

Social Security Basics

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Article Highlights

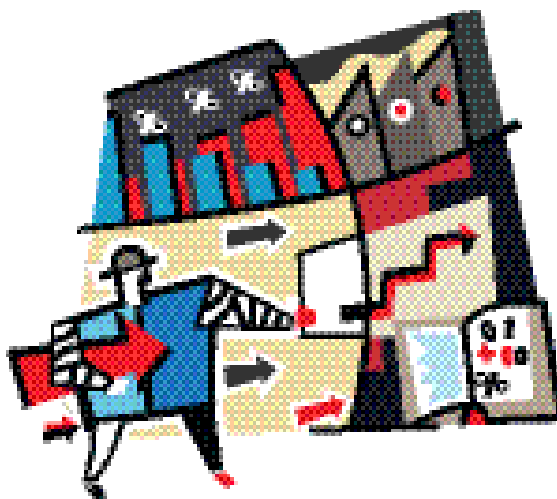
- Full benefits are paid at full retirement age (FRA), reduced for retiring early and increased for retiring late.
- In some instances, the Social Security Administration's estimate of benefits at FRA may be too high.
- Benefits can be reduced by earned income, but the relinquished benefits may not be completely lost.

This is the first in a series of three articles designed to help most people decide when to begin Social Security benefits.

To simplify the discussion, we made several assumptions that would exclude some people. For example, we assume your Social Security benefits would not be affected by the earnings test, which is explained at the end of this article. We further assume you do not have children who would receive Social Security benefits based on your earnings record and you do not qualify for disability benefits. We further assume neither you nor your spouse receives a pension from work not covered by Social Security (e.g., public-school teachers, police officers, firefighters, and other government employees).

There are many complex rules governing Social Security benefits that cannot be completely covered even in a series of three articles. However, we address four key points that will help you make an informed decision about when to claim benefits.

The strategies discussed in this article, and in the forthcoming articles about claiming strategies as a single person and as a married couple, are based on the current promises of the Social Security system. Obviously, changes to this system need to be made. However, we join others who believe these changes will likely have little, if any, impact on current retirees and those approximately 55 or over. The U.S. Congress, however, can change benefit formulas at its discretion.



Social Security Terms and Basics

People who begin their retirement benefits at full retirement age (FRA), also referred to as normal retirement age, receive their full benefits—that is, their primary insurance amount (PIA). The full retirement age for individuals varies by year of birth. Social Security rules

consider people to attain an age the day before their birthday. So, according to the Social Security Administration (SSA), someone born on January 1 has the same full retirement age as someone born on December 31 of the prior year. With the exception of this caveat, Table 1 presents the full retirement age by year of birth. The full retirement age is 66 for people born between 1943 and 1954, and it increases by two months per year thereafter. For someone born in 1960 or later, full retirement age is 67. (Unless otherwise stated, full retirement age denotes the full retirement age for your own retirement benefits and spousal benefits. There is a separate FRA for survivor's benefits.)

Someone who begins retirement benefits at full retirement age receives the primary insurance amount. Someone who begins these benefits before attaining full retirement age receives reduced benefits, while someone who delays these benefits until after full retirement age receives a higher level of benefits. Table 1 shows the reductions in retirement benefits for starting Social Security benefits before attaining full retirement age and the increase in benefits for delaying

Table 1. Social Security Eligibility

This table shows the ages for receiving the primary insurance amount (PIA) at full retirement age (FRA) for your own and spousal benefits, as well as reductions and credits for early and delayed benefits.

Year of Birth*	Full Retirement Age	Per Month Reduction to PIA If Benefits Begin Prior to FRA**	Age 62 Benefit as % of PIA	Per Month Delayed Retirement Credit (%)	Age 70 Benefit as % of PIA
1943-54	66	5/9% for 36 mos + 5/12%/mo	75	2/3	132
1955	66 and 2 mos	5/9% for 36 mos + 5/12%/mo	74.17	2/3	130.67
1956	66 and 4 mos	5/9% for 36 mos + 5/12%/mo	73.33	2/3	129.33
1957	66 and 6 mos	5/9% for 36 mos + 5/12%/mo	72½	2/3	128
1958	66 and 8 mos	5/9% for 36 mos + 5/12%/mo	71.67	2/3	126.67
1959	66 and 10 mos	5/9% for 36 mos + 5/12%/mo	70.83	2/3	125.33
1960 or later	67	5/9% for 36 mos + 5/12%/mo	70	2/3	124

*Social Security considers people born on January 1 to have been born in the prior year.

**The monthly reduction is 5/9% for the first 36 months prior to full retirement age, and 5/12% for every month after the first 36 months.

the start of benefits until after full retirement age.

We discuss the reductions and increases for someone with a full retirement age of 66 because this affects most individuals who will be deciding when to begin Social Security benefits in the next several years. If this individual begins Social Security benefits before attaining full retirement age, the reduction is 5/9% per month for the first 36 months plus 5/12% per month for months 37 through 48. So, if retirement benefits are begun at age 62, 63, 64 or 65, the reduction is 25%, 20%, 13.33% and 6.67%, respectively, below the primary insurance amount. If benefits are begun at 64 years and six months, then the reduction is 10%, where this reduction is 18 months times 5/9% reduction per month.

If benefits are begun after full retirement age, the increase is 2/3% per month for each month benefits are delayed until age 70. So, if benefits are begun at age 66 years and six months, 67, 68, 69 or 70, the increase in benefits—called delayed retirement credits—are 4%, 8%, 16%, 24% and 32%, respectively, above the primary insurance amount.

For someone with a full retirement age of 66 and a primary insurance amount of \$1,000, the levels of monthly benefits if started at ages 62 through 70

would be: \$750 at 62, \$800 at 63, \$866 at 64, \$933 at 65, \$1,000 at 66, \$1,080 at 67, \$1,160 at 68, \$1,240 at 69 and \$1,320 at 70. All payment amounts are adjusted for annual cost of living adjustments (COLA) and are rounded down to a whole dollar.

The primary insurance amount is based on a detailed calculation using average indexed monthly earnings (AIME). AIME is the worker's average monthly earnings for the 35 years of highest earnings, where earnings for years before age 60 are indexed to reflect increases in U.S. workers' average wage level. For example, if the average wage level in the U.S. is twice as high when the worker is 60 than when the worker was 44, the formula doubles the age-44 earnings. If someone worked less than 35 years, the incomes are zero for the remainder of the 35 years. The maximum income for any year is equal to that year's maximum income subject to Social Security taxes, which is \$113,700 in 2013.

Workers may receive increased benefits for work performed after beginning Social Security benefits. Each year, the Social Security Administration reviews the records for all recipients who work. If your latest year of earnings turns out to be one of your highest 35 years, the SSA refigures your benefit and pays you any increase due. This is an automatic process, and benefits are paid in

December of the following year. For example, in December 2013, you should get an increase for your 2012 earnings if those earnings raised your benefits. The increase would be retroactive to January 2013.

Getting an Estimate of Your PIA

The information used to estimate your primary insurance amount is available from the online estimator at www.socialsecurity.gov/estimator. You will be asked to input your name and other identifying information. In addition, you will be asked for your estimate of earned income in the last year. To explain the information this estimate conveys, consider the following example for Joe:

Assuming you continue to earn the same amount, if you

- Wait to start your benefits at your full retirement age (66 years and 00 month(s) for you), your monthly benefit will be about...\$2,180.00.
- Delay starting your benefits until age 70, your monthly benefit will be about...\$2,880.00.
- Stop working at age 62 and start receiving Social Security benefits, your monthly benefit will be about...\$1,623.00.

Assumptions: We estimate your benefits using your average earnings over your working lifetime. If you worked

last year, we will also assume that you will continue to work and make about the same amount as you entered for last year's earnings.

These estimates do not include:

- Medicare premiums or other amounts that may be deducted from your benefit.
- Any Social Security benefits you may be eligible for on the record of your current, divorced, or deceased former spouse.

This estimate presents the levels of projected monthly benefits in today's dollars if Joe were to begin benefits at age 62, at his full retirement age (66 in this example) or at age 70. These projections assume he will continue to earn his current level of inflation-adjusted income (or, at least, the maximum annual income subject to Social Security taxes) until benefits begin. All benefit levels are stated in today's dollars. So, if cumulative inflation is 20% before benefits begin, the nominal payments will be 20% higher, but goods and services will also cost 20% more.

To repeat, this estimate presents the levels of monthly benefits at various ages assuming Joe continues to work until the date that benefits begin. Suppose Joe plans to stop working at 62, and is deciding whether to begin benefits at 62, full retirement age (66) or 70. The \$1,623 benefit level would be a good estimate of his benefits if begun at age 62. If he stops working at 62 but begins benefits at 66, he would get approximately \$2,164 [$\$1,623/0.75$, where 0.75 reflects the 25% benefit reduction for beginning benefits at age 62 from Table 1]. The \$2,180 figure in the estimate for postponing retirement until age 66 is slightly

higher than \$2,164, which reflects the increase in benefits from continuing to work. Similarly, if he stops working at 62 but begins benefits at 70, he would get approximately \$2,856 [$\$2,164 \times 1.32$, where 1.32 reflects the 32% delayed retirement credit for delaying benefits from 66 to 70 from Table 1]. The \$2,880 benefit for delaying retirement until age 70 is slightly higher than \$2,856, which reflects the increase in benefits from continuing to work from age 62 to 70.

In general, the projected benefit level of \$2,180 at full retirement age is a good estimate of the primary insurance amount. As noted, it may be a bit too high if Joe plans to quit work before his full retirement age. Potentially of more concern is the fact that this estimate provides no guidance about reductions in benefits for workers who will receive a pension from work not covered by Social Security. In brief, the estimate may substantially overstate the benefits received by someone who receives a pension from work not covered by Social Security taxes.

The Earnings Test

Monthly Social Security benefits may be reduced or eliminated due to the earnings test, which applies to individuals who begin receiving payments before reaching full retirement age. In the years before reaching FRA, Social Security benefits are reduced by \$1 for every \$2 of earned income above \$15,120 (in 2013). In the year someone reaches full retirement age, benefits may be reduced by \$1 for every \$3 of earned income above \$40,080 (in 2013). After reaching full retirement age, individuals can receive full benefits with

no limit on earnings.

Benefits lost due to the earnings test are not necessarily permanently lost. Suppose Ken begins receiving Social Security benefits of \$800 a month in January 2013 at age 62. He told the Social Security Administration that he expects to earn \$19,000 in 2013, which is \$3,880 over the \$15,120 limit. Social Security would withhold \$1,940 (\$1 for every \$2 earned over the limit). To do this, Social Security Administration would withhold all benefit payments from January 2013 through March 2013. Beginning in April 2013, Ken would receive his \$800 monthly benefit and this amount would be paid each month for the rest of the year. In January 2014, he would be paid the additional \$460 withheld in March 2013.

Continuing with the prior example, suppose Ken lost all or part of three months' benefits for four years before he reached full retirement age. When he reaches FRA, his benefits will be adjusted as if he began Social Security benefits 12 months after he actually began his benefits. If Ken lives to an average life expectancy of about 80 years, the increase in benefits at his full retirement age will approximately make up for the benefits lost due to the earnings test. For more information on the earnings test, see "How Work Affects Your Benefits," www.socialsecurity.gov/pubs/10069.html, or our book, "Social Security Strategies" (2011).

Up Next in This Series

In the next two articles, we will discuss strategies for claiming Social Security benefits for those who are single and those who are married. ▲

William Meyer and William Reichenstein, CFA, are the principals of Social Security Solutions, Inc. (www.socialsecuritysolutions.com), a service that provides personalized recommendations as to when to claim Social Security benefits. For more on the authors, go to www.aaii.com/authors/william-reichenstein and www.aaii.com/authors/william-meyer.