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

May you grow up to be righteous,
May you grow up to be true,
May you always know the truth
And see the light surrounding you.
May you always be courageous,
Stand upright and be strong,
And may you stay forever young.

—Song lyrics by Bob Dylan

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 75-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 is 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 are 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 which would immediately be paid out in benefits to retirees.

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

What are the benefits of Social Security?

Unlike other sources of retirement income, Social Security offers a unique combination of benefits.

- **A predetermined amount of income.** By the time you come to the end of a long working career, the amount of Social Security income you will be entitled to is pretty well known. The benefit is based on your earnings history as it is applied to a formula. While the amount may vary depending on when you apply for benefits (delaying benefits results in a larger amount), the relative accuracy of the estimate makes it easy to build the rest of your retirement income plan around it.
- **Steady income.** Once you have qualified for Social Security benefits, the amount of income you'll receive is set. Some people worry that benefits may be cut in the future, but it is highly unlikely that benefits paid to current retirees will be significantly affected by proposals to reform the Social Security system.
- **Lifetime income.** Social Security is one of the few sources of income that can be assured of never running out. Ida Mae Fuller, the first recipient of monthly Social Security benefits, continued to receive checks until her death at age 100.
- **Inflation-adjusted income.** Social Security benefits are usually increased each year based on the previous year's increase in the Consumer Price Index. These cost-of-living adjustments (COLAs) help retirees keep up with the rising cost of living.
- **Survivor benefits.** Although Social Security checks stop at death, benefits are paid to surviving spouses and dependents.

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 do not 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 is not computed until you turn 62. At that time, all 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 less 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 1952, 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 comes out to be $8,890.

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

Maximum wages subject to Social Security tax

Year	Maximum earnings subject to Social Security tax	Year	Maximum earnings subject to Social Security tax
1969	7,800	1992	55,500
1970	7,800	1993	57,600
1971	7,800	1994	60,600
1972	9,000	1995	61,200
1973	10,800	1996	62,700
1974	13,200	1997	65,400
1975	14,100	1998	68,400
1976	15,300	1999	72,600
1977	16,500	2000	76,200
1978	17,700	2001	80,400
1979	22,900	2002	84,900
1980	25,900	2003	87,000
1981	29,700	2004	87,900
1982	32,400	2005	90,000
1983	35,700	2006	94,200
1984	37,800	2007	97,500
1985	39,600	2008	102,000
1986	42,000	2009	106,800
1987	43,800	2010	106,800
1988	45,000	2011	106,800
1989	48,000	2012	110,100
1990	51,300	2013	113,700
1991	53,400	2014	117,000

Source: Social Security Administration

- The first $816 of the AIME is multiplied by 90%.
- The amount between $816 and $4,917 ($4,101) is multiplied by 32%.
- The amount over $4,917 ($8,890 - $4,917 = $3,973, in this case) is multiplied by 15%.
- These are called "bend points," and they are adjusted slightly each year.

The PIA for a maximum wage earner born in 1952 would be:

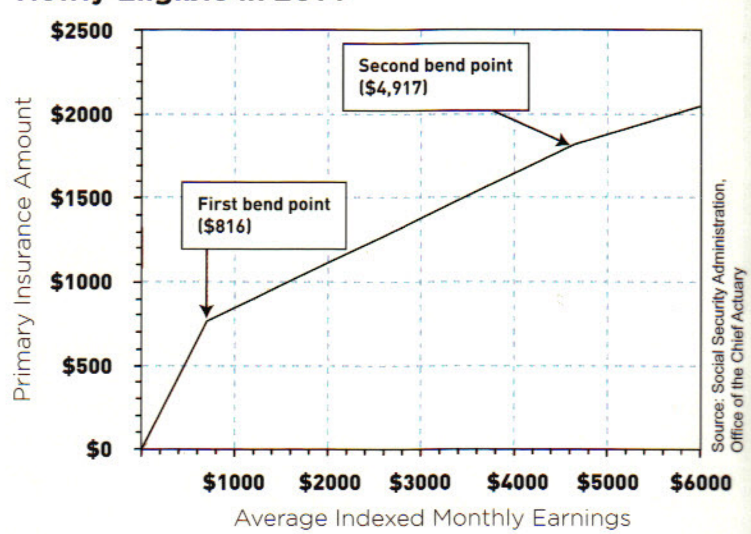
$816 x .90 =	$734.40
$4,101 x .32 =	1,312.32
$3,973 x .15 =	595.95
Total	$2,642.67

Rounding to the next lower dime, Bob's PIA is $2,642.60. This is the amount he will receive if he applies for benefits at age 66, his full retirement age.

When you may begin receiving Social Security benefits

Full retirement age for people born between 1943 and 1954 is 66. This is the age at which you may begin receiving your full, unreduced PIA. Early eligibility begins at age 62. If you apply at this age, your benefit will be reduced. The age at which you apply for Social Security benefits has a tremendous impact on your monthly income and the total amount of benefits you stand to receive over your lifetime. This is one of the most crucial aspects of Social Security planning.

Primary-Insurance-Amount Formula for Those Newly Eligible in 2014



What if you apply between the ages of 62 and 65?

If you apply for Social Security when you first become eligible at 62, your benefit will equal 75% of your PIA. So if Boomer Bob, whose PIA is $2,642, applies in 2014 when he turns 62, his monthly benefit will be 75% of his PIA, or $1,981.50. This is the amount he would receive 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 amount starting at age 62, or the higher amount starting at age 66, 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 62, you will receive a lower monthly benefit for life. If you live longer than average, you will receive less in total benefits than if you'd waited until full retirement age (66) or even later to apply.

What if you apply between the ages of 66 and 70?

At age 66, you attain full retirement age. Now you can start receiving your full, unreduced primary insurance amount.

If you delay the onset of benefits past age 66, you will earn delayed credits. For each year you delay the start of benefits, your benefit will increase by 8% per year up to age 70, after which no further credits may be earned. So if Boomer Bob waits until age 70 to apply, his $2,642 PIA will be increased by 32% to $3,487 (not including annual COLAs).

At the time of application, your delayed credits are calculated on a monthly basis. So you can apply anytime between your 66th and 70th birthdays and receive a prorated credit for the delay. Applying at age 70 earns you the most credit and results in the highest benefit.

How COLAs affect Social Security benefits

Each year in October, the Social Security Administration announces the amount by which monthly benefits will be increased 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 waits the full four years to age 66 to begin receiving benefits, his PIA will be increased each year by the amount of the announced COLA. When he finally starts receiving his benefit, it is likely to be higher than the PIA that was calculated when he was 62.

Social Security cost-of-living adjustments

Year	COLA	Year	COLA	Year	COLA
1976	6.4%	1989	4.0%	2002	2.6%
1977	5.9%	1990	4.7%	2003	1.4%
1978	6.5%	1991	5.4%	2004	2.1%
1979	9.9%	1992	3.7%	2005	2.7%
1980	14.3%	1993	3.0%	2006	4.1%
1981	11.2%	1994	2.6%	2007	3.3%
1982	7.4%	1995	2.8%	2008	2.3%
1983	3.5%	1996	2.6%	2009	5.8%
1984	3.5%	1997	2.9%	2010	0.0%
1985	3.5%	1998	2.1%	2011	0.0%
1986	3.1%	1999	1.3%	2012	3.6%
1987	1.3%	2000	2.5%	2013	1.7%
1988	4.2%	2001	3.5%	2014	1.5%

Source: Social Security Administration

There is no way of knowing exactly what COLAs will be in the future. However, long-term, the Social Security trustees estimate annual inflation adjustments of 2.8% under their intermediate-cost scenario. You may wish to use this estimate in your planning.

How spousal benefits are calculated

A married person who has little or no earnings history can receive a spousal benefit equal to half the working spouse's PIA. Let's say Boomer Bob is married to Boomer Barbara, who spent her time raising children and doing nonprofit work and therefore has no earnings record under Social Security. When Bob applies for his Social Security benefit, Barbara can apply for her spousal benefit. If his PIA is $2,642, her benefit will be half that, or $1,321, if she applies at full retirement age. If she applies at 62, her spousal benefit will be 35% of his PIA, or $925.

It is also 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 Bob 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.

Coordinating spousal benefits is one of the most complex areas

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 are 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 should really be considered in the context of your overall financial plan. Which strategy will give you the highest income later on, when you are likely to need it the most? The Savvy Social Security planning calculators can show you your projected income stream based on the various claiming ages to help you make the decision that is right for you.

of Social Security planning. It provides many opportunities to maximize a married couple's combined benefits, but the rules are complicated and you must follow them carefully. Note: Now that the U.S. Supreme Court has struck down the federal Defense of Marriage Act, same-sex couples who are legally married and who live in a state that recognizes gay marriage are now 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 are currently unmarried. If you and your spouse have been divorced for at least two years, he does not need to apply for his benefit in order for you to receive yours. (He does need to be eligible for benefits and be at least 62.) You do not need to know his earnings history or even his 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 his records. It will then tell you what your benefit will be based on his record and help you proceed with the application.

How widowhood affects Social Security benefits

If you are 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 is higher. Your survivor benefit will equal 100% of your deceased spouse's benefit if you are over full retirement age when you claim it. There are three things to note about this.

One, your survivor benefit will be based on your deceased spouse's actual benefit, not his PIA. So if he maximizes his benefit by waiting until age 70 to apply, this would also maximize your survivor benefit. For this reason, the higher-income spouse is often encouraged to delay applying for benefits because this is the benefit that will prevail in the event of either spouse's death.

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

The third thing to know is that if you remarry after becoming widowed, you will not be eligible for a survivor benefit unless you are age 60 or older when you remarry (50 if disabled).

How working affects Social Security benefits

If you are 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 called the earnings test. It is adjusted for inflation each year. In 2014, the earnings test amount is $15,480 per year, or $1,290 per month. For every $2 you earn over the earnings test amount, $1 in benefits will be 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 would be recalculated, you would still end up with a lower benefit than if you had 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 will be withheld. However, there is a special rule for the year you turn full retirement age. In the months leading up to the month in which you turn full retirement age, the earnings test amount increases. In 2014 it is $41,400 per year, or $3,450 per month, and $1 in benefits are withheld for every $3 you earn over the earnings test amount. Note that the earnings test amounts are adjusted for inflation, so if you are under full retirement age now, the amounts may be higher when you reach full retirement age. Once you retire, earnings prior to application do not count toward the earnings test. For example, if you retire in June 2014 after earning, say, $50,000 from your full-time job, none of those earnings prior to application would count for the earnings test.

The earnings test applies to spousal and survivor benefits as well as earned benefits.

Retirement Earnings Test Calculator

You can find out how working will affect 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 will show you the amount of Social Security that will be withheld for the year.

Also see the Social Security publication "How Working Affects Your Benefits," available at **http://www.socialsecurity.gov/pubs/10069.html**.

How pension income affects Social Security benefits

If you receive a pension from a former employer, your Social Security benefits are not 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 do not affect Social Security benefits. (Such income may affect the taxation of benefits, however; see next page.)

The only time pension income affects Social Security benefits is when you worked in a job that was not 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 did not contribute to the Social Security system may not receive their full Social Security benefit. The most common occurrence of this is when a person works for over 20 years in a civil-service job, then retires and works just long enough in a Social Security–covered job (10 years) to become eligible for Social Security benefits. (Or vice versa, 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 are not reflected in your Social Security estimate. This is because Social Security doesn't know if you are entitled to a pension until you apply for benefits and are asked to provide this information. Savvy Social Security planning would necessitate 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 earn. Here, we are not just talking about earned income but also income from pensions, investments, and even tax-free income from municipal bonds. If your modified adjusted gross income, plus one-half of your combined Social Security benefits, plus any tax-exempt interest you receive—called your combined income—exceeds $32,000 if you are married filing jointly, or $25,000 if you are single, up to 50% of your benefits will be taxed. If your combined income exceeds $44,000 if married filing jointly or $34,000 if single, up to 85% of your benefits will be taxed. If you are married filing separately, 85% of your benefits will be taxable no matter how much other income you have.

These threshold amounts were set in 1983 and are not 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 taxable. About one-third of Social Security recipients pay income tax on their benefits.

The issue of taxation gathers complexity when you are coordinating Social Security with other sources of income. In fact, if you have other sources of income such as pensions or IRAs, it might be wise to delay taking Social Security benefits to age 70. This would allow you to earn delayed credits to boost your Social Security benefit and also defer taxation on those benefits. Consult with your tax advisor for guidance pertaining to your own situation.

How to apply for Social Security benefits

There are three ways to apply for Social Security:

- Online at **www.socialsecurity.gov**—for retirement, disability, and spousal benefits only (not 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 will need to provide

Have ready 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 are 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 would apply for Social Security and Medicare at the same time. But now that full retirement age is increasing, baby boomers will become eligible for Medicare at 65, before they become eligible for full Social Security benefits at 66.

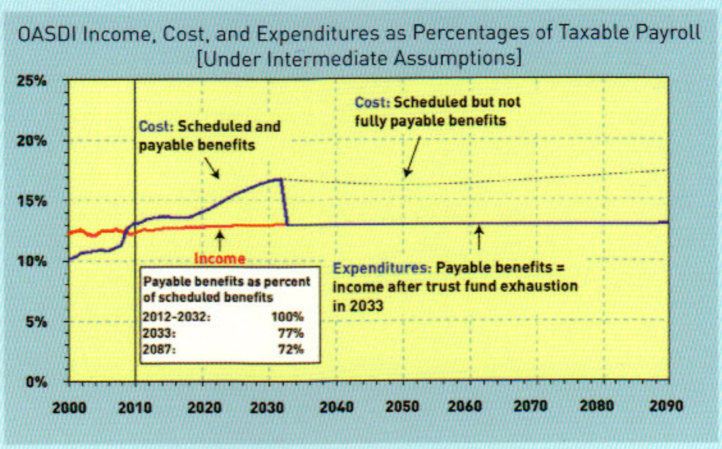
The most important thing to know about Medicare is that unless you are receiving Social Security benefits at age 65 (that is, you applied for early reduced benefits), you must proactively apply for Medicare when you turn 65. If you don't apply in a timely manner, a 10% penalty will be added to your Part B premiums for each 12-month period that you go without applying after becoming eligible. This penalty will continue for the rest of your life. (An exception exists if you are covered under an employer's group plan if it is based on your or your spouse's current employment and the plan covers 20 or more employees. In that case you may defer Medicare without penalty until your group coverage ends.)

Social Security website has a wealth of information

Go to: **www.socialsecurity.gov**
Click on the Retirement Planner 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

What about Social Security reform?



Source: 2013 OASDI Trustees Report

Starting in 2033, Social Security trustees project that the system will be able to pay only 77% 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 should not 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**.