



January 1, 2015

## Social Security Benefits: How to Maximize Them and How to Plan with Them

Ever since the Social Security Act was signed into law in August of 1935, the federal insurance program has grown leaps and bounds in terms of the number of beneficiaries and coverage. According to data from the Social Security Administration, a little over 53,000 people received a total of \$1.3 million dollars of benefits in 1937. By 2008, the number of recipients was almost 51 million while aggregate benefits paid totaled over \$615 billion. Several amendments throughout the decades have added significant changes, such as disability (1954), medical coverage for seniors through the Medicare bill (1965), and automatic cost-of-living-adjustments or COLAs (1972).<sup>1</sup>

Did you know Social Security tax has two parts, OASDI (Old-Age, Survivors, Disability Insurance) and Medicare?

In this quarterly letter, we will be looking at the factors determining Social Security (SS) benefits and how to incorporate them into a retirement plan.

### Social Security Credits

In order to be eligible for SS benefits, a U.S. worker aged at least 18 has to accumulate credits. For 2015, it takes \$1,220 of covered earnings to earn one credit. Up to four credits can be earned throughout each calendar year and no more than 40 credits can be accumulated (10 years of earnings record). To properly receive the credits, make sure SS (FICA or OASDI) taxes are being deducted from payroll.

### Earnings Record and Retirement Benefits

So how are SS benefits determined? Two factors: earnings (dollar) and work history (years). SS looks at a worker’s highest 35 years of earnings and computes what is known as the “primary insurance amount,” or PIA, which is the benefit a person would receive at full retirement age (FRA). When clients are contemplating retirement, one of the questions we ask them is how many years of SS earnings do you have in the system? Sometimes it makes sense to stay in the workforce for a few more years.

### Retirement Age and Benefits

In addition to earnings history, deciding when to retire has perhaps an even bigger impact on benefits. FRA for baby boomers (born in 1943 to 1954) is 66, and that increases to 70 for those born in 1960 and later.

Workers can opt to claim SS retirement benefits as soon as they turn 62, with a reduction up to 25%. There is a

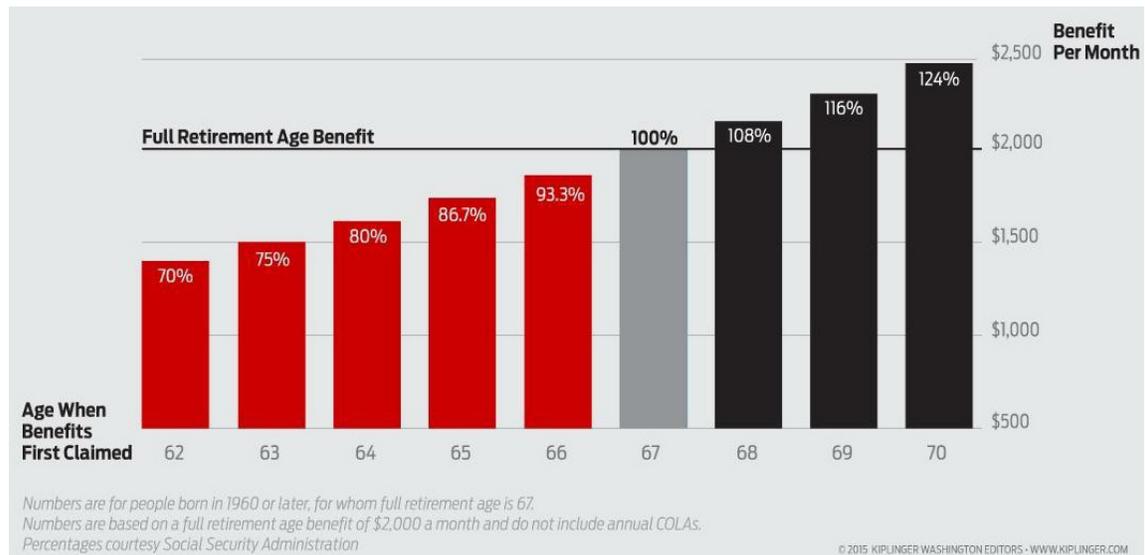
Rising Retirement Ages	
Year of Birth	Full Retirement Age
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

<sup>1</sup> <http://www.ssa.gov/history/briefhistory3.html>



handy calculator online that compares benefit decrease (and increase) at different retirement date.<sup>2</sup>

While claiming SS benefits early results in benefits reduction, delaying them, on the other hand, comes with a bonus. For every year of not claiming SS benefits once FRA is reached, a worker will receive a bump of 8% in benefit, up to age 70 (Figure 1).



**Figure 1. Social Security retirement benefits when claimed at different ages**  
Source: Kiplinger, Social Security

## Work, Taxation and Social Security

There are some special rules regarding working and claiming SS benefits before FRA. In a nutshell, SS benefits are reduced if a worker/recipient makes over \$15,480 in 2015.

For people younger than FRA during the whole year			
If your monthly SS benefit is	And you earn	Your annual SS benefits is	Reduction is
\$700	\$15,480 or less	\$8,400	\$0
	\$16,000	\$8,140	\$260
	\$20,000	\$6,140	\$2,260
\$900	\$15,480 or less	\$10,800	\$0
	\$16,000	\$10,540	\$260
	\$20,000	\$8,540	\$2,260
\$1,100	\$15,480 or less	\$13,200	\$0
	\$16,000	\$12,940	\$260
	\$20,000	\$10,940	\$2,260

**Table 1. SS benefits comparison for workers claiming benefits before FRA.**  
Source: Social Security Administration

<sup>2</sup> [http://www.socialsecurity.gov/OACT/quickcalc/early\\_late.html](http://www.socialsecurity.gov/OACT/quickcalc/early_late.html)



The above rules do not apply anymore once a worker reaches FRA; however, SS benefits become taxable once household income goes over certain threshold.

Taxable portion of SS benefits is	Combined income* is	
	Single filers	Joint filers
50%	\$25,000 - \$34,000	\$32,000 - \$44,000
85%	\$34,000 and above	\$44,000 and above
*Combined income =	Adjusted gross income (AGI) + Non-taxable interest + ½ of your SS benefits	

**Table 2. SS benefits and taxation.**  
 Source: Social Security

This creates a dilemma to retirees and advisers alike. SS counts non-taxable interest income when figuring out how much of the benefits are subject to income tax. Retirees who count on municipal bond interests as one of the funding sources often have a hard time understanding this “taxable” concept. Having a sizable municipal bond portfolio during retirement, therefore, may not be as “tax-friendly” as one believes.

### Smart and Thoughtful Planning

How do we incorporate SS into a retirement planning scenario? Or better yet, how do we know which SS withdrawal strategy is the most beneficial? We can solve that puzzle! By looking at all the factors that go into creating a retirement plan, our plan can quantify 1) the maximum SS benefits throughout retirement and 2) the strategy with the best probability of success.

Social Security Strategy	Strategy Used in Current Scenario	At retirement	At FRA	At age 70	Jack begins at age 70 and Jill begins at FRA	Jack files/suspends, Jill restricted application	Jill files/suspends, Jack restricted application
Start age							
Jack	66	63	66	70	70	70	66
Jill	66	64	66	70	66	67	70
First year benefit in current dollars							
Jack	\$32,626	\$25,285	\$32,626	\$41,761	\$41,761	\$41,761	\$13,797
Jill	\$27,594	\$23,301	\$27,594	\$35,688	\$27,594	\$16,313	\$35,688

#### Maximization Based on Cash Received

Total lifetime benefit in current dollars	\$1,663,596	<b>\$1,461,568</b>	\$1,663,596	\$1,829,171	\$1,761,474	\$1,878,110	<b>\$1,884,359</b>
Break Even Point							
Jack		N/A	76	80	79	78	78
Jill		N/A	77	81	80	79	79

#### Maximization Based on Overall Plan Result

Probability of success	92%	91%	92%	<b>93%</b>	92%	<b>93%</b>	<b>93%</b>
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For instance, in the above plan for Jack and Jill, the difference of benefits between the circled choices is over \$400,000. Delaying SS may not always yield top dollar. Also, after considering other factors such





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Social Security Benefits  
Henry Yu, 1/1/2015

as investments, retirement lifestyle, goals, etc., we arrive at a strategy that would achieve two things—  
maximizing SS and maximizing plan probability (yellow highlights).

- Henry Yu, CFP®

