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The baby boomer's guide to Social Security

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THE BABY BOOMER'S GUIDE TO SOCIAL SECURITY
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The hope behind this statute is to save men and women from the rigors of the poorhouse, as well as from the haunting fear that such a lot awaits them when journey's end is near.

—Justice Benjamin Cardozo in a 1937 Supreme Court ruling upholding the legality of the Social Security Act

What baby boomers need to know about Social Security

After years of thinking of Social Security as a safety net for old people, baby boomers are realizing that it will soon be their turn to collect. This 83-year-old program that was originally designed to help senior citizens escape poverty in their old age is actually available to anyone who has paid into the system and reached retirement age.

Now that baby boomers are in or approaching their 60s, it's time to take a fresh look at Social Security as an important source of retirement income. This summary is designed to help you start thinking about Social Security so you can obtain all the benefits you're entitled to and coordinate Social Security with the rest of your retirement income plan.

What is Social Security?

Social Security was established in 1935 to alleviate poverty among the elderly during the Great Depression. It was created as a self-financing program that would collect payroll taxes from workers and immediately pay them out in benefits to retirees.

Millions of Americans depend on Social Security. For many, it's their primary source of retirement income. For others, it's an important supplement to pensions and personal savings.

Learning the basics

Unlike other sources of retirement income, Social Security offers a unique combination of benefits and rules. In this guide, we'll discuss:

- Eligibility
- Benefit calculations
- Claim timing
- Life events
- The effects of work and pensions
- Benefit taxation
- How to apply
- Medicare
- Online resources

How you become eligible for Social Security benefits

You become eligible for Social Security by working in a Social Security-covered job for at least 10 years. To be more precise, you need 40 credits. You can earn up to four credits in a year by earning a certain minimum dollar amount. If you earn four credits each year for 10 years, you accumulate the 40 credits necessary to be fully insured and achieve basic eligibility.

How your retirement benefit is calculated

Please note: You don't have to figure this out yourself. Tools are available to help you estimate your benefits. However, some people find the formula interesting. The exact amount of your Social Security benefit isn't computed until you turn 62. At that time, your annual earnings are indexed to account for wage inflation.

Once each year's earnings are indexed for inflation, your highest 35 years of earnings are tallied. If you worked more than 35 years, only the highest 35 years will count. If you worked fewer than 35 years, the missing years will count as zeroes. The 35 years of indexed earnings are totaled and divided by 420 (35 x 12 months) to arrive at your average indexed monthly earnings,or AIME.

Let's use Boomer Bob as an example. Born in 1957, Bob earned the Social Security maximum throughout his career. The maximum amount of wages subject to the Social Security tax is adjusted each year for inflation. When his earnings are indexed and averaged, his AIME is $10,296.

A three-part formula is applied to the AIME to arrive at the primary insurance amount, or PIA. Here's how the formula applies to Boomer Bob:

The first $926 of the AIME is multiplied by 90%.

The amount between $926 and $5,583 ($4,657) is multiplied by 32%.

The amount over $5,583 ($10,626 - $5,583 = $4,713, in this case) is multiplied by 15%.

These are called "bend points," and they're adjusted slightly each year.

The PIA for a maximum wage earner born in 1957 is:

$926	x .90	=	$833.40
$4,657	x .32	=	$1,490.24
$4,713	x .15	=	$706.95
Total			$3,030.59

Rounding to the next lower dime, Bob's PIA is $3,030.50. This is the amount Bob will receive if he applies for benefits at his full retirement age of 66.

Maximum wages subject to Social Security tax

Year	Maximum earnings subject to Social Security taxes
1974	$13,200
1975	$14,100
1976	$15,300
1977	$16,500
1978	$17,700
1979	$22,900
1980	$25,900
1981	$29,700
1982	$32,400
1983	$35,700
1984	$37,800
1985	$39,600
1986	$42,000
1987	$43,800
1988	$45,000
1989	$48,000
1990	$51,300
1991	$53,400
1992	$55,500
1993	$57,600
1994	$60,600
1995	$61,200
1996	$62,700
1997	$65,400
1998	$68,400
1999	$72,600
2000	$76,200
2001	$80,400
2002	$84,900
2003	$87,000
2004	$87,900
2005	$90,000
2006	$94,200
2007	$97,500
2008	$102,000
2009	$106,800
2010	$106,800
2011	$106,800
2012	$110,100
2013	$113,700
2014	$117,000
2015	$118,500
2016	$118,500
2017	$127,200
2018	$128,400
2019	$132,900

When you may begin receiving Social Security benefits

If you apply for Social Security at your full retirement age (66 to 67, depending on your birth year), you'll receive your full, unreduced PIA as your benefit. Early eligibility begins at age 62. If you apply at this age, your benefit will be permanently reduced. The age at which you apply for Social Security benefits has a tremendous impact on your monthly income and may affect your total lifetime benefit amount. This is one of the most crucial aspects of Social Security planning.

What if you apply at 62?

If you apply for Social Security when you first become eligible at 62, your benefit will be 70% to 75% of your PIA, depending on your birth year. If Boomer Bob, whose PIA (to the nearest dollar) is $3,030, applies in 2019 when he turns 62, his monthly benefit will be 72.5% of his PIA, or $2,196. This is the amount he'll receive each month for the rest of his life, increased only by annual COLAs. The reduction for early benefits is called the actuarial reduction. It was calculated by actuaries based on average life expectancies. Whether people receive the lower monthly amount starting at age 62 or the higher monthly amount starting at full retirement age, the effect on the system is the same. However, the effect on you will depend on how long you actually live. If you take reduced benefits at age 62, you'll receive a lower monthly benefit for life. If you live longer than average, you'll receive less in total benefits than if you'd waited until full retirement age or later to apply. You also may inadvertently cause your spouse's survivor benefit to be lower, if you pass away first.

What if you apply later?

Once you attain full retirement age, you can start receiving your full, unreduced primary insurance amount. If you delay the onset of benefits past full retirement age, you'll earn delayed credits. For each year you delay the start of benefits, up to age 70, your benefit will increase by 8% per year, prorated monthly. If Boomer Bob waits until age 70 to apply, his monthly benefit will be $3,878 (not including annual COLAs).

At the time of application, your delayed credits are calculated on a monthly basis. So you can apply any time between full retirement age and age 70 and receive a prorated credit. Applying at age 70 earns you the most credit and results in the highest benefit.

How COLAs affect Social Security benefits

Each October, the Social Security Administration announces the amount by which monthly benefits will increase starting the following January. This COLA is based on the year-over-year increase in the Consumer Price Index through the end of the third quarter.

COLAs are also applied to benefits that haven't been paid yet. If Boomer Bob, age 62 now, waits four more years to begin receiving benefits, his PIA will increase each year by the amount of the announced COLA. When he finally starts receiving his benefit, it's likely to be higher than the PIA that was calculated when he was 62.

There is no way of knowing the exact amounts of future COLAs. Long-term, Social Security trustees estimate annual inflation adjustments of 2.6% under their intermediate-cost scenario.

When should I apply for Social Security?

This is the biggest question facing baby boomers. Anyone approaching age 62 is wondering: Should I apply for benefits as early as possible and grab as much as I can as soon as I can? Or should I delay benefits until age 66, or even 70, in order to receive the higher amount? The answer depends in part on your situation and your plans. If you're not working and have few resources, you may have no choice but to take Social Security early. If you're still working in your primary occupation, it probably doesn't make sense to apply for early benefits because some or all of your benefits will be withheld. (See How Working Affects Social Security Benefits.) The when-to-apply question really should be considered in the context of your overall financial plan. Which strategy will give you the highest income later, when you are likely to need it the most? The Savvy Social Security planning calculators can show your projected income stream based on various claiming ages.

How spousal benefits are calculated

A married person can receive a spousal benefit equal to half the working spouse's PIA. Let's say Bill and Barbara are married. Barbara spent her time raising children and doing nonprofit work and, therefore, has no earnings record under Social Security. When Bill applies for his Social Security benefit, Barbara can apply for her spousal benefit. If Bill's PIA is $2,600, Barbara's spousal benefit will be half that, or $1,300, if she applies at full retirement age. If she applies at 62, her spousal benefit will be 35% of his PIA, or $910.

It also may be possible for two high earners to make use of spousal benefits. Let's say Barbara worked in a high-paying career and has a PIA of $1,800. After she files for her benefit, and as soon as Bill turns 66, he may restrict his application to his spousal benefit. This would give him an income of $900 per month (50% of Barbara's $1,800 PIA) while his own benefit builds delayed credits. When he turns 70, he switches to his own higher benefit.

Please note: Under the Bipartisan Budget Act of 2015, a person must have turned 62 prior to January 2, 2016, to file a restricted application for spousal benefits at full retirement age.

Coordinating spousal benefits is one of the most complex areas of Social Security planning. It provides many opportunities to maximize a married couple's combined benefits, but the rules are complicated.

Please note: Now that the U.S. Supreme Court has struck down the federal Defense of Marriage Act, same-sex couples who are legally married also are eligible for Social Security spousal benefits the same as any other married couple.

How divorce affects Social Security benefits

You can receive spousal benefits based on your ex-spouse's work record if the marriage lasted at least 10 years and you're currently unmarried. If you and your spouse have been divorced for at least two years, your ex-spouse doesn't need to apply for his or her benefit in order for you to receive yours. (He or she does need to be eligible for benefits and be at least 62.) You don't need to know your ex-spouse's earnings history or whereabouts. All you have to do is present proof that you were married and divorced and give enough identifying information that the Social Security Administration can look up the records. It will then tell you what your benefit will be based on your ex-spouse's record and help you proceed with the application.

How death affects Social Security benefits

If you're both receiving Social Security when your spouse dies, the deceased spouse's benefit will stop. You can then switch over to your survivor benefit if it's higher. Your survivor benefit equals 100% of your deceased spouse's benefit if you're over full retirement age when you claim it. There are three things to note about this:

1. Your survivor benefit is based on your deceased spouse's actual benefit, not the PIA. So if the benefit was maximized by waiting until age 70 to apply, this also maximized your survivor benefit. For this reason, the higher-income spouse is often encouraged to delay applying for benefits because this is the benefit that prevails in the event of either spouse's death.

Social Security cost-of-living adjustments

Year	COLA
1980	14.3%
1981	11.2%
1982	7.4%
1983	3.5%
1984	3.5%
1985	3.5%
1986	3.1%
1987	1.3%
1988	4.2%
1989	4.0%
1990	4.7%
1991	5.4%
1992	3.7%
1993	3.0%
1994	2.6%
1995	2.8%
1996	2.6%
1997	2.9%
1998	2.1%
1999	1.3%
2000	2.5%
2001	3.5%
2002	2.6%
2003	1.4%
2004	2.1%
2005	2.7%
2006	4.1%
2007	3.3%
2008	2.3%
2009	5.8%
2010	0.0%
2011	0.0%
2012	3.6%
2013	1.7%
2014	1.5%
2015	1.7%
2016	0.0%
2017	0.3%
2018	2.0%
2019	2.8%

2. One of the benefits stops after the death of a spouse. If your spouse dies and you switch over to your survivor benefit, your own benefit stops. If your own benefit is higher and that's the one you keep, your spouse's benefit stops. Either way, you need to plan for this loss of income, since most survivors need at least two-thirds of the income they received as a couple. Life insurance or a cushion of other liquid assets can help fill this gap.

3. If you remarry after becoming widowed, you're eligible for a survivor benefit only if you remarry at age 60 or older — or at age 50, if you're disabled.

How working affects Social Security benefits

If you're receiving benefits and are under full retirement age, some of your benefits may be withheld if you work. The maximum amount you can earn before benefits are withheld is determined by the earnings test. It's adjusted each year for inflation. In 2019, the earnings test amount is $17,640 per year, or $1,470 per month. For every $2 you earn over the earnings test amount, $1 in benefits is withheld. In the year you turn full retirement age, the earnings test threshold is higher ($46,920 in 2019). One dollar in benefits is withheld for every $3 you earn over the threshold amount. The earnings test applies to spousal and survivor benefits, as well as to earned benefits.

If you apply before full retirement age and have no further earnings for that year, none of your earnings prior to application count for the earnings test. For example, if you retire in June 2019 after earning, say, $50,000 from your full-time job, none of those earnings prior to application count for the earnings test. However, if you continue to work after applying for benefits, the first-year monthly earnings test applies: If you earn more than a certain amount in a month ($1,470 in 2019), your benefit for that month is withheld.

When you reach full retirement age, your benefit is recalculated to leave out the months in which benefits were withheld. This essentially cancels out the actuarial reduction for those months. However, an important long-term planning issue is whether you should apply for early benefits if you plan to work, because even though your benefit is recalculated, it's still lower than if you'd waited until full retirement age or later to apply. A complete explanation of how working affects benefits is available on the Social Security website, **http://www.ssa.gov/retire2/whileworking3.htm.**

After you reach full retirement age, you can earn any amount from working, and no benefits are withheld.

Retirement Earnings Test Calculator

You can find out how working affects your benefit by using the Retirement Earnings Test Calculator on the Social Security website.

Go to **http://www.ssa.gov/OACT/COLA/RTeffect.html**.

Enter your date of birth, annual earnings, and benefit amount. The calculator shows you the amount of Social Security that will be withheld for the year.

Also, see the Social Security publication How Work Affects Your Benefits, which is available at **https://www.ssa.gov/pubs/EN-05-10069.pdf.**

How pension income affects Social Security benefits

If you receive a pension from a former employer, your Social Security benefits aren't affected as long as you contributed to Social Security under that job. Other retirement income, such as distributions from 401(k) plans and IRAs, also don't affect Social Security benefits. (Such income may affect the taxation of benefits, however; see page 7.) The only time pension income affects Social Security benefits is when one or more of the jobs you held isn't covered by Social Security. Under the Windfall Elimination Provision passed by Congress in 1983, retirees who are eligible for both Social Security and a generous pension from a job in which they didn't contribute to the Social Security system may not receive their full Social Security benefits. The most common example is when a person works for over 20 years in a civil service job, then retires and works just long enough — 10 years — in a Social Security-covered job to become eligible for Social Security benefits. (Or the Social Security–covered job may have come first.)
A similar reduction may affect spousal benefits. If a spouse (not the worker) is eligible for a pension under a non–Social Security–covered job, the spousal benefit may be reduced under the Government Pension Offset. More information can be found on the Social Security website.

The important thing to note is that these benefit reductions under the Windfall Elimination Provision or the Government Pension Offset aren't reflected in your Social Security estimate. This is because Social Security doesn't know if you're entitled to a pension until you apply for benefits and are asked to provide this information. Savvy Social Security planning requires that you factor it into your benefit estimate now, rather than waiting to be surprised at the time of application.

How benefits are taxed

Your Social Security benefits may be taxable, depending on how much other income you have. This means not only earned income, but also income from pensions, investments, and even tax-free income from municipal bonds. To calculate your combined income, add (1) your modified adjusted gross income, (2) half of your combined Social Security benefits, and (3) any tax-exempt interest you receive. Up to 50% of your benefits may be taxed if you file individually and your combined income is between $25,000 and $34,000 or if you file jointly and it's between $32,000 and $44,000. If your combined income exceeds $44,000 if married filing jointly or $34,000 if single, up to 85% of your benefits may be taxed. If you're married filing separately, 85% of your benefits may be taxed, no matter how much other income you have.

These threshold amounts were set in 1983 and aren't adjusted for inflation. As Social Security benefits have increased and general income levels have risen over the years, more and more retirees are finding that their Social Security income is subject to taxation. The only way you can minimize this tax is to reduce your other income, which may require some belt-tightening as you strive to live on an annual income that puts you under one of the thresholds. Otherwise, you may have to accept the fact that part of your Social Security will be taxed. About one-third of Social Security recipients pay income tax on their benefits.

What about Social Security reform?
Starting in 2034, Social Security trustees project that the system will be able to pay only 79% of promised benefits. For this reason, a number of reforms have been suggested. These include raising the retirement age, raising payroll taxes, and revising the benefit formula in a number of different ways. Most proposals call for reforms to be phased in over a long period of time and, therefore, shouldn't affect baby boomers to any great degree. For more information on Social Security reform, visit the website of the American Academy of Actuaries at **www.actuary.org.**

The issue of taxation gathers complexity when you coordinate Social Security with other sources of income. A possible claiming strategy for those who have other income, such as pensions or IRAs, is to delay taking Social Security benefits until age 70. You can earn delayed credits to boost your Social Security benefits, while also deferring taxes on those benefits. Consult with your tax advisor for guidance pertaining to your own situation.

How to apply for Social Security benefits

You may apply for Social Security in one of three ways:

Online at **www.SSA.gov** – for retirement,disability,and spousal benefits only (not for survivor benefits)

By phone at 800-772-1213 (TTY 800-325-0778)

In person at a local Social Security office. Use the Social Security office locator at **www.ssa.gov** for the address, hours, and driving directions.

Information and documents you'll need to have ready

Provide the following when you make your application:

- Social Security number
- Name at birth
- Date and place of birth
- Citizenship status
- The beginning and ending dates of each period of active duty service, if service occurred before 1968
- Whether you receive, or expect to receive, a pension or annuity based on employment with the federal government or one of its state or local subdivisions
- Current marital status and spouse's name, date of birth, and Social Security number
- The names, dates of birth, and Social Security numbers (if known) of any former spouses
- The dates and places of each marriage and, for marriages that have ended, how and when they ended
- Names of any unmarried children under age 18
- The name and address of each employer for the last two years
- Information about self-employment
- Estimated earnings for last year and this year (and next year, if application is made between September and December)
- If you're within three months of turning 65, whether you want to enroll in Medicare Part B
- Bank account numbers for direct deposit

What about Medicare?

Medicare and Social Security used to go hand in hand. When full retirement age was 65 for everyone, most people applied for Social Security and Medicare at the same time. But now that full retirement age is increasing, baby boomers become eligible for Medicare at 65, before they become eligible for full Social Security benefits at 66 or 67.

The most important thing to know about Medicare is that unless you're receiving Social Security benefits at age 65 (that is, you applied for early reduced benefits), you must proactively apply for Medicare when you turn 65. If you don't apply in a timely manner, a 10% penalty is added to your Part B premiums for each 12-month period that you delay applying after becoming eligible. This penalty continues for the rest of your life.

Please note: An exception exists if you're covered under a group health plan that covers 20 or more employees and is based on current employment. In this case, you have a Special Enrollment Period to sign up for Part B (and/or Part A) any time and may defer Medicare enrollment without penalty until your group coverage ends.

The Social Security website offers a wealth of information.

Go to: **www.ssa.gov.**

Click on the Retirement Estimator and you'll be able to:

- Estimate your benefits
- Request a Social Security statement
- Compute the effect of early or delayed retirement
- Apply for benefits online
- Find a local office near you
- Get your questions answered
- Learn more about:
  - Working during retirement
  - The rules for marriage and divorce
  - The Windfall Elimination Provision
  - Dependents' benefits
  - The latest trustees' projections
  - The history of Social Security

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