

Social Security Strategies: Tricks of the Trade

Chicago Estate Planning Council

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- I. **The Dilemma:** What We Think We Know About Social Security
 - A. Social Security is such a fundamental and ubiquitous part of the U.S. retirement system that we assume we know everything important: at the time you want to retire, as long as you are age 62 or over, you simply sign up, collect your benefits – and oh, maybe there are issues with funding for the future. You get what you get – and if you die, your spouse gets something, too – so let’s move on to taxes, investments or more challenging concepts.
 - B. **Resources.** As it turns out, there may be a bit more to learn, and many Americans, as it also turns out, make decisions that can cause financial harm later in life for themselves or their spouses. Is it worth knowing more? Do clients even care? And by the way, when should I elect to take social security benefits?
 1. The Social Security Administration **website:** www.ssa.gov.
 2. The **Social Security Act**, P.L. 74-271, approved August 14, 1935, “An Act to provide for the general welfare by establishing a system of Federal old-age benefits, and by enabling the Several States to make more adequate provision for aged persons, blind persons, dependent and crippled children, maternal and child welfare, public health, and the administration of their unemployment compensation laws; to establish a Social Security Board; to raise revenue; and for other purposes. 42 U.S.C. Sec. 401-434 for Old-age, Survivors and Disability Insurance Benefit Payments.
 3. The **“POMS” Manual:** Social Security operates under an extensive “Program Operations Manual System” known as POMS. It is available online and refers to applicants/recipients as NH’s or number holders. The POMS manual represents the internal operating instructions used by social security personnel in processing claims. It is technical, “not intended for customer service” but very helpful in providing definitive answers to issues regarding social security.

4. The Social Security **Retirement Benefits Calculator**: www.socialsecurity.gov/estimator. I commend this tool to you for its ease of use (name, social security number, date and place of birth plus mother's name). It allows you to see your prospective benefits at age 62, full retirement age (66 for most of us) and age 70, assuming constant earnings. There are also additional calculators for additional retirement scenarios (reduced income, earlier or later retirement age, etc.) and other calculators available.
5. **The Center for Retirement Research at Boston College**: www.crr.bc.edu. "The goals of the Center for Retirement Research are to promote research on retirement issues, to transmit new findings to the policy community and the public, to help train new scholars, and to broaden access to valuable data sources." Their materials include a "Social Security Claiming Guide" which manages to communicate complex issues in a simple and clear manner as well as a number of in-depth studies on retirement issues in the United States and other countries.
6. Another resource is www.analyzenow.com – a website devoted to retirement planning by a retired Boeing engineer and MIT graduate. Henry K. "Bud" Hebel has come up with his own take on financial analysis that is refreshing and quite insightful, and offers a number of analytical charts and articles that discuss social security options at significant length. He is the author of *J.K. Lasser's Your Winning Retirement Plan*, available at many fine book sellers nationwide.
7. There are numerous articles on social security benefits, what strategies to consider in deciding when to take them, and how to maximize benefits. Sources consulted include articles from The Wall Street Journal, the New York Times, Forbes, AARP and many others.

II. **The Theory of Social Security and How Social Security Retirement Benefits Are Calculated**

- A. **Theoretical underpinnings of social security.** Social security benefits are designed to replace wages for workers who are unable to work due to disability or retirement. In order to qualify, the worker must have demonstrated a long term work history (and in the case of disability benefits, a recent work history as well relative to the onset of the disability). The benefits paid are based on how the **worker's actual reported wages compare with national averages**, replaced at higher rates for low paid workers and lower rates for wages in excess of certain break points in the system. This is based on the practical observation that lower paid workers have fewer realistic opportunities for savings outside social security as compared with higher paid workers. Benefits may also be payable to the worker's spouse and children when the worker retires or dies.

B. **Quarters of Coverage.** In order to create an earnings record to collect social security benefits, a person must have sufficient “quarters of coverage” or “QC’s.” Social Security Publication No. 05-10072.

1. A person may earn only four quarters of coverage in one year.
2. A quarter of coverage for 2015 is defined as the 1978 value for QC’s (\$250) multiplied by the ratio of the national average wage index for 2013 (\$44,888.16) compared to that for 1976 (\$9226.48). $\$250 \times \$44,888.16 / \$9226.48 = \$1216.29 = \$1220$ for a quarter of coverage in 2015.
3. Therefore, to have **four QC’s in 2015**, a person must earn a minimum of $4 \times \$1220 = \mathbf{\$4880}$ this year.

C. **Fully Insured status.** In order to be fully insured, a person needs at least one QC for each calendar year after age 21, with a minimum of 6 QC’s until the individual has reached a maximum of 40 QC’s or, the person has reached the year before attaining age 62, the year before death or the year before the person becomes disabled.

D. **Permanently Insured status.** A person is permanently insured if that person is fully insured (40 QC’s or at least 6 quarters earned before the year the person becomes disabled, dies or attains age 62) AND will not lose fully insured status when he or she stops working.

1. If a person has earned the maximum 40 QC’s, he or she is fully and permanently insured.
2. If a person has earned fewer than 40 QC’s, the person may be fully insured for a period of time but may lose both full and permanent insurance status if the person does not continue to earn QC’s over time.
3. For disability insurance, a person may still qualify if he has earned at least 20 QC’s and is fully insured. There are additional exceptions for those who become disabled under age 31.
4. Quarters may not be purchased for social security purposes.

E. **Primary Insurance Amount or PIA** is the benefit a person would receive if that individual elects to begin receiving retirement benefits at his or her normal retirement age. It is the standard benefit, neither reduced for early retirement nor increased for delayed retirement.

1. The **PIA is calculated on a person’s average indexed monthly earnings.** These monthly earnings are subject to comparison to national

averages of earning, **indexed to wage levels two years before the first eligible date of retirement (age 62)**. Indexed wages are credited in bands, tiers, or in social security language, bend points. The PIA formula has 3 bend points and in 2015, according to the Office of the Chief Actuary, the amounts and percentages are:

- (a) **Bend point one: 90%** of the first \$826 of average indexed monthly earnings – earnings below \$9792 per year. [= \$734.40].
 - (b) **Bend point two: 32%** of the average indexed monthly earnings over \$826 and below \$4980 (that is, on annual earnings between \$9912. and \$59,760 per year) [= \$1329.28]
 - (c) **Bend point three: 15%** of the average indexed monthly earnings over \$4980, up to a maximum of \$9875 per month or \$118,500 per year [= \$734.28] Over wages of \$118,500 in 2015, the maximum benefit base for this year, there is no contribution to social security and no PIA calculation.
 - (d) The total of the three bends for 2015 is \$2806.93 or the PIA for a person with 35 years of maximum earnings who attains age 62 in 2017 and later retires at age 66 in 2021.
2. An **individual's PIA is based on that person's 35 highest years of earnings relative to the national average wage index** of those years. For an individual who retires at age 62, most commonly that represents his or her earnings each year beginning at age 26. The later the retirement age, the greater the choice of years from which to choose the highest relative to the national indices.
- (a) The **first** step is to adjust or index a worker's earnings to reflect changes in general wage levels that occurred during the worker's years of employment. This is done to ensure that a worker's future benefits reflect the general rise in the standard of living that occurred over the working lifetime.
 - (b) The **second** step is to select the highest indexed earnings for up to 35 years; sum those indexed earnings and divide the total amount by the total number of months in those years. The result is the average indexed monthly earnings.
 - (c) The **third** step is to select the year of retirement. If retirement occurs in 2015, social security indexes an individual's earning to the average wage level two years before the year of first eligibility. To use the example given for retirement in 2015, social security would divide the national average wage index for 2012 (\$44,321.67) by the national

average wage index for each year prior to 2013 in which the worker had earnings and multiply each such ratio by the worker's earnings. This provides the indexed earnings for each year prior to 2013. Then social security would compute the average indexed monthly earnings and use this average amount in computing the worker's primary insurance amount for 2015. The maximum PIA for a worker retiring in 2015 at age 66 is \$2663.

3. Social security benefits are weighted most heavily to replace the lowest portion of a worker's earnings and a smaller percentage of the worker's higher earnings, up to the maximum earnings in 2015 of \$118,500.

(a) Because very low income workers are unlikely to be able to set aside significant savings to supplement their retirement benefits, note that social security uses substantially heavier weightings on the lower portion or first "bend point" of a worker's wages.

(b) For higher income earners, social security is intended to supply 40% or less of the worker's retirement benefits, hence the lower crediting at 32% and 15% for higher earnings.

B. Social Security's website has several benefit calculators that provide estimates of retirement benefits at ages 62, 66 and 70 for current workers.

(a) The simplest, the "**Quick**" **Calculator**, provides a quick overview of benefits based on the assumption that the worker will continue to earn what he or she did in the immediate last year. It is similar to what social security sends out each year.

(b) The second, the **Retirement Estimator**, allows an individual to create different scenarios, with different retirement ages and different earnings record estimates.

(c) The third, the **Social Security Detailed Benefit Calculator**, allows for the creation of multiple scenarios and will calculate such complexities as the Windfall Elimination Provisions and Government Pension Offsets (more on these later). It requires installation on an individual's own computer.

C. **Entitlement to Benefits.** A person becomes entitled to Retirement Insurance Benefits (RIB) when he or she reaches the benchmark year. The benchmark year for RIB is the year of age 62 attainment. A survivor's benchmark year for survivor's benefits is the earlier of age 62 attainment or the year of death. POMS RS 00201.002.

- D. **Day of Birth.** Social security follows English common law that finds that a person attains an age on the day before the birthday. Therefore, a person is age 62 through an entire month if that birthday is on the first or second date of that month. For purposes of the Full Retirement Age or FRA, unreduced benefits are payable beginning with the month FRA is attained regardless of the day of the month. If the birthday is June 1, 1935, FRA is attained on May 31, 2000 and unreduced benefits can begin with May 2000. POMS RS 00615.015.
- E. **Year of Claiming.** If a person is born late in the year, he or she may consider deferring electing benefits until the following year as the base benefits tend to be higher due to national wage indexing.
- F. **When Entitlement Ends.** Entitlement to a RIB ends with the month before the month in which the NH dies. Since the claimant must be entitled for an entire month, the month in which death occurs is not an entitlement month (no surprise to trusts and estate attorneys!). POMS RS 00201.002.

III. Social Security Options for a Single Person

A. Early Retirement at Age 62 – a Penalty

1. About one half of Americans file for retirement benefits at age 62, the earliest possible age, and this trend is increasing, not decreasing, even in the face of increased life expectancy.
2. Early retirement benefits at age 62 are **25 % lower** than they would be if the person waited until full retirement age (currently age 66 for those born in 1943 through 1954). That is, an early retiree will receive three quarters of a full retirement benefit over the balance of his or her lifespan. For those born between 1955 and 1960, the full retirement age is 66 years and one or more months.
3. The penalty for early retirement used to be slightly lower, 20%, when the full retirement age was 65 (for those born in 1937 or earlier).
4. For those **born in 1960 or later**, full retirement age will be age 67, and the **penalty** for early retirement at age 62 in 2022 and beyond will be **30%** of full retirement benefits. That is, someone who is 50 years old today and wants to take social security at age 62 will receive only 70% of the benefits that he or she could have received by waiting an additional 5 years.
5. Because Social Security benefits are calculated on the highest 35 years of a person's working career as compared with the national average, for

those whose higher earning years came later – as a result of military service, lengthy education including medical school, internship and residency programs; raising a family, illness, caring for a disabled family member -- taking benefits early may *indirectly increase the penalty* by providing fewer high income years for benefits computation. Age 61 minus 35 means that your 35 highest years begins at age 26. Waiting until age 66 means that one's 35 highest years begin at age 30, more likely to be higher earning years relative to the national average. At age 70, one's highest years need only go back to age 35 which may provide a higher average.

6. Early retirement looks even worse if the client electing early retirement continues to work after electing to take social security benefits as there is a benefit reduction for working before full retirement age.
 - a) For early retirees (those who have not reached their full retirement age), earning more than \$15,720 (in 2015) reduces their benefits by \$1 for every \$2 earned.
 - b) In the calendar year you reach full retirement age (currently age 66) the benefits are reduced less: \$1 for every \$3 earned.
 - c) For full time workers, the benefits may be reduced to zero.
 - d) There is, however, a **roll forward** so that the temporarily forfeited benefits **increase** your monthly benefits **after** you reach the full retirement age. Many people do not understand this later benefit and unduly restrict their earnings and their corresponding ability to receive higher benefits after attaining age 66 to avoid the immediate "penalty."

B. Single Person – Full Retirement Age – the Primary Insurance Amount

1. A person receives his or her full retirement benefits (the Primary Insurance Amount) without reduction for early retirement or reduction for working while receiving benefits at his or her full retirement age.
2. **Full Retirement Age** is based on the year of your birth. Attached is a chart that sets forth full retirement ages for retirees, spouses and survivors by date of birth. The current full retirement age for those born between 1943 and 1954 is 66 years.
3. **Tax benefits.** A single person whose combined income (adjusted gross income + nontaxable interest + one half social security benefits) is below \$25,000 per year receives these benefits free of income tax.

4. Social security benefits are not fully taxed, even at high income levels, unlike withdrawals from traditional qualified retirement plans. The maximum amount of social security benefits subject to tax is 85%. Income taxation begins for single individuals with a combined income of \$25,000 or more per year and married couples with a combined income of \$32,000 or more per year, not indexed for inflation.

C. Single Person - Late Retirement – a Premium

1. The **Senior Citizens' Freedom to Work Act of 2000** (Public Law 106-182) provides that persons at full retirement age (currently 66) or older can work without reduction in their social security benefits. Put a different way, there is no "Earnings Test" after attainment of full retirement age.
2. This provides new options and strategies for those who want to continue to work, even if at a different job.
3. For those who wish to maximize their inflation protected social security benefits and expect to live beyond age 78-80, late retirement offers an option many people do not fully understand.
4. For each year beyond a person's full retirement age, **the social security benefits increase an additional 8% per year, up to a maximum of 32% at age 70**. This is a 76% increase over benefits received from early retirement at age 62. These extra benefits are called **Delayed Retirement Credits** or **DRCs**
5. Further, since social security benefits are based on one's highest 35 years of earnings, **working longer** may further increase benefits by **causing one's highest 35 years of earnings to rise** relative to the national average. The combined premiums for late retirement (higher average earnings plus increased credits for delay) can produce benefits almost double that for early retirement.
6. Of course, by foregoing benefits, a person needs to be able to replace otherwise available social security benefits by being healthy enough to work, keeping or finding a job or by withdrawing savings. Employment need not be full time or high stress to equal social security benefits at early or standard retirement. If a person is unable to continue working, it can be a difficult but important calculation.

IV. Married Couples – Spousal Benefits and Survivor Benefits

- A. **Same Sex Marriage.** Because the federal Defense of Marriage Act (“DOMA”), Public Law No. 104-199 has been declared unconstitutional for certain federal law purposes by *United States v. Windsor*, 570 U.S. ___ (2013), the social security administration has been struggling to determine how best to cope with same sex married couples. Unlike federal tax law, the Social Security Act defines marriage by reference to the law of the state in which the couple is living when benefits are paid, resulting in a potential chaos of eligibility versus ineligibility as a couple may move around the country.
1. Because this requirement is statutory, not regulatory, the Social Security Administration is working with the Department of Justice to try to reach a workable solution.
 2. On an interim basis, same sex spouses are encouraged to apply as soon as possible for benefits to protect against the loss of any potential benefits.
 3. The Social Security Administration is processing some applications in states where same sex marriage is legal; for other states, it appears they are accepting and holding applications for the time being.
 4. For same sex married couples where one spouse is receiving SSI, the marriage could negatively affect that spouse’s benefits now
 5. The pending U.S. Supreme Court case, *Obergefell v. Hodges et al.*, to be argued next week, may help decide this issue on a permanent basis.
- B. In general, at **retirement**, each spouse receives the larger of: his or her own social security benefit based on his or her work history OR a portion of the higher earning spouse’s benefits, up to a maximum of 50% of the higher earner’s benefit.
1. The **spousal benefit** is 50% of the higher earner’s full retirement benefit if the lower earning spouse waits at least until the lower earning spouse’s full retirement age.
 2. If the lower earning spouse takes early benefits (at age 62), the spousal benefit is only 37.5% of the higher earner’s full retirement benefit.
 3. The higher earning (primary) spouse does not need to retire for the lower earning (auxiliary) spouse to collect the spousal benefit **but must file**.
- C. In general, at **death**, (at the death of the first spouse) if the couple were married for at least 9 months or the spouse died accidentally, the **survivor’s benefits** are based on the larger of the surviving spouse’s own earnings, OR 100% of the

benefits of the deceased spouse (if the survivor is at full retirement age), whichever is greater.

1. If the higher wage earner spouse dies before his or her full retirement age, the survivor may collect benefits based on the equivalent of the deceased spouse's full retirement age benefits calculated as described below.
2. When a married worker dies before full retirement age, social security does not use the highest 35 years for an earnings record for the survivor, but instead subtracts the years from FRA to death from the normal 35 year requirement. For example, if a worker dies at age 61, the survivor benefits will be calculated on the 30 highest years of earnings, not 35 years. If the worker dies at age 56, the survivor benefits will be calculated on the 25 highest earnings years.
3. If a widow or widower elects to take survivor's benefits at the widow or widower's full retirement age, there is no reduction in benefits.
4. However, survivor's benefits are potentially subject to two types of reduction. **First**, if the primary spouse took early retirement while married and then died, the survivor is entitled to 100% of the benefits of the deceased spouse. Since the deceased spouse's benefits were reduced for early retirement, the survivor would be entitled to 100% of those (reduced) benefits. This is a common cause of lower income for widows today.
5. **Second**, if the primary earner dies while the survivor is under full retirement age and that widow or widower wishes to take early retirement himself or herself, the retirement benefits would be reduced for the survivor's early retirement.
6. **Third**, there are no delayed retirement credits (DRCs) for survivor or spousal benefits themselves, so there is no reason for a surviving spouse to wait beyond his or her full retirement age to collect spousal benefits. However, if the predeceased spouse had earned DRC's on his or her record, the surviving spouse will get the benefit of those DRC's.
7. Early retirement age for survivors is slightly lower than for the primary worker himself or herself. A widow or widower can elect to take **reduced retirement benefits at age 60**, two years earlier than for a worker's own early retirement benefits (or earlier if there are dependent minor children). Current full retirement age for a survivor is still age 66.
8. If the surviving spouse has a child under age 16, he or she can receive 75% of the deceased spouse's benefit, regardless of age.

9. Children receive 75% of the worker's benefit amount as well, subject to certain family maximums of 250% to 180% of the deceased worker's benefit.

D. **Divorced spouses are entitled to survivor's benefits** as well provided that the marriage lasted at least ten years. The divorced spouse can file on the deceased spouse's retirement record when he or she is age 60 or older for reduced benefits, age 50 if the divorced spouse is disabled, and age 66 or higher for full retirement benefits on the former spouse's record.

V. **The Windfall Elimination Provision and the Government Pension Offset**

A. **The Windfall Elimination Provision** affects workers who earned a pension in any job where they did not contribute to social security and also worked in other jobs long enough to qualify for Social Security retirement or disability benefits. WEP is a mathematical reduction in the Primary Insurance Amount (PIA) that a worker would otherwise receive.

B. The theory behind this reduction is that social security benefits are intended to replace only a percentage of a worker's earnings, not the full amount. Since **social security pays a proportionately higher benefit** (about 55% of low income wages) **to lower paid workers**, due to the difficulty of their being able to accumulate substantial savings, than the benefit to highly paid workers (about 25%), people who worked under both social security and an additional pension system have the potential for a windfall. SSA Publication No. 05-10045, January 2010.

1. Prior to 1983, dual system workers who worked primarily in a job not covered by social security had their social security benefits calculated as if they were long-term, low-wage workers. This gave them the advantage of receiving a social security benefit representing a higher percentage of their wages than others at their same overall earnings level, plus a pension from a non-social security job.
2. The Windfall Elimination Provision reduces the 90% factor for the first "bend" of a worker's earnings record to a factor of 40% for workers who reached 62 or became disabled in 1990 or later.
3. However, if you have 30 or more years of "substantial" earnings in a job where you paid social security taxes, the windfall elimination provision does not apply. Substantial earnings in 2009-2010 are defined as \$19,800 per year.
4. The WEP reduction does **not** apply to survivors' benefits.

5. If a worker gets a relatively low pension from the other system, there is a guarantee that the reduction in social security benefits cannot be more than one-half of the non-social security based pension.
6. The detailed rules are, of course, complicated, and are covered in the POMS manual at RS 00605.005 *et seq.*

C. The **Government Pension Offset** – another possible reduction in the PIA amount. This reduction applies **only** to survivors' or spousal benefits, not to a worker's own benefit. **Social Security does not allow a spouse to receive benefits both on his or her own record and on his or her spouse's record *at the same time*** (but more on this later). Social security law has always provided that a person's benefit as a spouse, widow or widower be offset dollar for dollar by the amount of his or her own retirement benefit.

D. If a spouse's earnings had been subject to social security taxes, the spouse automatically chooses between his or her own earnings record and the spousal (or survivor) benefit. **But if the spouse is a government worker who did not pay into social security, Congress saw a potential unfairness.** "In enacting the Government Pension Offset provision, Congress intended to ensure that when determining the amount of spousal benefit, government employees who do not pay Social Security taxes would be treated in a similar manner to those who work in the private sector and do pay Social Security taxes." SSA Publication No. 05-10007.

1. Benefits are not reduced if the spouse receives a government pension not based on his or her earnings;
2. Benefits are not reduced for a state or local employee whose government pension is based on a job where the employee also paid social security taxes and retirement was before July 1, 2004 or for at least 5 years before retirement;
3. Benefits are not reduced for certain federal employees who pay social security taxes on earnings or switched from the Civil Service Retirement System to the Federal Employees Retirement System before June 30, 1988.
4. If a worker gets a relatively low pension, there is a guarantee that the reduction in social security benefits cannot be more than one-half of the non-social security based pension.
5. There are more complex rules; see POMS Manual sections RS 00202.035, Spouse's Benefits – Deductions; and GN 02608.104,

Exemption – Pension Eligibility Before Dec. 1982 and 1977 Requirements Met (GPO).

6. The Windfall Elimination Provision may also apply to international workers who spent time working abroad, did not have social security taxes withheld and who will receive a pension as a result of employment in another country.

VI. International Workers

A. Payroll Taxes, the Detached Worker, Totalization Agreement Countries

1. Dual social security tax liability is a significant problem for many U.S. companies with foreign offices, as well as their foreign affiliates and employees, in part because our social security system covers expatriate U.S. workers more broadly than the social security programs of many other countries cover their own citizens. Most countries impose payroll taxes for their social security systems based on the location of the worker. However, U.S. social security rules apply to U.S. citizens and resident aliens working abroad for American employers regardless of where the employees is located, how long the assignment is or whether the employee is covered by the foreign system. This can result in double social security payroll taxes for the employee who may be required to pay these taxes to both the U.S. and the foreign country in which he or she is working, without being employed in the foreign country long enough to ever qualify for its pension benefits.
2. To entice U.S. employees to work in their foreign offices, many U.S. companies offer tax equalization programs that reimburse any additional taxes, both payroll and income, imposed on a U.S. worker – but this can become a tax on tax system since the foreign country then imposes income taxes on the reimbursement of the foreign country’s payroll tax deduction, resulting in further reimbursement payments to the U.S. worker and so on. This is expensive either to the employer who offers an equalization system, or to the employee who pays taxes under two systems but may receive retirement benefits under only one.
3. Accordingly, the U.S. government has entered into a number of agreements with selected foreign countries to **eliminate dual social security taxation and coverage for shorter term or temporary employees**. Instead these agreement countries look to match payments and benefits with the country to which the employee has the greatest attachment during both working and retirement years. The result is the concept of the “**detached worker.**” This applies to individuals who work for a U.S. company and are temporarily transferred abroad to work for that company for five years or less. The U.S. company may obtain a

“certificate of coverage” and present it to the appropriate foreign authorities for an **exemption** from that country’s payroll tax system for any detached workers they may employ. Medical insurance presents a different challenge.

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4. Self-employed U.S. citizens who reside and work in a foreign country may not fall under the detached worker rule, but instead fall under the standard territoriality rule that a person is covered by and pays payroll taxes in the country where one works and lives, as well as the U.S. rules that employed U.S. citizens must remit payroll taxes to the U.S. social security system.. Again, this can result in dual taxation. In this case, the U.S. social security agreement restricts coverage to the self-employed worker’s country of residence. If a U.S. citizen lives and is self-employed in a foreign agreement country, the U.S. citizen may obtain a “certificate of coverage” from the foreign country in which he or she lives and works and file it with his or her U.S. income tax return as proof of exemption from U.S. self-employment taxes.
5. Foreign nationals from an agreement country working in the United States for a limited period of time (detached or temporary workers in the U.S.) may obtain an equivalent certificate from the social security program in their home country to be exempted from U.S. social security taxes.
6. Workers who divide their employment history among two or more foreign countries may sometimes find themselves not qualifying for retirement benefits under any system. In that case, agreement countries have created a system called “totalization” that allows these orphan workers to combine or totalize coverage credits from both countries.
7. To qualify for U.S. benefits under totalization, a worker must have at least 6 U.S. quarters and then may apply to count periods of coverage that the worker has earned in the agreement country toward qualifying for U.S. benefits. The foreign benefits are not actually transferred or paid to the U.S. social security system, but the worker may qualify for a partial U.S. pension based on a sufficient number of quarters. Correspondingly, the foreign agreement country may credit or totalize the worker with quarters or years worked in the U.S. to qualify for a partial pension in the foreign agreement country as well. The Windfall Elimination Provision may apply to the U.S. benefits depending on the size of the pension received, if any, from the foreign country.
8. The **social security agreement countries** are: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, The Netherlands,

Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland and the United Kingdom.

9. There is a separate, longer list of **reciprocal payment countries** (a different concept that allows benefits earned in one country to be paid to a resident of another country) as well. For more information on this complex topic, see U.S. International Social Security Agreements or write to the Social Security Administration, Office of International Programs, P.O. Box 17741, Baltimore, MD 21235-7741.

B. Payment of Benefits

1. U.S. citizens who qualify for U.S. social security benefits may retire to almost any country they wish and receive their benefits in that location.
2. Exceptions are: Cambodia, Cuba, North Korea, Vietnam and certain other former USSR countries (but Armenia, Estonia, Latvia, Lithuania and Russia are OK). There are lists on the social security website that help clarify which countries are fine and which are not.
3. If the worker is not a U.S. citizen, he or she may be subject to the six month rule (must not be gone from the U.S. for more than six months in order to continue receiving benefits) unless the worker returns to an agreement country or a secondary list of reciprocal payment countries. Many foreign countries have similar rules; there is a great deal of technical detail regarding when benefits can be paid to someone residing in another country.
4. Family members who live outside the U.S. and are not U.S. citizens may be subject to special rules in order to receive survivor or children's benefits. The survivor or dependent child must have lived in the U.S. for five years and been a part of the family (spouse or child) during that five year period. Again, there are detailed rules on this subject.

C. A Brief Background on Other Countries' Systems. No one country has a perfect retirement system, as no country has a perfect medical system for its population. However, some countries are better than others, as measured by common sense factors such as current affordability, future sustainability, coverage among a country's workers, and the adequacy of benefits to sustain the population, including lower income workers, in retirement. According to a study by an independent Australian consulting firm, the Melbourne Mercer Global Pension Index, top rated countries world wide include The Netherlands, Switzerland, Sweden, Australia and Canada; the U.S is in the second tier behind the United Kingdom, Chile, Brazil, and Singapore. France and Germany are just behind the U.S. in the middle while Japan and China are near the bottom of Mercer's rankings.

D. The U.S. social security website also contains short, comprehensive summaries of the retirement systems of many countries as well as any agreements between those countries and the U.S. There are also reports or studies of the systems of selected countries, including recent developments that may be of interest to the U.S. experience. Appendix H includes a brief summary of five different countries' social security plans: the United Kingdom, Chile, Sweden, the Netherlands and China.

VII. COLA's and Social Security: The Imperfect But Important Power of Indexing

A. **Wage Indexing Before Retirement.** Before one's initial social security benefit is calculated, whether the PIA at full retirement, the more modest benefit at age 62 to 65, or the higher, premium benefit at ages 67-70, one's past **earnings are indexed not to inflation but to relative pay scales** in the U.S. economy for the same historical period. The goal is to allow the replacement rate of retirement benefits to remain consistent with earnings.

B. **Inflation Indexing After Retirement.** Once a person starts receiving social security benefits, those benefits are **indexed for inflation**. This indexing has been automatic since 1975.

1. Social security uses the **CPI-W**, the Consumer Price Index for Urban Wager Earners and Clerical Workers. The CPI-W is a subset of the CPI-U, the latter being the primary consumer price index for all urban consumers compiled by the Bureau of Labor Statistics. The CPI-W represents an index of prices of goods and services typically purchased by urban wage earners and clerical workers in households that receive more than half of their income from clerical or wage occupations and have at least one earner employed for at least 37 weeks during the last 12 months. This reflects social security's concept of wage replacement, but oddly, by definition, it explicitly excludes household's that primarily rely on pension income. For more background, see Munnell, Alicia and Muldoon, Dan, "The Impact of Inflation on Social Security Benefits" October 16, 2008, Center for Retirement Research at Boston College.
2. A study by Kenneth J. Stewart, an economist at the Bureau of Labor Statistics, "The Experimental Consumer Price Index for Elderly Americans (CPI-E):1982-2007" *Monthly Labor Review*, April 2008, concludes that the **CPI-E**, an experimental index also compiled by the Bureau of Labor Statistics for Americans aged 62 and over, rose somewhat faster over the last 25 years than both the CPI-U and the CPI-W. This faster increase is in large part due to heavier weighting for medical care and shelter costs for the elderly, although the author cautioned that the relatively new CPI-E index currently has limitations and should be used with caution until the index is further refined.

3. The CPI-W has produced an average annual increase of 3.8% over the past 30 years. Munnell and Muldoon, *supra* at page 3.
4. The proposed new “Chained CPI” is predicted to understate even further the effects of inflation on elderly retirees than the current CPI-W. The effect would be to reduce social security benefits for the oldest and poorest workers. Munnell, “Social Security”’s Financial Outlook: the 2013 Update in Perspective” June 2013, Center for Retirement Research at Boston College.

C. **Medicare Premiums** for Parts B and D are deducted from social security benefits (although Part D premiums may be paid directly if the recipient prefers). By law, Medicare Part B premiums must reflect 25% of the estimated Part B per capita expenditures for that program. As health care costs rise, Part B premiums must also rise. Part B premiums have increased at an average annual rate of 9% over the past 30 years. The disparity has been increasing since 2000. Munnell and Muldoon, *supra*, page 3.

1. Legislation does provide that the dollar value increases in the premium for current beneficiaries not exceed the dollar value of the annual social security COLA.
2. This provision prevents the actual social security benefit from decreasing from year to year, but does not protect against the real erosion in purchasing power in the net benefit. *Id* at 4.
3. Further, for higher income recipients, Medicare Part B (and Part D) premiums will rise further and faster as these premiums become linked to higher income levels.

D. Finally, **income tax thresholds** for the taxation of social security benefits are flat amounts and are not indexed to inflation, so the income taxation of social security benefits is effectively increasing over time.

1. If a **single person**’s combined income (adjusted gross income + untaxed interest + one half of social security benefits) is between \$25,000 and \$34,000, that individual may have to pay taxes on up to 50% of social security benefits. If the combined income is over \$34,000, up to 85 % of the benefits will be subject to tax.
2. For a **married couple** filing a joint return, the first threshold is between \$32,000 and \$44,000 for 50% taxation; if the combined income is over \$44,000, up to 85% of the social security benefits will be subject to tax.

VIII. Demographic Observations.

- A. **The population of the United States is steadily living longer.** Bell, Felicitas C. and Miller, Michael L, “*Life Tables for the United States Social Security Area 1900-2100,*” *Actuarial Study No.120*, Social Security Administration Office of the Chief Actuary.
1. The factors that have contributed to the rapid average rate of mortality improvement during the 20th century include: access to primary medical care for the general population, improved healthcare provided to mothers and babies, availability of immunizations, improvements in motor vehicle safety, clean water supply and waste removal, safer and more nutritious foods, and rapid rate of growth in the general standard of living. Once achieved, these factors will make a much smaller contribution to mortality rates in the future. *Id.* at pages 10 and 11.
 2. This study posits that future reductions in mortality will depend on other factors, including: development and application of new diagnostic, surgical and life sustaining techniques, presence of environmental pollutants, improvements in exercise and nutrition, the incidence of violence, the isolation and treatment of causes of disease, emergence of new forms of disease, prevalence of cigarette smoking, misuse of drugs including alcohol, extent to which people assume responsibility for their own health, education regarding health, changes in our conception of the value of life and the ability and willingness of our society to pay for the development of new treatments and technologies, and to provide these to the population as a whole. *Id.* at 11.
 3. Reductions in death rates for those under age 65 are expected to be relatively small compared with past reductions, but reductions for the aged are expected to continue at a relatively rapid pace.
 4. The tables demonstrate a gap in life expectancies between males and females but observe the **gender gap narrowing**. The average rate of mortality improvement for men is expected to be .77 percent per year while it is only .68 percent per year for women. Increases in life expectancy between 2002 and 2100 are projected to be 8.2 years for males and 6.2 years for females. *Id.* at pages 12 and 19.
 5. It has been observed that the **mortality rates of women, though lower than those of men, now tend to increase faster with very advancing age than those of men**. At the rather advanced age of 95 in this study, mortality increases about 6% per year for women and only 5% per year for men. *Id.*

- B. The current life expectancy for a male at birth in the United States is 74.81 years (2005 table) and 79.95 years for a female. **But life expectancy increases as age increases, and also as economic status increases.** At age 60, a male in the upper 76th to 100th percentile of earnings has a life expectancy of 21.3 years, while a male in the bottom 0 to 25th percentile of covered workers has a life expectancy of only 18 years. At age 70 the life expectancy of the higher earning male worker is 17 years (age 87). Social Security Bulletin Volume 67, No. 3, 2007.
- C. While life expectancy is increasing significantly over time, **disability-free expectancy is increasing much more slowly.** Accordingly, this means that many people may not have the ability to continue working longer even if it is in their economic self interest to do so. *Id.*
- D. The length of retirement is increasing as life expectancy lengthens but the average retirement age in the U.S. remains around age 63. Munnell, Alicia H., Soto, Mauricio and Golub-Sax, Alex, “Are Older Men Healthy Enough to Work?” October 2008, Center for Retirement Research at Boston College.
- E. **If the average retirement age continues to be age 63, social security benefits will decrease proportionately as the Full Retirement Age reaches 67 and the penalty for early retirement increases** (the penalty for early retirement at 62 when the FRA was 65 was 20%; it is now 25% for FRA’s at 66 and will be 30% for FRA’s of 67 for the 1960 cohort and beyond).
- F. Fewer people receive traditional corporate pensions (defined benefit plans) and many receive their non-social security retirement coverage through 401(k) plans or the equivalent, many of which have not been well managed.
- G. The stock market and housing market drops of 2008 through the present, shortly before baby boomers begin to retire in significant numbers, compounds the problem. At the same time, interest rate yields on bonds and CD’s have dropped as well.
- H. Medical expenses are increasing.
- I. Historically, people have been saving less over the years. Whether recent trends appearing to reverse this pattern will last are hard to predict.
- J. The Great Recession and Social Security. A May 2011 paper sponsored by the Urban Institute and authored by Barbara Butrica, Richard Johnson and Karen Smith, calculates that the recent Great Recession will have a 4 % negative effect on all workers’ age 25 to 64 income in retirement, and a negative 5% effect on older workers (ages 55 to 59). **Wage stagnation lowers the index factor for everyone who turns 60 after 2008** and permanently lowers those workers’ Social Security benefits. Because individuals nearing retirement have less time and

fewer opportunities to earn more or to save more, their retirement security is at greater risk. See www.urban.org for more information.

IX. Strategies for Deciding Which Benefits to Elect When

A. For a single person:

1. **Psychological Issues.** For many workers, retirement is more of an emotional concept than it may be a financial one. For many years, retirement and age 65 have been synonymous; Medicare's continued availability at age 65 reinforces the concept that 65 year olds are at retirement age. Claiming Medicare benefits is done through the Social Security Administration, either in person, through the mail or very commonly now, on its website, and applying for one can easily lead to applying for the other even though the full retirement age for most individuals is now 66. See Norma B. Coe, Mashifiqu R. Khan and Matthew S. Rutledge, "Sticky Ages: Why is Age 65 Still a Retirement Peak?" Center for Retirement Research at Boston College, January 2013.
2. For those without substantial other income or assets, early retirement is an important social safety net for those who lose their livelihood near the end of their working careers, but it can mean a significantly lower standard of living for the rest of that person's life.
3. **Statistics and Break Even Points.** The chance of a 62 year old American male living beyond **age 78**, the Social Security break even point for early versus standard retirement, is about 78%; for a 62 year old female, the chance of living beyond the break even point of age 78 is about 85%. Delayed retirement until age 70 carries a break even of about **age 82.5** as compared with standard retirement (and age 80.5 as compared with early retirement). Statistics from Social Security website.
4. **For individuals with very substantial resources** for whom social security payments are a rounding error and will **never** be relied on for retirement income or consumption, the strategy to produce the greatest overall wealth may be for an individual to begin taking benefits somewhat earlier and invest them fully. The long term effect of compound investing early to some extent cancels out the lower income later in life. However, as time increases, the higher inflation adjusted benefits begin to tip the scales. At 25 years out (from age 62), taking retirement benefits at age 66 provides the better result in most scenarios, and the same is true 30 years out.

- (a) The risk, of course, is that even very wealthy individuals can have serious financial setbacks including bankruptcy later in life.
 - (b) For those individuals, one option is to use the limited “**re-set**” or “do-over” button discussed below treating social security benefits as the source of an **interest free loan** from the government, but this option is **limited to one year** from the date one elects retirement benefits.
5. **Strategy for Uncertainty.** If a single person has a serious life threatening disease and as a result, fears leaving money “on the table,” is early retirement always the best choice? There is an option that allows you to “wait and see.” It is called “**File and Suspend**.” If a worker would like the certainty of knowing that his or her benefits will not be utterly lost in the event of an untimely death but would like to try for DRCs if at all possible, a single worker can file for social security at full retirement age, but elect to suspend receipt of benefits. The worker will then begin to accrue delayed retirement credits, now known as VOLDRCs. At a later date, if this decision turned out to be a mistake due to the onset of a terminal illness, for example, the worker can **re-open the file and receive benefits retroactive to the date of the original filing**. An extra insurance policy! Please note this strategy only works for primary retirement insurance benefits (RIBs) and only for the NH’s (numberholder’s) benefit. POMS GN 02409.110. The receipt of disability insurance benefits prior to RIB has no effect on a beneficiary’s request to voluntarily suspend his or her RIB; also, note that the worker may be able to collect other benefits during the VOLDRC period such as survivor benefits if the worker was widowed.
 6. This strategy allows a person who has reached retirement age to file and suspend receipt of benefits, but also allows that person to change his or her mind at a later date and ask for the payment of those back benefits in a lump sum.
 7. For those with chronic but not life threatening disease, the calculus is more difficult, because higher, inflation adjusted social security payments later in life can be particularly valuable in paying for expensive medical or related care. People in poor health can still live a long time!
 8. But even if one does not live until the break-even age, the higher monthly benefits can be considered peace of mind insurance against such an eventuality. Novack, Janet “The Big Decision: When to Claim Social Security,” *Forbes*, April 7, 2009, quoting Steven A. Sass of the Center for Retirement Research at Boston College.

9. If work is difficult, or employment is not available, there are some complex charts that indicate the effect of reducing one's savings to achieve a delayed and higher later social security payment. The results can be counter-intuitive. See analyzenow.com and Boston College's Center for Retirement Research for more materials, as well as a number of articles by financial magazines and planners available on the web.
- a) The calculations for trade off vary with each client's circumstances and can be counter-intuitive. Clients with more modest savings may be better off with higher social security benefits; clients with substantial assets may do better preserving those assets.
 - b) As many middle class Americans age in their retirement, they tend to outlive their savings. Unexpected expenses such as home repairs, helping a child or children in distress, or debilitating long term illness can erode what seemed to be ample savings for many.
 - c) Statistics demonstrate that by the time many middle class Americans reach age 90, their savings have been significantly reduced or eliminated and social security benefits become the primary source of their retirement security. Even wealthy clients can fall victim to **bad investment markets and too much leverage**, for example, and become **formerly wealthy clients**.
 - d) Alicia H. Munnell, Director of the Center for Retirement Research at Boston College argues that "Social Security's Real Retirement Age is 70" in a working paper of the same name published in October of 2013 through that organization.
 - (i) When Social Security started in 1940, age 65 was the sole retirement age, determined to be the age at which many people could no longer work and provide their own independent support for health reasons. Because married women are often younger than their husbands, women were allowed to claim at age 62 so that both spouses could retire simultaneously in 1956; in 1961, men became eligible for early retirement as well. Then in 1972, DRC's were introduced up to age 72; in 1983 the age was reduced to the current age 70.
 - (ii) Life expectancy has increased by about 7 years from 1940 to 2014 and for many workers, age 65 no longer represents an age

they are physically unable to continue to work.

- (iii) However, **life expectancy varies greatly in the United States with socioeconomic status**, with higher status correlating strongly with longer life expectancy. This makes an overall retirement age for the population as a whole challenging. Those who have higher educations tend to work longer.
- (iv) Social security benefits tend to “replace” about one half of an average worker’s wages at full retirement age, although deductions for Medicare premiums and taxes may erode that replacement rate over time to one third. Those who take early retirement fare worse; social security tends to replace one third of their wages, dropping over time to one quarter. Those who retire at age 70 are more likely to achieve a 50% replacement rate (see Working Paper for graphs and tables).
- (v) Because of the psychological effect of “full retirement age” on claiming patterns, Prof. Munnell argues that age 70 should really be labeled as the full retirement age and all earlier years should be considered early retirement and the reductions more clearly identified in program materials.

B. Strategies For a Married Couple – One Primary Wage Earner

1. **For married couples** there are a number of factors to consider. The relative age of the spouses, their respective earnings history, their desired age of retirement, the difference between their ages, and finally, the desire of both spouses to retire at the same time (or not) can lead to a number of different retirement choices with one spouse choosing late retirement, another choosing early, or both choosing the same.
2. **One early, one late.** Many traditional couples consist of one spouse with a much higher wage earning record than the other, and an age difference of one to four years. The husband is often older and the primary wage earner, while the wife has a lower or non-existent earnings record and may be younger. In this case, some analysts believe that **the strategy to produce a good income in retirement over the lives of**

both spouses is the important but not well known technique known as **“file and suspend.”** Specifically, the higher wage earner may elect to delay benefits until age 70 (providing the maximum income for herself for life and the maximum survivor’s benefit for the surviving spouse for life) while the auxiliary or lower earning spouse takes spousal benefits (based on the higher earnings record of the primary earner) at the lower earning spouse’s early retirement age of 62 if the couple needs additional income right away. (Lower earner takes early retirement, higher earner delays to earn DRC’s). Bernard, Tara Siegel, “Collect Now, or Later? Timing Your Social Security Benefits”, the *New York Times*, July 11, 2009. This is one version of the **“file and suspend” strategy** mentioned earlier for single workers. Janet Novack, “The Big Decision: When to Claim Social Security,” *Forbes*, April 7, 2009.

3. Using this concept, **even if the primary spouse does not live beyond 82.5, the so-called break even year for maximum delayed retirement at age 70, these higher benefits will still be available to the lower earning or auxiliary spouse as survivor’s benefits.** These techniques have become available since the Senior Citizens’ Freedom to Work Act of 2000 and were first publicized by Glenn Ruffenach in “The Baby Boomer’s Guide to Social Security, *Wall Street Journal*, November 17, 2007.
 - (a) The lower earner’s reduced spousal benefits are often only temporary. If the “auxiliary” spouse is the younger wife, with a longer life expectancy, she will graduate to her husband’s higher DRC enhanced survivor benefits on his death.
 - (b) This can provide a high income over the longest period of time, adjusted for inflation.
 - (c) Since most couples rely on social security for spending and consumption, their focus is on maintaining income rather than the creation and increase of capital.
 - (d) Interestingly, this strategy to produce a high retirement income over the lives of a married couple is the opposite of the current American trend, which is increasingly for both spouses to take early retirement benefits at age 62 or 63.
 - (e) See also POMS Manual GN 02409.100, Voluntary Suspension, and GN 02409.110, Conditions for Voluntary Suspension.
4. **One standard (FRA), one late retirement.** Other financial analysts demonstrate both higher residual savings and higher income for spouses and survivors of modest means who delay taking benefits until the lower

earner is at full retirement age, currently 66, and the higher earner reaches age 70. (FRA for lower earning spouse, DRC's for higher earner). See, for example, Hebel, Henry K., "Should an early retiree take Social Security at 62?" *Analyzenow.com*, July 14, 2009. See also, Mahaney, James and Carlson, Peter, "Innovative Strategies to Help Maximize Social Security Benefits," *Prudential*, April 2009.

5. Even if the couple reduces retirement savings initially in order to finance the later start of social security, **they still may have increased savings from about age 80 on** due to the power of the substantially higher social security income according to Mr. Hebel. *Id.*
6. In addition to higher savings later in life, the couple, and later the surviving spouse, will have higher income as well, especially with COLA adjustments for inflation. *Id.*
7. **Other factors – the real reasons for retirement decisions:** poor employment options later in life, a bad economy, the decline of career employment and compromised health can lead a family's primary bread winner to take early retirement to avoid leaving "money on the table." A husband may fail to consider the survivor's benefit for his wife, who then may face a reduced standard of living for the balance of her potentially long life.

C. Dual Earner Married Couples – Alternate Strategies

1. For couples whose earnings records are roughly equal, what strategies are best? Are married dual earners better off simply acting as single individuals, or are there any special strategies available for them? Does the fact that both continue to work preclude them from electing spousal benefits?
2. If one working spouse wishes or needs to collect benefits earlier than the other, one option to consider is as follows. **The first retiring spouse can take benefits on that earlier retiree's own record at FRA, while the later retiring (and preferably higher earning) spouse elects spousal benefits on the early retiree's record once the later spouse reaches FRA, adding DRC's to his or her own record until age 70.** That provides two social security benefits before the higher earner reaches age 70: the earlier retiree's own benefits, and the higher earner's spousal benefits on the earlier retiree's record. At age 70 the later working spouse collects DRC enhanced benefits, which will then be available to the early retiree as survivor benefits if the late retiree/higher benefit spouse predeceases. Ruffenach, Glenn, "The Baby

Boomer's Guide to Social Security," *Wall Street Journal*, November 17, 2007.

3. **Both spouses maximize benefits.** An even more aggressive strategy is to wait until the **younger spouse reaches age 66, full retirement age**, and then have the older spouse "file and suspend" on the older spouse's record while both spouses continue to work to earn delayed retirement credits or DRCs. **The younger spouse may then elect to take spousal benefits, even while working**, on the older spouse's record. Then, when the younger spouse reaches age 70, he or she can elect to take retirement insurance benefits (RIB) on his or her own now fully enhanced record without any penalty for the four years of receiving spousal benefits.
4. This latter strategy works because the **Senior Citizens Economic Freedom to Work Act of 2000** does not allow social security to reduce benefits for a person who works beyond his or her full retirement age **and because the younger spouse is not collecting on her own record**, but on her spouse's record. Thus, a 66 year old wife should be able to claim full spousal benefits on her 66 year old or over husband's record without reduction for working until she chooses to stop working and receive her own RIB, enhanced by delayed retirement credits for not filing on her own record. See POMS Manual RS 00202.020, Spouse's Benefit – Payment; and RS 00202.025, Spouse's Benefits, Simultaneous Entitlement.
5. Well, if this works for one spouse, can it work for both spouses? For example, spouse #1 files on his record and suspends benefits, allowing spouse #2 to elect on #1's earnings, while spouse #2 files and suspends on her record, allowing spouse #1 to do the same. The answer, alas, under current rulings is no, unless the spouses divorce. The reason: both spouses have to open their files (albeit restrictedly) in order for spousal benefits to be paid to the other. Entitlement rules come into play once both files are open that would mandate calculating both regular and spousal benefits on at least one file, if not both, and POMS rules require that in cases of dual entitlement, the higher benefit be selected. The highest benefits on that open record would be the spouse's own retirement benefits. This is fine if one spouse wishes to stop working and collect (see example in paragraph 2 above) but not if both spouses wish to obtain the maximum DRCs by working until age 70. If only one spouse files for benefits, spouse #2 in our example, on spouse #1's record, her record is never opened for the purpose of computing benefits and she can collect the spousal benefits without jeopardizing future DRC increases to her RIB. See POMS Manual RS 00201.001, Entitlement.

6. Oddly, **if the spouses divorced** (we presume for other reasons), social security would allow both of them to collect spousal benefits on the other's record at age 66 while still working and collecting DRCs until age 70. Why? **Divorced spouses can collect on each other's earnings record without the primary spouse's record being opened.** They collect independently of each other's own filings. This is not the case for married spouses, alas, who must open at least one file in order to collect any benefits.
7. Separate claiming works if a working widowed spouse claims on the record of a deceased spouse. The working survivor can receive widow's benefits for a number of years and then file on her own higher earnings record.
8. Divorce and death are high prices to pay to maximize benefits. Dual earners may wish to content themselves with one of the two temporary strategies set forth above, depending on their individual circumstances, followed by years of dual primary benefits thereafter.

X. The Re-Set Button (Yes, There is a Start Over – BUT NOW IT IS LIMITED)

- A. Social security offers current recipients a “start over” or “do over” if a recipient wishes to obtain the benefit of the higher monthly income available for those who took later retirement.
- B. A recipient can take advantage of this option by “simply” paying back all social security benefits received to date, **without interest or penalty.**
- C. However, Social Security Regulations changed in mid-December 2010 to restrict this option for one year only from the date the recipient first elects to receive benefits.
- D. Be careful – a full pay back is tricky. Some local offices are not familiar with the procedure. One must pay back the gross, not net amount, which means that any Medicare payments deducted for Parts A, B, C and D must also be returned.
 1. **Form 521, Request for Withdrawal of Application**, is the form to use (see **Example attached**). It is available at www.ssa.gov.
 2. If income tax was paid on the early social security benefits that are later repaid using this method, may claim a deduction on Schedule A of the current year Form 1040. **IRS Publication 915**, Social Security and Railroad Retirement Benefits, provides guidance.

E. **What are social security benefits worth?** In an attempt to calculate the cost of replacing social security benefits by other means, the author looked at the cost of purchasing an immediate, lifetime annuity as an alternative means of replacing this income stream.

1. As of January 2010, to replace \$1500 per month in benefits (the difference, for example, of retiring at age 62 or at age 70), the cost of an **immediate lifetime annuity with no guaranteed term** through Vanguard would be as follows:

(a) female, age 62, Connecticut:

(1) no inflation protection \$262,917.53

(2) **with inflation protection \$388,550.14**

(b) male, age 62, Connecticut

(1) no inflation protection \$243,399.45

(2) **with inflation protection \$349,165.65**

2. For an annuity with **survivor benefits**, the cost of a \$1500 per month immediate annuity is higher:

(a) male, age 62, spouse, age 60, Connecticut

(1) no inflation protection \$296,316.82

(2) **with inflation protection \$450,249.90**

(b) For inflation protection, these annuities use the CPI Urban Index, whereas social security retirement benefits use the CPI Wage Index, so the comparisons are not exact.

(c) The annuities currently offered are provided by AIG, which has been downgraded in the national rating systems.

(d) This is a very low interest rate environment, so annuity prices are higher today than they would be in a higher interest rate environment. For those retiring now, however, this does give an approximate idea of the current value of \$1500 worth of social security benefits, both singly and with survivor benefits.

F. The cost of repaying social security for one year at age 66 or 68 for benefits received, and then possibly waiting in order to receive higher benefits going forward (for oneself and potentially for a survivor) may be much less than the cost of purchasing a commercial annuity for an equivalent amount. The only way to be certain, of course, is to do the calculations and compare.

G. For another take on what social security benefits are worth, The Urban Institute, a nonprofit, nonpartisan, policy research and educational organization, calculated

how much average American wage earners first pay in payroll taxes and then receive back in Social Security and Medicare benefits over their lifetimes. A recent study further compared the figures for retirees in 1960, 1980 and the present, as well as estimates for retirees in the future.

1. For social security benefits alone, average single wage earners who retired in 1960 and 1980 received substantially more back in benefits than they paid in for social security taxes; the balance begins to shift for those who retire in 2010 (and likely the future).
2. For married couples, those who retired in 1960 or before did very well, as did 1980 retirees. Married couples with only one wage earner will still receive back much more than the primary wage earner paid in, even for current and future retirees. However, dual wage earners, where each spouse earns the same average wage, do the worst of all groups, paying in combined OASDI taxes higher than what they likely will receive if they retire now or in the future.
3. However, taking into account Medicare taxes and benefits changes the equation in favor of all retirees (suggesting likely future funding problems with the Medicare system) as even current or future dual wage earner retirees will take out more than they paid in!
4. For more information, see C. Eugene Steuerle and Stephanie Rennane, "Social Security and Medicare Taxes and Benefits Over a Lifetime," January 2011, Urban Institute.

XI. Disability Benefits Under Social Security

- A. An important aspect of the social security system is the disability benefits it provides, not only for workers, who receive benefits if they are unable to work, but also for their children, if the child is disabled from an early age and is never able to work.
- B. Studies from the Social Security Administration show that a 20 year-old worker has a 3 in 10 chance of becoming disabled before reaching retirement age. SSA Publication No. 05-10029 August 2009.
- C. "The federal government is responsible for establishing disability criteria, approve DDS budgets, issuing national instructions and developing policy and procedure, as well as paying benefits and maintaining records." "State participation has been an important authorized component in the disability determination process from its introduction. With some technical exceptions from State jurisdiction, most disability claims are decided by the Disability Determination Services (DDS) in the State where the worker resides." POMS Section DI 0015.001.

- D. **For adults** (NH's age 18 or over), the term disability means **“The inability to engage in any substantial gainful activity (SGA) by reason of any medically determinable physical or mental impairment(s) which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.”** POMS Section DI 00115.015.
- E. DIB benefits are payable after a waiting period of 5 full calendar months of disability. An application for benefits may be retroactive for no more than 12 months before the month the application is filed. POMS Section DI 00115.025.
- F. **Social security disability benefits for workers** are based on two earnings tests: a “recent work” test based on the age the worker becomes disabled; and a “duration of work test” to show that the worker has sufficient quarters of coverage under social security.
- G. The “recent work test” or “20/40 test” establishes that a person has been active in the work force.
1. A person must have worked 20 out of the last 40 quarters or 5 of the last 10 years to meet this test.
 2. Interestingly, people who are statutorily blind are exempt from meeting the recent work test in determining their disability. POMS DI 10105.005.
- H. The “duration of work test” establishes that the worker is fully insured and has disability insured status. A person meets this test if he or she has worked a minimum number of quarters based on age.
- I. Younger workers need fewer years of work to qualify, approximately half the quarters since age 21; for older workers there are specific targets.
1. If a person becomes disabled in the quarter before he or she reaches age 24, then 1.5 years of work during the three year period ending with the quarter the disability began is sufficient.
 2. If a person becomes disabled in the quarter after reaching 24 but before the quarter turning 31, then the person must have worked at least half the time during that period before the person became disabled.
 3. If a person becomes disabled at age 31 or later, the total number of years worked to be fully insured for disability increases with age. At age 46, the total number of years is 6; at age 50 it is 7 years; at age 60 it is 9.5 years. Publication Number 05-10029.
- J. A worker's disability payment under the Disability Insurance Benefit DIB is slightly less than that worker's PIA under the RIB program.

- K. **Social Security benefits for children** with disabilities initially fall under the Supplement Security Income or SSI program.
- L. **“A claimant under age 18 will be considered disabled if he/she has a medically determinable physical or mental impairment or a combination of impairments that causes marked and severe functional limitations that can be expected to result in death or has lasted or can be expected to last for a continuous period of not less than 12 months.”** POMS Section DI 00115.05.
- M. The second essential qualification for a child is based on income and resources. The child must not be working and earning more than \$1000 per month (2010 figures). There are more complex rules about the child’s resources, see
- N. The child’s circumstances are reviewed when the child reaches age 18. At that time, the definition of disability is the same as the adult definition of disability (no substantial gainful employment) and social security no longer counts the income and resources of family members in the needs computation.
- O. A primary benefit of having a child or young adult be determined disabled is several fold.
1. **First, being disabled as determined by the Social Security Administration is a requirement for the establishment of a Special Needs Trust** pursuant to 42 U.S. Code Sec.1396p (d)(4)(A) or (C) to shelter assets belonging to the child without penalty and without loss of eligibility for the Medicaid and SSI programs. This requirement does not apply, of course, to third party special needs trusts, but many disabled children inadvertently end up with resources that can create eligibility problems for them.
 2. Second, this determination can provide a child **entrée into a number of programs run by the child’s state** that may be vitally important to the child’s well-being, especially when the child reaches age 18 or 21. The breadth of programs may not necessarily be duplicable by private means.
 3. Third, **when the disabled child’s parent retires, becomes disabled or dies, the child may receive benefits under the SSDI program** rather than the SSI program based on the parent’s social security earnings record. See POMS Section RS 00203.001.
 - (a) For a disabled adult to become entitled to this “child” benefit, **the child must have had a disability that began before the child became 22 years old.** This can be difficult to prove 40 years after the fact.

- (b) The parent must be receiving social security retirement (RIB) or disability (DIB) benefits or must have died while fully or currently insured.
- (c) The means testing of SSI is eliminated when the child “graduates” to SSDI and the benefits are often substantially increased.
- (d) Note that a child must be unmarried and must have been dependent upon the NH (parent). There is a social security version of the “slayer” statute in the POMS as well.

IX. Proposals to Reform Social Security

- A. **The finances of the current system.** There are a number of proposals to reform the U.S.’s social security system, a pay-as-you-go pension system. As the baby boomers reach early retirement age in a down economy, many unemployed workers are electing early retirement as their unemployment benefits have run out. For the first time since 1983, according to the Congressional budget office, social security payments have exceeded payroll taxes this year. While this is likely to be a temporary phenomenon if the economy recovers from the current severe recession, the system is likely to go into negative balance again in 2016 if no changes are made. At that time, interest from the bonds in the Trust Fund will be needed to help pay benefits. Around 2024, benefits will exceed payroll taxes plus interest, so the Trust Fund will need to start selling bonds to pay benefits.
- B. **The problem.** The future imbalance between system receipts and outlays is primarily be caused by the aging of the U.S. population. Beginning in 2039, or now as early as 2037 (due to recession based reduction in earnings and more early retirements) according to the Congressional Budget Office, if revenues are not increased, benefits would need to be cut by 20% in 2038 or sooner to bring the system into balance. Particular pressure has come from increased disability claims (although women’s mortality has increased in recent years), as well as reduced payroll and hence payroll taxes during the Great Recession. The shortfall is currently projected to be about 0.9% of GDP over a 75 year actuarial balance calculation (that is, to bring the program into balance over the next 75 years, payroll taxes would have to be increased by 0.9% of GDP or scheduled benefits would have to be reduced by an equivalent amount, or a combination). Another way to consider the problem is that Social Security’s long run deficit is projected to equal 2.72 percent of covered payroll earnings and increasing payroll taxes by 2.72 % would also bring the system back in balance for the next 75 years. The long term goal, of course, is to “fix” social security permanently, not just for 75 years. See Prof. Alicia Munnell, “Social Security’s Financial Outlook: the 2013 Update in Perspective.” Center for Retirement Research at Boston College, June 2013.

- C. **Possible solutions** have been proposed from a number of different partisan, bi-partisan and non-partisan groups.
1. **The Congressional Budget Office’s July 2010 Study.** This extensive report analyzes 30 different options to provide long term stability for the existing social security system. It does not consider reducing initial benefits to those who are currently over age 55 nor does it consider options such as privatizing the system or using individual private accounts. Policy options fall into five categories (and combinations of these alternatives examined for fairness to young and older workers; higher and lower earning workers; current workers and current retirees).
 2. **The basic options considered by the CBO:**
 - a. Increases in the social security payroll tax (including extending the earnings subject to the tax from the current \$117,000 to a higher number, such as \$172,000)
 - b. Reductions in people’s initial benefits
 - c. Increases to benefits for low earners
 - d. Increases in the full retirement age
 - e. Reductions in the cost of living adjustments that are applied to continuing benefits.
 3. **The Commission to Reduce the Public Debt** chaired by Erskine Bowles and Alan Simpson have also weighed in on social security reform. Their proposals include reducing social security benefits for wealthier recipients, a less generous COLA for benefits (chained CPI) expanding from 35 years to 40 years the record for calculating benefits (which tends to reduce benefits and particularly hurts women), and very slowly increasing the full retirement age from 67 in 2027 to 68 in 2050 and 69 in 2075. Note that research indicates the traditional CPI-W tends to understate inflation for the elderly and a chained CPI would do so to a greater extent, indirectly reducing benefits more to older retirees.
 4. **Boston College’s Center for Retirement Research** has looked at this problem over the years and has published its own “Social Security Fix-It Book.” The revised 2009 edition is available on their website and includes “everything the earnest but over-burdened citizen needs to know – cheerfully narrated and handsomely presented in 52 pages.” Solutions are divided into two categories, with analyses of the pros and cons of each: cutting benefits and increasing taxes. A final solution

may be like a Chinese restaurant menu: a combination of several from each column. Clearly some options are more palatable than others.

- a. **Ways to cut benefits** include the following:
- (i) an immediate, across the board 13% cut in benefits (**or** no change for current retirees but a 20% reduction for new retirees);
 - (ii) raising the full retirement age to 67 more quickly and continuing to raise the FRA as life spans increase;
 - (iii) freezing the purchasing power of benefits by indexing to prices rather than wages (ultimately reducing retirees' standard of living relative to the rest of the population);
 - (iv) freezing the purchasing power of benefits on a sliding scale;
 - (v) changing the COLA to a revised CPI; and
 - (vi) doing nothing now ("we are good at that") followed by abruptly cutting benefits in 2037 or 2039 to 78 cents on the dollar.
- b. **Ways to increase revenues** include the following:
- (i) increasing the payroll tax today by 2 % of earnings, half from workers and half from employers;
 - (ii) allowing social security to build up a larger trust fund and finance more of the program's obligations;
 - (iii) raising the earnings cap from the current \$106,800 representing 83% of all U.S. earnings, back to the 90% of all earnings (\$172,000) when the program was first begun, or 100% of earnings as the Medicare tax does;
 - (iv) using the estate tax to help fund social security;
 - (v) transferring the program's start-up costs from many years ago (when retirees received benefits worth far more than what they paid in) to general revenues so that each generation's payroll taxes would more closely reflect the benefits it receives;

- (vi) raising the return on assets in the trust fund, which currently holds about \$2.5 trillion in government bonds by investing some of these dollars, perhaps about 40%, in stocks. Experience from the Railroad Retirement Fund indicates that using index funds and other restrictions may be appropriate for such an approach.
 - (vii) doing nothing now (yes, we are good at that) but raising taxes in 2037 or 2039 abruptly to 16.3 percent of earnings, split between employer and employee.
- c. **Easier to fix now than later.** The Center points out that a lasting fix for social security should begin now, when it is least expensive and might include a combination of options. Raising the payroll tax by 2%, indexing the full retirement age to longevity and investing the trust fund 40% in equities instead of 100% in low yielding Treasury obligations might provide a possible way for permanent long term reform.

X. Conclusion.

- A. Social Security is a complex field; this outline merely provides a brief overview.
- B. Because these benefits are ubiquitous but poorly understood, having a basic knowledge of the system and the most common problems, strategies and techniques helps us in our role as counselors to add value as we advise our clients, their parents and their children through the maze of benefit programs and maximize their own entitlements.
- C. Since many of us will, with luck, retire someday, having a basic knowledge of social security may make our own retirement a bit smarter, when that day inevitably arises. Our clients, spouses and children may thank us.