missing 25 percent. COLA increases have averaged 4.17 percent in the 37 years since it was made permanent in 1975. Using an inflation factor of 2 percent, a $250 difference in monthly benefit today, at age 62, will grow to a $333 difference in monthly benefit by age 95.

Suggestion: Wait until FRA to begin Social Security retirement benefits.

Exceptions: If the client is physically unable to work beyond age 62, in poor health, or does not have other sources of income.

Should I start at FRA (age 66) or wait until age 70? A client who continues to delay receiving Social Security retirement benefits beyond FRA receives an 8 percent per year increase in benefits that is not compounded; however, the COLA would be applied and compound annually. Waiting to age 70 will increase the client's benefit by 32 percent above what he or she would receive if the client began at age 66. The breakeven point, where the total dollars received by waiting to age 70 begin to exceed total dollars received by beginning at age 66, is approximately age 81. Life expectancy tables show that a person who has attained age 66 will live to be age 86.2, and a person who has attained age 70 will live to be 87.

Suggestion: Wait to age 70 to begin Social Security retirement benefits. This suggestion takes on added significance when consulting a married couple. See survivors chapter 4 for more information about survivors benefits.

Exceptions: Since the breakeven point is age 81, if most people in the client's family history do not live much beyond their early 80s, it may be not be very advantageous to wait.

Social Security retirement benefits are *not* retroactive. This is an important risk consideration for clients who opt to delay receiving Social Security retirement benefit payments. An untimely death during the delay will leave a surviving spouse or estate with no value in-hand for the years Social Security payments were not taken.

Example

Joe delays Social Security retirement benefits to age 70 to obtain the future projected higher benefit. He dies at age 69. Without considering COLA adjustments and the opportunity cost of lost earnings, the following table illustrates the value in-hand that this strategy gave up.

Age Benefits Could Have Begun	*Monthly Benefit*	*Accumulated Benefit at Death at Age 69*
Age 62	$1,700	$142,800
Age 66	$2,266	$ 81,576

If the risk of loss of value is a concern, one solution might be to verify a client has life insurance coverage for this amount through age 70.

Decisions for Couples

When can or should my spouse begin taking the spousal benefit? A non-working spouse can collect a spousal benefit (half of the worker's benefit) based on the earnings of his or her working spouse when the worker applies for his or her own benefit. (The worker does not need to start collecting; he or she could defer personal benefits.) Working spouses can collect a spousal benefit when their spouse applies for benefits if half of their spouse's benefit is greater than their own benefit at their attained age.

> **ACTUAL CLIENT CONCERN:** Can my spousal benefit be reduced by the earnings test?
>
> **ADVISER RESPONSE:** Yes, spousal benefits (and survivors benefits) are subject to the earnings test and are based on the earnings of the person receiving the benefits. So spousal benefits would be affected by the spouse's earnings, and the worker's benefits would be affected by the worker's earnings.

Can or should my spouse begin receiving benefits before I do (using *file and suspend*)? A worker who wishes to wait until age 70 to begin collecting benefits would disqualify his or her spouse from collecting spousal benefits until that time. Recognizing this, the SSA developed a method for the non-working or lower-earning spouse to begin a spousal benefit before his or her working spouse collects his or her own benefit at age 70. *File and suspend* allows the working spouse to file for Social Security retirement benefits at FRA and then immediately suspend receiving his or her own benefit so it can accumulate the additional 8 percent per year to age 70. Because one spouse filed, though, the nonworking or lower-earning spouse can collect the spousal benefit on the worker's earnings record at the worker's FRA value. Spousal benefits do not accrue additional DRCs if the worker waits beyond FRA for the nonworking or lower-earning spouse. Spousal benefits also do not reflect the worker's benefit increases from age 66 to age 70.

> **PLANNING TIP:** With the 2013 FRA, the file and suspend provision is only beneficial with a spousal benefit if the lower earner is either older than or less than eight years younger than the high wage earner. The smaller the difference in ages, the bigger the benefit.

PLANNING TIP: The high earner would likely not want to file and suspend before his or her FRA, as the early benefit reduction percentage would be applied against the deferred benefit he or she takes at age 70.

Assuming the Social Security retirement benefit is not needed, the file and suspend option should be used in most situations with a wage earner and a nonworking spouse. It should also usually be used when the lower-earning spouse's lifetime earnings are significantly less than the higher-earning spouse's.

ACTUAL CLIENT CONCERN: I will turn 66 in September. My wife is 64 and has already filed for her retirement benefit based on her work record. I want to delay taking benefits until age 70. Can I file and suspend now and draw spousal benefits based on my wife's work record?

ADVISER RESPONSE: There is no need to file and suspend. It is used to allow a spouse to collect spousal benefits on the other spouse's earnings record when he or she wishes to delay retirement benefits past FRA. That is not necessary in your situation. You need only file for spousal benefits at this time (since your wife has already filed for her benefit) and wait until age 70 to begin your own benefit.

ACTUAL CLIENT CONCERN: I have delayed applying for my own Social Security benefit (I will be turning 66 in a few months) and tried to apply for a spousal benefit on my spouse's record (she turned 66 last year and has been receiving her own benefit). The representative at the Social Security office told me that I could not do this, as I was eligible to receive my own benefit. What do you recommend in this situation? Is there a particular ruling or bulletin that I could reference with the Social Security representative?

ADVISER RESPONSE: Choosing between your own higher benefit and a lower spousal benefit can be confusing decision, even for Social Security representatives who might not familiar with all of the regulatory details. The following references will help a high earner (or anyone) to claim his or her spousal benefit at FRA and delay his or her own benefit in order to build DRCs.

- The SSA "Benefits for Your Spouse" website, www.ssa.gov/retire2/yourspouse.htm, states the following:

If your spouse has reached full retirement age and is eligible for a spouse's benefit and his or her own retirement benefit, he or she has a choice. Your spouse can choose to receive only the spouse's benefit now and delay receiving retirement benefits until a later date. If retirement benefits are delayed, a higher benefit may be received at a later date based on the effect of delayed retirement credits.

- The POMS, which is the reference source used by Social Security personnel, also supports the strategy. Section GN 00204.004(B), "Considering Possible Entitlement to Retirement Insurance Benefits (RIB) when a Spouse's Application is Filed," states in part that "a spouse claimant at or past Full Retirement Age (FRA) has the right to restrict the application to exclude RIB." See https://secure.ssa.gov/apps10/poms.nsf/lnx/0200204004!opendocument. In addition, Section GN 00204.020(D)(1), "Scope of the Application," states the following:

A claimant may choose to limit or restrict the scope of the application to exclude a class of benefits he/she may be eligible to on one or more SSNs for any reason (except where deemed filing applies). The reason may be to receive higher current benefits or to maximize the amount of benefits over a period of time (see GN 00204.042), including the effect of delayed retirement credits (DRCs).

See https://secure.ssa.gov/apps10/poms.nsf/lnx/0200204020. In October 2010, this option was confirmed with the SSA Press Office, which emphasized that when a client applies, he or she must make it clear that he or she is "restricting" the application to the spousal benefit only. If necessary, you should tell the Social Security representative that you are not applying for your own benefit at this time. Otherwise, you may be told that your own benefit is higher and that you must take it. Many articles other articles reinforce this strategy.

- The article "Strange But True: Claim Social Security Now, Claim More Later," by Alicia Munnell of the Center for Retirement Research at Boston College, discusses having a high-earning spouse claim the spousal benefit at 66 and delaying his or her own benefit to 70. See http://crr.bc.edu/briefs/strange_but_true_claim_social_security_now_claim_more_later.html.

ACTUAL CLIENT CONCERN: My spouse (Jill) and I (Jack) are virtually the same age and have basically the same PIA. Can we both file and suspend our own benefits, then each apply for our respective spousal benefits, allowing us each to collect some sort of benefit while we both delay starting our own Social Security benefits?

ADVISER RESPONSE: According to Dorothy Clark in the SSA Press Office, both spouses cannot claim spousal benefits on the other's record.

When a person files for both retirement and spouse's benefits at or after FRA and elects to suspend the retirement benefit to earn DRCs, he or she will receive only the excess payable on the spouse's record. The spouse benefit will be paid as if the retirement benefit was also being paid. Since their PIAs are basically the same, their own retirement benefit will exceed 50 percent of the other's PIA and no spousal benefits are payable to either. This is generally the result when both have basically the same PIA and both file and suspend their own benefits.

On the other hand, it is more advantageous if one files and suspends their own benefits and the other files on the same record, restricting the application to spouse's benefits, and delays filing for retirement benefits. For example, Jill files and suspends her own benefit to earn DRCs. Jack can file and restrict his application to spouse's benefits on Jill's record and receive 50 percent of Jill's PIA. At age 70, Jack can file for retirement benefits on his record and enjoy higher monthly payments because of his DRCs. Jill's suspended benefit would automatically be resumed at age 70 (unless she requests it sooner).

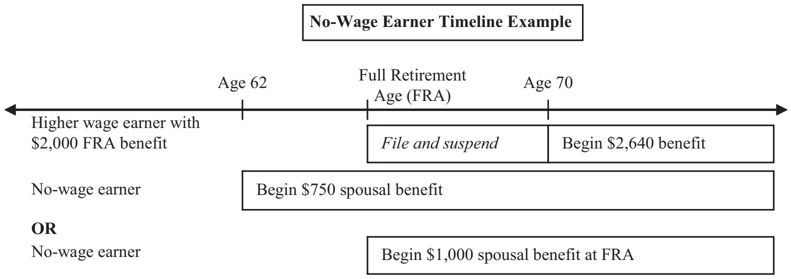
Simply put, if you file and suspend, Jill can claim her spousal benefit. At FRA, she may restrict her application to her spousal benefit so that her own benefit earns DRCs. She is entitled to her spousal benefit since you have filed for (and suspended) your own benefit. But now you can't claim your spousal benefit because you have already filed for your own benefit, even though it was voluntarily suspended.

PLANNING TIP: When working with two high-earning spouses of equal ages who each want to delay benefits to age 70 in order to earn DRCs, your best course of action is to help them decide which spouse should claim the spousal benefit at FRA. Since no couple will be the exact same age and have the exact same PIA, the answer will be different for each couple.

What if my spouse does not have an income? If one spouse has no earnings (and no benefit of his or her own), the wage earner should file and suspend and then the non-wage earner can apply for the spousal benefit. The earliest this can be done is after the non-wage earner reaches age 62 and the wage earner is at FRA or later.

Because this is the benefit that the non-wage earner will receive for the remainder of his or her life (unless predeceased by the wage earner), it is necessary to decide whether to take the reduced spousal benefit at age 62 or the full spousal benefit at FRA. (See the discussion in the section titled "Decisions for Individuals" in this chapter.)

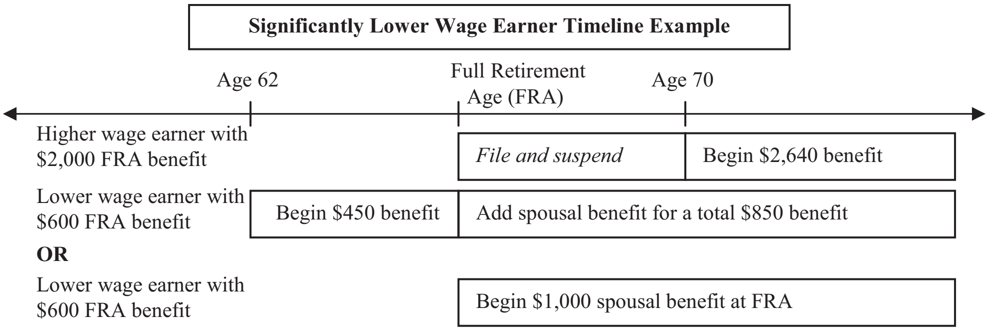
Regardless, when the wage earner starts collecting his or her higher deferred benefit (no later than age 70), the spousal benefit is not adjusted. It continues to be based on the wage earner's FRA benefit, not the higher deferred benefit.



What if my spouse and I both have earnings records? If the lower earner's earnings are significantly lower, and if the lower earner's reduced or FRA benefit is less than the spousal benefit he or she would receive from the higher earner's FRA benefit, then the lower earner should begin his or her benefits at age 62. The higher earner should file and suspend at FRA. The lower earner can potentially step up to a higher spousal benefit at that time or when the lower earner attains his or her FRA.

Example

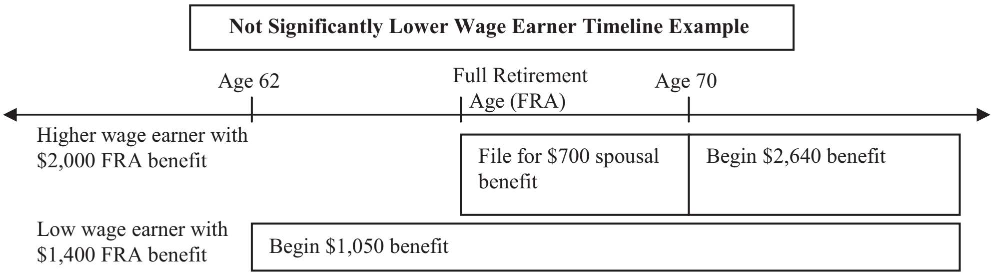
John, the lower wage earner, has a projected monthly benefit at FRA of $600. Jane, the higher wage earner, has a projected monthly benefit at FRA of $2,000. John begins collecting his own benefit at age 62 and receives $450 per month ($600 × 0.75). Jane files and suspends at FRA. When John reaches FRA, he switches to spousal benefits and receives an increase in monthly benefit of $400 (half of his spouse's FRA benefit of $2,000 less his own FRA benefit of $600). John is then receiving a monthly benefit of $850 (his original reduced benefit of $450 plus the additional spousal benefit of $400). Jane begins her enhanced benefit of $2,640 per month at age 70. (COLA adjustments have been ignored in this example for ease of illustration.)



If the lower earner's earnings are not significantly lower, then the lower earner should begin his or her own benefit at age 62. The higher earner should begin spousal benefits on the lower earner's record at FRA, waiting to apply for his or her own benefit until age 70.

Example

Sally, the lower earner, has a projected monthly benefit at FRA of $1,400. Jim, the higher earner, has a projected monthly benefit at FRA of $2,000. Sally begins her own benefit at age 62 and receives $1,050 per month ($1,400 × 0.75). Jim files for spousal benefits on Sally's earnings at FRA and begins receiving a benefit of $700 per month (half of $1,400). Jim begins his enhanced age 70 benefit of $2,640 per month at age 70. Jim's enhanced benefit is not reduced because he waited until FRA to begin the spousal benefit. (COLA adjustments have been ignored in this example for ease of illustration.)



An individual cannot file and suspend while collecting a spousal benefit; he or she must choose one or the other. When working with married clients, in situations in which one spouse has no earnings or the lower earner's earnings are significantly lower, recommend using file and suspend to provide the much-lower-earning spouse an increase in monthly benefit using the spousal benefit. However, when the lower earner's earnings are not significantly lower, recommend that the higher-earning spouse wait to apply for his or her own benefit until age 70. Using file and suspend for this situation would not offer the lower-earning spouse any increase in monthly benefit and would also prevent the higher-earning spouse from receiving a spousal benefit.

It is important to note that when the lower earner's earnings are not significantly lower, as the high earner reaches FRA, he or she would *not* file and suspend, but instead would apply only for the spousal benefit. This is an important but often misunderstood point. Once again, the client must specify to the SSA that the he or she is applying only for the spousal benefit if he or she wants to earn DRCs after FRA.

ACTUAL CLIENT CONCERN: I am taking a spousal benefit. It is my understanding that I can later elect to take my own full benefit. Where can I find that rule in the Social Security benefit rule book?

ADVISER RESPONSE: You are correct. As someone who is receiving a spousal benefit, you can change to your own benefit—as long as the spousal benefit starts at your FRA or later. The SSA's "Benefits for Your Spouse" website, www.ssa.gov/retire2/yourspouse.htm, states the following:

If your spouse has reached full retirement age and is eligible for a spouse's benefit and his or her own retirement benefit, he or she has a choice. Your spouse can choose to receive only the spouse's benefit now and delay receiving retirement benefits until a later date. If retirement benefits are delayed, a higher benefit may be received at a later date based on the effect of delayed retirement credits.

ACTUAL CLIENT CONCERN: My husband is age 60. If he waits to collect spousal benefits until *he* is age 66, what will he receive? Will it be 50 percent of my reduced Social Security retirement benefits at my age 62? Or 50 percent of my full-retirement-age PIA when he turns 66? I understand he would get 50 percent, but I don't know what I am figuring that on if I have already begun receiving Social Security retirement benefits.

ADVISER RESPONSE: The amount of the spousal benefit depends on when *he* applies. It is based on your (the working spouse's) PIA. This is the benefit you would receive had you waited until age 66 to apply. The benefit you (as the worker) are currently receiving is not relevant to the spousal benefits formula.

So, for example, say a husband and wife are both age 62. The wife has a PIA of $2,230. This means if she applies at age 66, her benefit will be $2,230 (not counting COLAs). If she applies now, she will receive a reduced benefit of $1,673. If her husband waits until age 66 to apply for his spousal benefit, he will get 50 percent of $2,230, or $1,115.

The following example illustrates how complex various combinations can be.

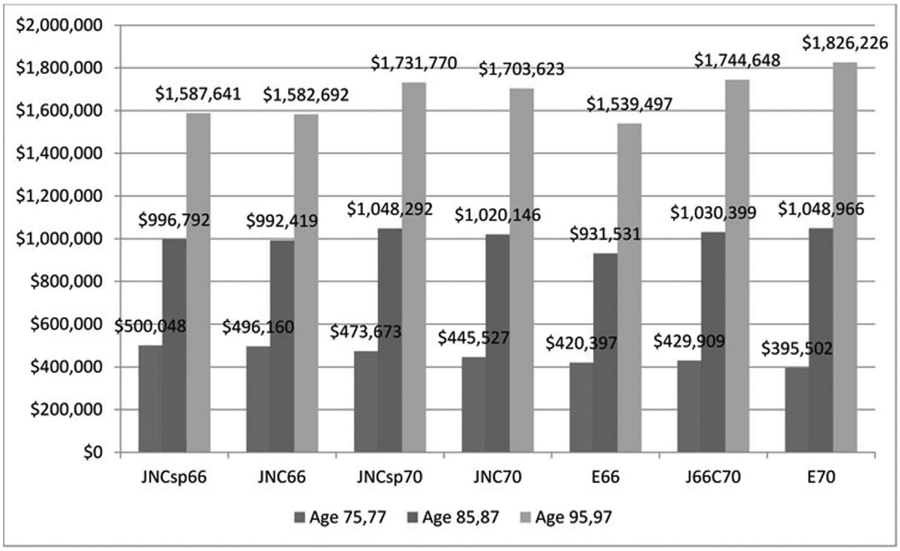
Example

Craig and Jane are 65 and 63, respectively, and each of their parents are over age 90 and still living independently. Craig's Social Security retirement benefit is estimated to be $2,100 monthly at his FRA, and Jane's is estimated to be $1,200 at her FRA.

Compare the following seven different combinations and then compute the various benefits Craig and Jane will receive over time. The number in parentheses at the end of each combination corresponds to entries in the subsequent chart.

1. Jane starts collecting her own benefits now; Craig starts collecting spousal benefits now and changes to his own at FRA (JNCsp66).
2. Jane starts collecting her own benefits now; Craig starts his own benefits at his FRA (JNC66).
3. Jane starts her own now; Craig starts spousal benefits now and changes to his own benefits at age 70 (JNCsp70).
4. Jane starts her own benefits now; Craig starts his own benefits at age 70 (JNC70).
5. Each of them starts their own benefits at FRA of 66 (E66).
6. Jane starts her own benefits at FRA; Craig starts his own benefits at age 70 (J66C70).
7. Each starts their own benefits at age 70 (E70).

Using a 1.75 percent COLA adjustment going forward, the following chart illustrates the total funds received by the couple in each of the seven combinations through Craig and Jane's respective ages as identified by the colored bars.



Note: Due to longevity in the family, combination 3 would likely be a good recommendation; however, this is a specific situation and this type of analysis should be done for each individual client.

> **PLANNING TIP:** For a self-employed husband and wife who work together, the time to shift income to the younger spouse is when the older spouse begins to collect Social Security retirement benefits. At that point, recommend that the initial enrollee lower his or her wages to the maximum allowable amount at age 62 to avoid a pay-back. This strategy will allow the household to enjoy the highest possible benefit for the first four years in which it is eligible.

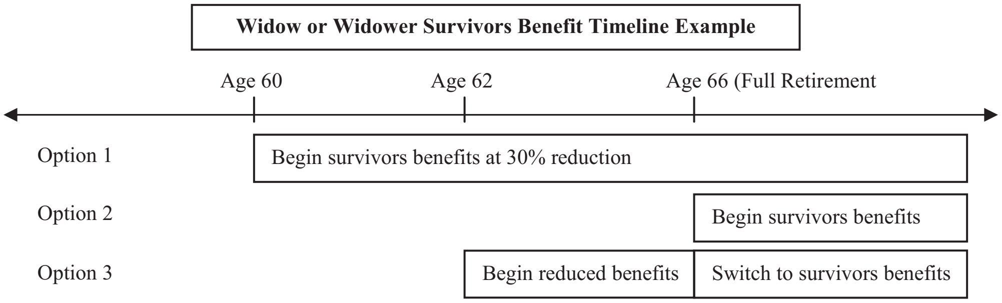
Special Considerations for Widows and Widowers

Should a widow or widower take survivors benefits at age 60? A surviving widow or widower who is at or above FRA generally receives 100 percent of the highest benefit received by the couple before the spouse's death. A surviving widow or widower who is under FRA and age 60 or over receives a reduced benefit of 71 percent to 99 percent of the deceased spouse's benefit but no less than what the widow or widower was receiving before the spouse died. A widow or widower can begin claiming a survivors benefit at age 60. (See chapter 4 for examples involving widows or widowers at younger ages and with dependent children)

Example

Examine the following three ways to begin benefits assuming a widow or widower's own retirement benefits are lower than survivors benefits:

1. Begin survivors benefits at age 60 as allowed.
2. Begin survivors benefits at FRA.
3. Begin his or her own retirement benefits at age 62 and switch to survivors benefits at FRA.



Obviously, taking one's own reduced retirement benefits at age 62 and then switching to survivors benefits at FRA (Option 3) is always going to be better than waiting to FRA to begin the survivors benefits (Option 2). But how does Option 3 compare to beginning survivors benefits at age 60 (Option 1)? Starting to collect survivors benefits at age 60 results in a 30 percent reduction (assuming age 66 is FRA) in benefits from the amount that would be received at FRA. The decision is similar to collecting one's own benefit at age 62 or at FRA. The breakeven point, when the total dollars received under Option 3 (assuming age 66) exceeds total dollars received under Option 1, is approximately age 74.

PLANNING TIP: Remind clients, and their parents, who are widows or widowers to evaluate whether they should begin to collect Social Security retirement benefits at age 60 as a survivors benefit. The SSA will not notify them of their eligibility for survivors benefits.

Decisions for Special Situations

It is possible to withdraw a Social Security application, using Form 521, repay all of the benefits received to date in one lump sum with no interest, and then start collecting again at a future date. This election must be used within

12 months of the first month in which benefits are received and may only be done once in a lifetime. The repay provision applies to all benefits received on a worker's earnings, including spousal and children's benefits. Why would a client wish to do this? Say the client began benefits at age 62 and then found a dream job 9 months later and went back to work. Or the client began collecting benefits at FRA and then came into an inheritance. The client would now like to delay Social Security payments until age 70 in order to collect an additional 8 percent for each year he or she waits. A widow or widower might elect to repay and reapply if his or her spouse began benefits at age 62 due to poor health and then died a few months later. The widow or widower would be left with a lower survivors benefit for the rest of his or her life because his or her spouse began collecting benefits before FRA. If possible, the widow or widower might consider using life insurance proceeds to cover living costs and repay and reapply at his or her own FRA to receive a much higher survivors benefit.

> **PLANNING TIP:** Some confusion exists regarding the repay and reapply option. Prior to December 8, 2010, there was no 12-month or once-in-a-lifetime restriction, and many media articles have since promoted it as an interest-free loan. Although it is still a valuable tool, it is important to be aware of the option's limitations in advance so clients who would benefit from it can complete the necessary steps within the time limits.

Benefit Reductions

Two benefit reductions affect people who have not paid into the Social Security system. The WEP potentially reduces the Social Security retirement benefit received based on a worker's own earnings history. The government pension offset (GPO) potentially reduces a Social Security retirement benefit received based on someone else's earning record (for example, spousal or survivor benefits).

Windfall Elimination Provision. The WEP affects any worker who earned a pension in a job in which he or she did not pay Social Security taxes but also worked in other jobs in which he or she did pay Social Security taxes long enough to qualify for Social Security retirement benefits. For example, under Section 218 of the Social Security Act, state and local governments can opt out of the Social Security program if they have an eligible pension plan in place. State or government employees who did not pay into the Social Security system may have had concurrent part-time positions or jobs after retiring from civil service that qualified them for Social Security retirement benefits.

If that work does not represent the bulk of their income, the Social Security system will regard them as long-term low earners. As discussed in the section titled "What Is the PIA?" in this chapter, low earners receive a greater proportion of their pre-retirement income from the Social Security system than do higher earners. In 1983, Congress passed the WEP to reduce the benefit for individuals receiving both a Social Security retirement benefit that was a high percentage of their earnings as well as a pension from employment in which they did not pay into the Social Security system.

The WEP is applied by reducing the percentage applied before the first bend point in the Social Security calculation (see section titled "What Is the PIA?" in this chapter) from 90 percent to 40 percent. The Social Security retirement benefit cannot be reduced by more than half of the pension received from the employment in which the client did not pay into the Social Security system.

The WEP reduction is modified when the client has 21–30 years of substantial employment in a job in which he or she paid into the Social Security system, and it does not apply at all if there were 30 years or more of substantial employment in such a job. Substantial employment means having earnings greater than $19,800 per year. The modification for 21–30 years of substantial employment is the percentage applied before the first bend point in the PIA calculation, as shown in the following chart.

Years of Substantial Earnings	*Percentage*
30 or more	90 %
29	85 %
28	80 %
27	75 %
26	70 %
25	65 %
24	60 %
23	55 %
22	50 %
21	45 %
20 or less	40 %

For more information on the WEP, see SSA Publication No. 05-10045, *Windfall Elimination Provision*, available at www.ssa.gov/pubs/10045.html.

Government Pension Offset. Many federal government employees hired before 1984 are not part of the Social Security system and receive only a government pension. The GPO was instituted to reduce the amount of Social Security retirement benefit received by anyone who receives a government pension and a spousal or a widow or widower survivors benefit. The goal is to equalize the government pension with the Social Security retirement benefit. Clients receiving their own Social Security retirement benefit receive a spousal benefit or a widow or widower survivors benefit only if the benefit is greater than their own individual Social Security retirement benefit.

Under the GPO, the Social Security spousal or widow or widower survivors benefit is reduced by two-thirds of the individual's government pension benefit.

Example

Mary, who collects a government pension of $900 per month, is married to Stan, who receives a Social Security retirement benefit of $1,500 per month. The spousal benefit on the Social Security retirement benefit is $750 (half of the $1,500). The GPO computation reduces the $750 by $600 (two-thirds of $900) for a net Social Security spousal benefit of $150 per month ($750 – ($900 × 0.667)). If Stan died, Mary's widow's benefit would still be reduced by $600, and she would continue to receive her government pension and a Social Security retirement benefit of $900 ($1,500 – $600).

Source	*Mary*	*Stan*
Government pension	$ 900	
Social Security retirement benefit	$ 750	$1,500
Government Pension Offset (GPO)	($ 600)	
Total	**$1,050**	**$1,500**
		Spouse dies
Government pension	$ 900	
Social Security retirement benefit	$ 1,500	
GPO	($ 600)	
Total	**$1,800**	

A federal, state, or local worker who is receiving a pension from wages that were not subject to the Social Security tax and who also has earnings from employment where Social Security tax was withheld is subject to the GPO for spousal or survivors Social Security benefits *and* is subject to the WEP for his or her own Social Security retirement benefit calculation.

Using the previous example, if Mary also had earnings resulting in her own Social Security retirement benefit of $800, then it would be reduced by WEP. Mary would have to determine which net Social Security retirement benefit is better for her: her benefit reduced by WEP or the spousal benefit reduced by the GPO.

For more information on the GPO, see SSA Publication No. 05-10007, *Government Pension Offset*, available at www.ssa.gov/pubs/10007.html.

PLANNING TIP: Verify the type of Social Security benefit that your client is planning on receiving. The GPO only applies to a government employee who receives survivors or widow or widower benefits, not his or her own retirement benefit. Consider the following two situations:

- If the government worker had a previous earnings record that qualified him or her for Social Security retirement benefits, his or her Social Security retirement benefits would *not* be subject to the GPO. In the previous example, if Mary collected a $1,000 Social Security retirement benefit on her own earnings record, she would not have the GPO reduction applied because it is not a survivors or widow's benefit.
- If the government worker dies and the widow or widower receives a survivors benefit from the government pension, then the GPO does not apply. In the previous example, if Mary died, and Stan received a $450 government pension survivors benefit, he would be entitled to his $1,500 Social Security retirement benefit and the $450 government pension benefit with no GPO applied because he is not the government worker.

PLANNING TIP: When speaking with clients, clarify the federal plan from which they will receive benefits. The GPO only applies to federal government employees under the Civil Service Retirement System (CSRS) as they are not a part of the Social Security System. In 1984, the current plan, the Federal Employee Retirement System, was created, and employees covered under this plan do contribute to the Social Security and Medicare programs and are not subject to the GPO. (They would receive both their full pension and full Social Security retirement benefit.)

ACTUAL CLIENT CONCERN: I am age 60 and my wife is 56. I am retired under the federal government CSRS system and have never paid into the Social Security system. My wife is still working and has been paying into the Social Security system for her entire working life. My current gross pension payment is $2,658 per month. I receive less per month than I otherwise would have, because I am paying for survivors benefits for my wife. If something happened to me, she would receive a check of $1,454 per month in survivors benefits. We estimate that her Social Security benefit upon retirement will be $1,369 (without considering inflation). I would like to estimate what would happen to our benefits if something happened to my wife, and then what would happen if something happened to me. Will she be able to receive full pension survivors benefits if something happens to me, or will she have to use an offset calculator since she will also be receiving Social Security from her own earnings record? I am fairly sure that I will not receive any of her Social Security due to the GPO, but I wanted to clarify that.

ADVISER RESPONSE: It looks like the GPO would affect you, but not your wife. That's because the government pension is based on your work. So if something happened to her, you would receive your Social Security survivors benefit based on her work record, but it would be reduced by the GPO. If something happened to you, she would be entitled to $1,454 per month in survivors benefit from your pension plus her own $1,369 Social Security retirement benefit.

See SSA Publication No. 05-10007, which states that for you, as the GPO recipient, this is a law that affects spouses and widows or widowers: 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 spouse's or widow's or widower's benefits may be reduced.

Regarding your spouse, the publication states the following:

When won't my Social Security benefits be reduced? Generally, your Social Security benefits as a spouse, widow or widower will not be reduced if you are receiving a government pension that is not based on your earnings.

Railroad workers. Legislation passed in 1937 established a National Railroad Retirement Investment Trust that nationalized nearly 50,000 private railroad pensions in existence at that time. Legislative changes over the ensuing years established a link with the Social Security system. The railroad retirement program now has two tiers. Tier one benefits are nearly a mirror image of Social Security benefits. Tier two is structured to provide additional benefits similar to private, multi-employer pension plans. Tier one benefits are subject to a provision similar to the WEP, which means that a railroad worker who also had Social Security-covered employment would not get a dual benefit. The U.S. Railroad Retirement Board (RRB) oversees the railroad retirement program separate from the SSA.

For more information on the railroad retirement system, visit the RRB website at www.rrb.gov/.

Social Security Rules in Specific Situations

Divorce

Many CPAs engage in divorce planning each year with clients. Understanding the implications of divorce on Social Security benefits should be an integral part of that planning. The following chart illustrates the frequency of divorce and the need for divorce planning.

U.S. Divorce Statistics

Marriage	*Divorce Statistics*
First marriage	45% to 50% marriages end in divorce
Second marriage	60% to 67% marriages end in divorce
Third marriage	70% to 73% marriages end in divorce

Source: Jennifer Baker, Forest Institute of Professional Psychology, Springfield, MO.

A divorced client is entitled to Social Security spousal or survivors benefits based on the earnings of his or her ex-spouse if he or she was married for at least 10 years before the finalization of the divorce or had been divorced from the ex-spouse for at least 2 years before applying for benefits and has not remarried before age 60. Remarriage before age 60 will not disqualify an individual from a survivors benefit if the subsequent marriage(s) end in death or divorce before applying for benefits. Social Security benefits received by an ex-spouse have no effect on what may be received by children or a new spouse. Unlike a married couple, an ex-spouse can begin collecting spousal benefits even if the working spouse has not yet begun to take his or her own benefits. If a client remarries after age 60, he or she can choose the better spousal benefit between his or her new spouse and any previous qualifying ex-spouse.

PLANNING TIP: Remember that a marriage must have lasted at least 10 years for an ex-spouse to collect benefits. If you are advising a soon-to-be-divorced lower earner whose marriage is in its ninth year, you might advise the client to wait a bit longer with this timeline in mind.

> **PLANNING TIP:** A 50-something client who has been in a long marriage may want to wait until after age 60 to remarry in order to maintain as many Social Security benefit options as possible.

Divorcing a Social Security disability recipient or Social Security retirement recipient has implications if children from a prior marriage are involved. Stepchildren of a Social Security disability or retirement recipient are eligible for the children's benefits if under age 18 and in school. The stepchild's disability benefit will end in the month following the month of the divorce finalization. See chapters 3 and 4 in this guide for more on children's benefits.

> **ACTUAL CLIENT CONCERN:** I was a widow but have since remarried. I am 57 years old. I did not find out until after I got married that I would lose my survivors benefit if I married before age 60. I can divorce my current husband and claim my widow's benefit at age 60. After I begin receiving my widow's benefit, I then intend to remarry my current husband. Will this qualify me to receive benefits again? Am I misunderstanding something, or is this a loophole I have found? I and my late husband worked too hard and paid too much into the Social Security system not to receive what I have coming. I intend to do this unless there is a reason that I should not.
>
> **ADVISER RESPONSE:** It is true that you are eligible to receive survivors benefits based on your deceased husband's work record if you are unmarried when you apply for survivors benefits after age 60, or if you are married when you apply but the marriage took place after you turned 60. The SSA is only concerned with whether you meet the requirements, not how you got there. If you are married when you apply and the marriage took place after age 60, you are eligible. Or, of course, if you are unmarried when you apply, you'll be eligible for the benefit. Divorcing your current husband would allow you to regain eligibility for the survivors benefit that you otherwise would have lost by marrying before age 60. Most likely, your survivors benefit would be higher than your spousal benefit from your current husband when you eventually remarry him, since the spousal benefit is only half of PIA (or less, if under FRA). See www.ssa.gov/ww&os2.htm for more information on survivors benefits for families.

ACTUAL CLIENT CONCERN: I am divorced and have not remarried. I have reached FRA, and I'm going to continue to work full time for at least a few more years. My benefit based on my earnings record will be higher than my divorced spouse benefit. Can I apply for what I would receive as a divorced spouse now, and then switch to my own benefit when I retire? I have received conflicting information.

ADVISER RESPONSE: There's a great deal of confusion about the "claim now, claim more later" strategy. That's when a high-earning worker files for his or her spousal benefit—or in this case, divorced spouse benefit—at FRA and then switches to his or her own benefit at age 70. The SSA website clearly states that it can be done. If you do receive information to the contrary, refer them to www.ssa.gov/retire2/yourdivspouse.htm, which states the following:

> If your divorced spouse is eligible for retirement benefits on his or her own record we will pay that amount first. But if your divorced spouse has reached full retirement age and is eligible for a spouse's benefit and his or her own retirement benefit, he or she has a choice. Your divorced spouse can choose to receive only the divorced spouse's benefits now and delay receiving retirement benefits until a later date. If retirement benefits are delayed, a higher benefit may be received at a later date based on the effect of delayed retirement credits.

Disabled Children

A child disabled before age 22 may begin receiving Social Security disability benefits based on a worker's earnings record, at any age, carrying through adulthood, as long as he or she remains disabled and is unable to work. See SSA Publication No. 05-10026, *Benefits For Children With Disabilities*, available at www.ssa.gov/pubs/10026.html, for additional information.

The Lump-Sum Death Benefit

A one-time $255 lump-sum death benefit is payable to a spouse or a child(ren) under age 18 who lived with a covered worker who died. The lump sum is not payable to an ex-spouse who might be otherwise eligible for other benefits.

3

Social Security Disability Benefits

How Do I Qualify for Social Security Disability Benefits?

When a client can't work due to a medical condition that is expected to last at least one year or result in death, he or she qualifies for Social Security disability benefits. The approval process for Social Security disability benefits is subjective and can take a long time, so it is a good idea for the client to apply as soon as possible after the onset of a disability. In the application, the client will be asked questions about his or her work history as well as extensive medical information regarding the disabling condition. It is possible to appeal if the application is denied. See Social Security Administration (SSA) Publication No. 05-10041, *The Appeals Process*, at www.ssa.gov/pubs/10041.html. Benefits will be paid up to 12 months retroactively.

The client must meet both of two different earnings tests to qualify: a recent work test and a duration of work test.

The recent work test is based on calendar year quarters according to the following chart:

Rules for Work Needed for the Recent Work Test	
If you become disabled...	***Then you generally need...***
In or before the quarter you turn age 24	1.5 years of work during the 3-year period ending with the quarter your disability began.
In the quarter after you turn age 24 but before the quarter you turn age 31	Work during half the time for the period beginning with the quarter after you turned 21 and ending with the quarter you became disabled. **Example:** If you become disabled in the quarter you turned age 27, then you would need 3 years of work out of the 6-year period ending with the quarter you became disabled.
In the quarter you turn age 31 or later	Work during 5 years out of the 10-year period ending with the quarter your disability began.

Source: SSA Publication No. 05-10029, *Disability Benefits*, http://ssa.gov/pubs/10029.html.

The duration of work test must meet the requirements of the following chart. (Note that this table does not cover all situations.)

Examples of Work Needed for the Duration of Work Test	
If you become disabled...	***Then you generally need...***
Before age 28	1.5 years of work
Age 30	2 years
Age 34	3 years
Age 38	4 years
Age 42	5 years
Age 44	5.5 years
Age 46	6 years
Age 48	6.5 years
Age 50	7 years
Age 52	7.5 years
Age 54	8 years
Age 56	8.5 years
Age 58	9 years
Age 60	9.5 years

Source: SSA Publication No. 05-10029.

What Are the Family Benefits?

Other members of the family also qualify for benefits based on a disabled worker's benefit, subject to a family maximum. Refer to the following chart to see which family members qualify and the duration of benefits allowed.

Family Member	***Percent of Worker's Disability Benefit***	***Length of Benefit***
Spouse age 62 or older	50%	Earlier of length of worker's benefit or death of the spouse
Spouse of any age caring for a natural child of the worker under age 16	50%	Earlier of length of worker's benefit or when youngest child reaches age 16
Natural children of the worker under age 18	50%	Earlier of length of worker's benefit or when child reaches age 18
Natural children of the worker disabled under the age of 22	50%	As long as they qualify as disabled for their entire life
Disabled stepchildren of the worker disabled under the age of 22	50%	As long as they qualify as disabled for their entire life, unless the worker divorces child's natural parent, then one month after the divorce is finalized

Unlike the case with survivors benefits, divorced spouses and dependent parents are not eligible for a disability benefit based on the disabled worker's benefit.

The family maximum is 85 percent of the worker's average indexed monthly earnings (AIME) but cannot be less than 100 percent of the worker's primary insurance amount (PIA) or more than 150 percent of the worker's PIA. The Social Security statement that each eligible person received each year through April 2011 showed an estimate of the disability benefit that would be received in the event of immediately becoming disabled.

Example

A qualifying disabled worker has an AIME of $3,800 and a corresponding PIA of $1,650. The worker has a spouse and 3 eligible children. Each of the 4 eligible people can receive half of the worker's PIA or $825. That adds up to $3,300. However, under the family maximum, 85 percent of the worker's AIME is $3,230 ($3,800 × 0.85) and 150 percent of the worker's PIA is $2,475. The benefits for each of the four eligible people would be reduced equally to $618.75 ($2,475/4).

Let's take the same worker with an eligible spouse and 1 eligible child. Both the spouse and the child could receive the full $825 because their total—$1,650—is less than either of the family maximums of $3,230 or $2,475 previously computed.

How Are Social Security Disability Benefits Taxed?

Taxation is the same for Social Security disability and retirement benefits. Disability benefits are fully taxable to the extent of the current laws on Social Security taxation. See the section titled "How Can I Lower or Avoid Taxation of My Social Security Benefits?" in chapter 2, "Social Security Retirement Benefits," in this guide.

Planning Opportunities

A spouse of a disabled worker may not want to collect the spousal benefit if the couple has two or more children and the spouse is working. Collecting the spousal benefit could subject the family to the family maximum, which would reduce the worker's benefit as well as those of the children, and also subject the Social Security disability benefit to income taxation. If the spousal benefit is forgone, each child may be eligible to receive more under the family maximum formula. The Social Security disability benefits for the children would likely not be taxable since the children would probably have little or no income from other sources. In addition, if the nondisabled spouse is still working, taking the spousal benefit might subject the worker's earnings to the give back rules if earning more than $15,120.

Returning to Work

The SSA has various programs to encourage disabled workers to return to the workplace on a test basis without losing their Social Security disability benefit. See SSA publications No. 64-030, *2013 Red Book*, www.socialsecurity.gov/redbook/eng/main.htm; No. 05-10095, *Working While Disabled—How We Can Help*, http://ssa.gov/pubs/10095.html; and No. 05-10061, *Your Ticket To Work*, http://ssa.gov/pubs/10061.html, for information on these programs.

See SSA Publication No. 05-10029, for additional information on Social Security disability benefits.

4

Social Security Survivors Benefits

How Do I Qualify for Survivors Benefits?

Survivors benefits are available as long as the deceased worker earned the required number of Social Security credits. In most cases, the required number of Social Security credits is 10 years, but those who die younger than age 32 have a lower Social Security credit threshold. The benefit amount is computed based on average lifetime earnings in much the same way as the Social Security retirement benefit. The Social Security statement one can view online shows an estimate of what the widow or widower and qualifying children would receive upon the client's death. The following people can receive Social Security survivors benefits on the earnings of a deceased worker:

- A widow or widower
- A surviving divorced spouse
- Unmarried children
- Dependent parents

What Are the Family Benefits?

A widow or widower can receive full benefits at full retirement age (FRA) or reduced benefits as early as age 60. (See the section titled "Special Considerations for Widows and Widowers" in chapter 2, "Social Security Retirement Benefits," in this guide). The marriage must have lasted at least 9 months to qualify for this benefit. A surviving divorced spouse can receive widow or widower benefits as well as the current spouse as long as the former marriage lasted at least 10 years and the divorced spouse did not remarry before age 60. The benefits paid to a divorced spouse are not included in computations for the family maximum (see the following chart) unless the divorced spouse was caring for a dependent child of the deceased under age 16 at the time of the worker's death. A widow or widower can qualify for benefits at any age if he or she is caring for a child younger than age 16 or a disabled child.

Unmarried children who are younger than age 18 can receive Social Security survivors benefits on a deceased worker's earnings record. Stepchildren, grandchildren, step-grandchildren, or adopted children also qualify if they were dependents of the deceased. Dependent parents of the deceased qualify if they are age 62 or older and the deceased was providing more than half of their support.

The benefit amounts that can be received as a percentage of the deceased's primary insurance amount (PIA) (see the section titled "What Is the PIA" in chapter 2 in this guide) are (subject to the family maximum computation).

Family Member	*Percent of Deceased's Primary Insurance Amount*
A widow or widower or surviving divorced spouse at or above full retirement age (FRA)	100%
A widow or widower or surviving divorced spouse between age 60 and FRA. (See "Special Considerations for Widows and Widowers" in chapter 2, "Social Security Retirement Benefits," in this guide for discussion on when to apply)	70%–99%
A widow or widower or surviving divorced spouse at any age caring for a child under age 16	75%
Unmarried children	75%
Dependent parents	75% each if two parents 82.5% if one parent

Family Maximum Computation for Survivors Benefits

The computation of the family maximum allowed to a deceased worker's family is similar to the computation of the PIA for a retiree. This same formula would be used to compute the family maximum for a retiree's family if more than the retiree and spouse were collecting from the worker's earnings history. The formula for computing the family maximum in this section has three bend points. Each year the bend points are adjusted based on average wage indices.

The following chart illustrates the four-tiered family maximum formula for the family of a worker who dies in 2013.

Family Maximum Calculation	2011 Bend Points	Examples From Previous Average Indexed Monthly Earnings table	
		Case A	Case B
150% of primary insurance amount (PIA) amount up to the first bend	150% of first $1,011	$ 1,517	$ 1,517
FIRST BEND	**$ 1,011**		
272% of PIA amount between the first and second bends	272% of next $448	$ 1,219	$ 1,219
SECOND BEND	**$1,459**		
134% of PIA amount between the second and third bends	134% of next $444	$ 201	$ 595
THIRD BEND	**$1,903**		
175% of PIA amount over the third bend	175% of excess over $1,903	—	$ 1,103
Total Family Maximum		**$2,937**	**$4,434**
PIA Amounts		**$1,606**	**$2,533**

Example

In the Case A example in the section titled "What Is the PIA" in chapter 2 in this guide, the deceased worker's PIA is $1,606. The family maximum amount for all eligible beneficiaries is then $2,937 (as shown in the previous table).

A surviving spouse who is younger than 60 and caring for a child under age 16 would receive $1,205 (75 percent of $1,606), as would each child under age 18. Once 3 or more people begin collecting benefits on this deceased worker, those survivors will hit the family maximum. At that point, the benefits for each person are reduced proportionately.

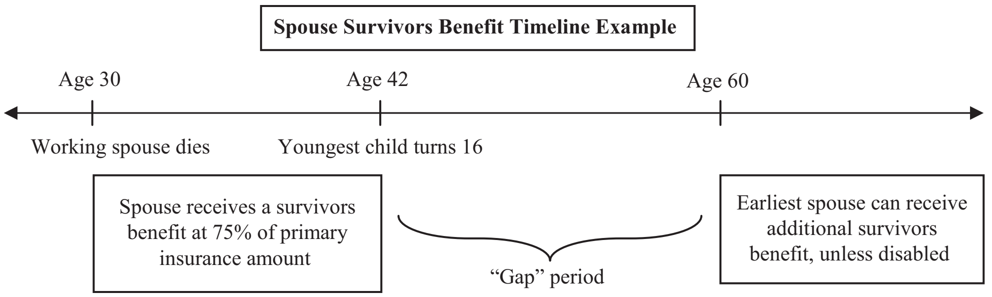
How Are Social Security Survivors Benefits Taxed?

Taxation is the same as for Social Security survivors benefits as Social Security retirement benefits. They are fully taxable to the extent of the current laws regarding Social Security taxation. See the section titled "How Are Social Security Benefits Taxed?" in chapter 1, "Social Security Retirement Benefits" in this guide.

Planning Opportunities

Planning for Spousal Income Needs

Depending on the age of the parents and children, there will be a gap in the survivor benefits provided by Social Security. Addressing potential areas of risk is a crucial area of financial planning. Discuss with clients the impact of this "gap" in Social Security survivor benefits on their financial goals as a part of their comprehensive financial plan. Discuss the availability of alternatives for funding income needs during this gap period, such as adequate investments or life insurance.



Allocating the Survivors Benefit Between Family Members

A spouse of a deceased worker may not want to collect the spousal benefit if the surviving spouse has two or more children and is working. Doing so could subject the family to the family maximum, which would reduce the spouse's benefit as well as those of the children. It would also subject the spouse's survivors benefit to income taxation. If the spousal benefit is forgone, each child may be eligible to receive more under the family maximum formula. The Social Security survivors benefits for the children would likely not be taxable since the children would probably have little or no income from other sources. In addition, if the surviving spouse is still working, taking the spousal benefit might subject the surviving spouse to the give back rules if earning more than $ 15,120.

Death of Two Parents With Minor Children

The Social Security survivors benefit received by eligible surviving minor children if both parents die would be based on the larger of the two parents' earnings records and would be subject to the family maximum formula.

ACTUAL CLIENT CONCERN: I was hoping you might be able to help me with a situation I have. I am age 62 and work full time. My husband passed away, and I am entitled to his benefit, which is lower than my expected benefits. My question is this: Even though I am working and would be penalized for receiving Social Security benefits, doesn't it still make sense for me to obtain the benefit from my deceased husband? Doesn't that benefit go away once I reach my full retirement age?

ADVISER RESPONSE: Yes, I believe it makes sense for you to take your survivors benefit, even though it will be reduced for your age and some of it will be withheld for working. Your primary benefit—the one you will be receiving into old age—is the one based on your work record, so the longer you delay collecting it, to FRA or later, the higher it will be. The survivors benefit will bring in some extra income now, and you'd better grab it, because yes, it will go away when you claim your own benefit.

ACTUAL CLIENT CONCERN: I am age 66 and have a PIA of $2,000. My wife Jane is 45. We have a 10-year-old son. My understanding is that if I die, Jane is eligible for survivors benefits because she's raising our son who's younger than age 16. I also believe she would receive the full $2,000 benefit on my death. However, when she is 52, our son will be 17 and she will no longer be eligible for survivors benefits. Let's assume for a second that her benefit had grown to $2,200 during this period. When she is 60, what benefit can she apply for? Is it 71.5 percent of the initial $2,000 number, or does she get to pick up where she left off?

ADVISER RESPONSE: A survivor who is caring for the worker's child under 16 receives 75 percent of the worker's PIA of $2,000. This is technically called a "mother's or father's benefit." So if your PIA is $2,000, Jane would receive $1,500 until her son turns 16. She would then receive nothing until she applies for her survivors benefit. The amount would depend on when she applies, ranging from 71.5 percent to 100 percent, or between $1,430 and $2,000, not counting COLAs.

See SSA Publication No. 05-10084, *Survivors Benefits*, available at www.ssa.gov/pubs/10084.html, for additional information regarding Social Security survivors benefits.

Appendix A

Glossary of Relevant Acronyms

AIME	Average indexed monthly earnings
COLA	Cost-of-living allowance
CSRS	Civil Service Retirement System
DRC	Delayed retirement credits
FRA	Full retirement age
GPO	Government Pension Offset
IRA	Individual retirement account
PIA	Primary insurance amount
POMS	Social Security's Program Operations Manual System
QC	Quarters of coverage
RMD	Required minimum distribution
RRB	Railroad Retirement Board
SSA	Social Security Administration
WEP	Windfall Elimination Provision

Appendix B

Social Security Administration Websites and Publications

2012 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Federal Disability Insurance Trust Funds	www.socialsecurity.gov/OACT/TR/2012/tr2012.pdf
2013 Red Book (Disability Benefits)	www.socialsecurity.gov/redbook/eng/main.htm
"Benefit Calculation Examples for Workers Retiring in 2013"	www.ssa.gov/oact/progdata/retirebenefit1.html
Benefits For Children With Disabilities, Social Security Administration (SSA) Publication No. 05-10026	www.ssa.gov/pubs/10026.html
"Benefits for your divorced spouse"	www.ssa.gov/retire2/yourdivspouse.htm
"Benefits for your spouse"	www.ssa.gov/retire2/yourspouse.htm
Benefits Planner	www.socialsecurity.gov/planners/index.htm
"Contribution And Benefit Base"	www.socialsecurity.gov/OACT/COLA/cbb.html
"Cost of Living Adjustment"	www.socialsecurity.gov/cola/index.htm
Disability Benefits, SSA Publication No. 05-10029	www.ssa.gov/pubs/10029.html
Government Pension Offset, SSA Publication No. 05-10007	www.ssa.gov/pubs/10007.html
How Work Affects Your Benefits, SSA Publication No. 05-10069	www.socialsecurity.gov/pubs/10069.html
"*my* Social Security"	www.ssa.gov/myaccount

"SSA's Program Operations Manual System Home"	https://secure.ssa.gov/apps10/
Program Operations Manual System (POMS) Section GN 00204.020, "Scope of the Application"	https://secure.ssa.gov/poms.nsf/lnx/0200204020
POMS Section GN 00204.004, "Spouses Benefits"	https://secure.ssa.gov/apps10/poms.nsf/lnx/0200204004!opendocument
POMS Section GN 02409.100, "Voluntary Suspension"	https://secure.ssa.gov/apps10/poms.nsf/lnx/0202409100!opendocument
U.S. Railroad Retirement Board	www.rrb.gov/
Retire Online—It's So Easy!, SSA Publication No. 05-10522	http://ssa.gov/pubs/10522.html
Retirement Benefits, SSA Publication No. 05-10035	www.ssa.gov/pubs/10035.html
"Retirement Estimator"	www.socialsecurity.gov/estimator/
Social Security Administration	www.ssa.gov
Survivors Benefits, SSA Publication No. 05-10084	www.ssa.gov/pubs/10084.html
The Appeals Process, SSA Publication No. 05-10041	www.ssa.gov/pubs/10041.html
Update 2013, SSA Publication No. 05-10003	www.ssa.gov/pubs/10003.html
Windfall Elimination Provision, SSA Publication No. 05-10045	http://ssa.gov/pubs/10045.html
"Social Security Survivors Benefits: Protection You and Your Family Can Count On"	www.ssa.gov/survivorplan/ww&os2.htm
Working While Disabled—How We Can Help, SSA Publication No. 05-10095	http://ssa.gov/pubs/10095.html
Your Ticket To Work, SSA Publication No. 05-10061	http://ssa.gov/pubs/10061.html