Retirement Fitness Challenge

The Retirement Fitness Challenge, while simple in concept, is an evolving program that presents different layers of complexity based on each retiree's unique needs.

Take The Retirement Fitness Challenge Today!

The following is a sample chapter of the book on how to maximize your Social Security benefits. The full book can be ordered on Amazon.com.

The strategy behind the Retirement Fitness Challenge is simple—put together your own customized retirement plan that will prevent you from outliving your money and enable you to enjoy the retirement of your dreams.

If you have any questions on the book or on planning your retirement please contact the author Marc Bautis.

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To learn more, please visit www.RetirementFitnessChallenge.com or www.BautisFinancial.com. You can also contact him at marc@bautisfinancial.com or 201-842-7655

Chapter Five – Social Security

Most people tend to minimize the value of Social Security. I know I initially did. After finishing college I got a job, and when I received my first paycheck I felt like a kid in a candy store. However, after I looked at my paycheck excitement turned to anger, frustration, and sorrow as I saw what my take home pay was after taxes.

One of the deductions that particularly stood out was the Federal Insurance Contributions Act (FICA) tax. I had no idea what FICA was until someone finally explained it was a Social Security and Medicare tax. I didn’t understand why at 21 years old I had to pay so much for something that I would not collect until at least forty years later. Once I understood Social Security benefits in more detail and realized how much they could actually be worth, my opinion towards Social Security changed.

Benefits of Social Security

After paying into the Social Security system for 30, 40, or more years, it is now your turn to collect. What exactly do you get for all the money you’ve contributed? Surprisingly, a lot. The first benefit, and the one that probably comes to most people’s mind, is the monthly Social Security payment people receive, which can be substantial.

As explained earlier, inflation is one of the biggest risks to outliving your money. Social Security provides a cost of living adjustment to help retirees handle rising prices. If your monthly Social Security benefit today is $2,000 and annual COLAs are 2.8 percent in 10 years your benefit will rise to $2,636 per month. In 20 years your benefit would be $3,474 and in 20 years it would be $4,580.

If your monthly benefit today is $2,000 and you live 10 more years, you will collect over $300,000 in lifetime benefits. If you live 20 years, you will receive a total of $673,000 and if you live 30 more years, you will collect over $1.1 million in benefits. The longer you live the more you will extract from the system. It is also one of the few sources of income that you cannot outlive and in that respect acts as an annuity.

Cost of living adjustments are one of Social Security's best features. But 2011 marked the second year in a row where there were not any COLA for Social Security recipients. When consumers see an increase in costs like groceries and gas, they may wonder why their Social Security monthly income remains the same. It's because COLAs are based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), which is determined by measuring price changes from one month to the next for a selection of goods and services such as food, housing, apparel, transportation, medical care, recreation, and education.

Between 2010 and 2011, for example, the biggest price jumps were in transportation and medical care, up 5.2 and 3.6 percent respectively. Food prices rose by 1.4 percent and fuel oil increased 12.3 percent. Housing was flat.

The reason there was no COLA in 2010 and 2011 is because in 2008 a dramatic spike in energy prices caused that year's third quarter average for the CPI-W to be 215.495. Even though the index fell immediately thereafter, Social Security recipients got a 5.8 percent increase in January 2009. So until the third quarter average for the CPI-W exceeds that previous high of 215.495, there will be no cost of living increase. In 2011, it was 214.136, so according to the formula established by Congress in 1973 Social Security benefits will not receive a cost-of-living adjustment in January.

Survivor Benefits

Another advantage of Social Security is that it offers survivor benefits. If you die, your spouse and your children may receive benefits based on your work record, which makes Social Security like an automatic life insurance policy.

Suppose you have a retired couple and both are receiving Social Security payments. Should one spouse die, the surviving spouse receives either their benefit or their spouse's benefit, whichever is greater. So if Joe's benefit is $2000/month and his wife Julie's benefit is $1500/month, if Joe dies, Julie would notify the Social Security department and her $1,500 benefit would automatically be replaced with her $2,000 survivor benefit. In the same example if Julie died, Joe would retain his $2,000/month benefit.

To collect survivor benefits the marriage must have lasted at least nine months and the survivor must be at least 60 to collect. Like all Social Security benefits, if the survivor applies before their full retirement age their benefit will be reduced.

Spousal Benefits

The Social Security program was initiated in the 1930s at a time when most married women did not work so spousal benefits were included to give them a sense of financial security. These benefits equal half of the primary worker's monthly payment. The spouse earning less receives either their own benefit or one half of the benefit of their spouse, whichever is higher. So if Joe's monthly benefit is $2000 and Joan's is $800, Joan could claim Spousal Benefits and receive $1000 per month. In another example, if

Stephanie’s benefit is $2000 while Lloyd’s is $1200, he would collect his own benefit of $1200 because it is greater than half of Stephanie’s benefit.

There are a couple of rules associated with Spousal Benefits: a spouse cannot claim both their own benefits and spousal benefits and cannot claim spousal benefits if the spouse has not claimed their own benefits.

Similar to individual benefits, the spouse must be at least 62 to claim spousal benefits. And like individual benefits, if you apply for spousal benefits prior to your full retirement age, you will receive a reduced benefit. Unlike individual benefits there are no delayed credits on spousal benefits after age 66.

A woman can receive Social Security based on her ex-husband’s work record provided the marriage lasted 10 years or more and she is currently unmarried. More than one ex-spouse can receive benefits on the same worker’s record. So Larry King could potentially have seven ex-spouses collecting off his work record. The worker is not be notified that an ex-spouse has applied for benefits. The applicant only needs enough identifying information that the Social Security people can look up the records.

If you are receiving divorced-spouse benefits and you remarry, your divorced spouse benefits will stop. However you can start collecting SS benefits on your own record or on your new husband’s work record.

When to Apply for Benefits

Planning for Social Security used to be a simple process. When you turned 62 or 65 you went to the Social Security office and applied for benefits. Nowadays, there are different factors unique to your situation that need to be considered before applying, but the decision of when to apply for benefits is important and can mean thousands of dollars over your lifetime.

The concept is simple: the longer you wait after age 62 to pull the trigger to start collecting your benefits, the larger your monthly Social Security payment will be. If you apply at age 62 for benefits, you'll receive only 75 percent of what you'd receive by waiting until full retirement age, which is 66 for most people.

The following table displays how your benefits will be impacted should you apply prior to your full retirement age.

If you were born between 1943 and 1954:

Apply at age	Percent of Monthly Benefit	Example: if monthly benefit is $2,230
62	75.0 percent	$1,672
63	80.0 percent	$1,784
64	86.7 percent	$1,933
65	93.3 percent	$2,080

On the positive side, if you apply after your full retirement age, you will earn delayed credits to the tune of eight percent per year. There are not many investments currently available where you can earn a guaranteed eight percent annual return on your money

If you were born between 1943 and 1954:

Apply at age	Percent of Monthly Benefit	Example: if monthly benefit is $2,230
66	100 percent	$2,230
67	108 percent	$2,408
68	116 percent	$2,587
69	124 percent	$2,765
70	132 percent	$2,943

When possible, I advise delaying applying for Social Security benefits. The above tables show the monthly benefit received from Social Security increases the longer you wait and the gap widens even more when the cost of living adjustments are factored in. If your monthly benefit is $2,230 and you apply when you are 62, you can expect to start with $1672 in benefits, but if you wait until you are 70 you can expect $2,943

But it can be very hard to pass up Social Security checks when you can start receiving them as early as 62. It is the same as when people in their 20s and 30s have a hard time saving for retirement. The breakeven point as to when you would receive more cumulative benefits by waiting rather than collecting early is between 77 or 78 years old. That means if you live to be older than 77/78 over your lifetime you would have collected more social security benefits by waiting to collect rather than collecting at 62

Some key points to remember about when to collect are:

- If you collect early your benefit does not go up when you reach age 66
- Your decision on when to collect also impacts survivor benefits. If the higher earning spouse delays when they collect it will give their survivor more income

Other Factors

The bottom line is: there is no one-size-fits-all answer on when to apply for benefits because there are a number of factors to consider:

- Health status and life expectancy: those who have a history of longevity in their families, they may need income well into their 90s. For people in this class it may make sense to delay collecting benefits to obtain the larger Social Security paycheck.

- Need for income: It is nice to delay benefits, however some people need the extra income at 62 and can't afford to wait and delay benefits.

- Whether or not you plan to work: if you are still collecting a paycheck from your job, probably won't need to collect Social Security benefits.

- Survivor needs: delaying benefits also increases the amount of benefits a survivor will receive should something happen to the primary worker.

Maximizing Benefits

The first thing you can do, while you still have time, is improve your earnings record. Your benefit is calculated by taking the highest 35 years of annual income. Working a couple of years may yield a significant increase especially for stay at home moms who have some gaps in their earnings history. It can also boost up the average for people who may have not collected a high salary early in their working careers.

The Primary Insurance Amount, or PIA, is the amount used as the beginning point in calculating any benefit

There is a lot of research being conducted by different organizations like the Center for payable under Research out of Boston College on how couples can maximize their benefits and one of the strategies is to coordinate spousal benefits. The goal is to maximize income for both spouses while they are alive and maximize income for the survivor after the other dies.

The first technique we are going to look at is called Claim and Suspend. With this strategy at full retirement age (FRA), the higher earning spouse applies for their benefit and asks that it is suspended. The lower earning spouse then files for their spousal benefit. At age 70, the higher earning spouse would activate their benefit to start receiving payments.

Claim and Suspend Example

Jack and Jill are 66.

Jack's PIA is $2,000; Jill's PIA is $800. If Jack waits until age 70 to apply, his benefit will increase to $2,640. However, Jill may not claim her spousal benefit until Jack files for benefits.

Jack Files and suspends at 66. This entitles Jill to her spousal benefit, while Jack's benefit continues to earn delayed credits.

Claim Now, Claim More Later Example:
Mike and Mary are 66
Mike's PIA is $2,000; Mary's PIA is $800
Mary files for her benefit at 66; Mike files for his spousal benefit at the same time and begins collecting $400 (half of Mary's PIA)
When Mike turns 70, he switches to his higher benefit.
Result: Mike receives an additional $400/month from age 66-70

Claim now, claim more later is another strategy that can be used to maximize benefits. At full retirement age the higher-earning spouse applies for their spousal benefit. At 70, they then switch to their own higher benefit.

There are a couple of things that must be considered when adopting this strategy:

- The higher-earning spouse may not do this before you your FRA
- Language to use when applying: Higher-earning spouse says he is "restricting" his application to his spousal benefit
- Only one spouse may do this (both spouses cannot receive simultaneous spousal benefits)

Some of the strategies can be complicated, but by understanding the concepts and executing some calculations, it is possible for married couples to come up with the right solution for their needs.

Social Security and Taxes

Do I have to pay taxes on the income I receive from Social Security?

That is one of the most frequent questions I am asked in giving a workshop on Social Security. The answer is most likely *yes*, with up to 85 percent of your benefits taxable. Like anything else regarding the United States tax code, Social Security taxes are not straight forward.

The taxability of Social Security benefits are a function of the total amount of Social Security benefits you receive, and the amount of any other income.

Calculating the Taxable Portion of Social Security Benefits

If a taxpayer's modified adjusted gross income for the tax year plus half of the Social Security benefits received during the tax year exceed the base amount, then the lesser of the following two amounts must be included in gross income and is therefore taxable:

- One half of the Social Security benefits received during the year; or
- One-half of the amount by which the provisional income exceeds the base amount

The base amount is:

- $32,000 for married individuals filing jointly
- $0 for married individuals filing separately
- $25,000 for everyone else

For taxpayers with provisional incomes above an adjusted base amount—$44,000 for married individuals filing jointly; $0 for married individuals filing separately; and $34,000 for unmarried individuals— your Social Security income has to be included in your taxable income:

Example

John, a single individual has income of $20,000, plus $10,000 of Social Security benefits. He also received tax-exempt interest of $7,000 during the tax-year

Step 1: Determine modified adjusted gross income
Income: $20,000
Plus Tax-exempt income: $7,000
Modified adjusted Gross Income: $27,000

Step 2: Determine if modified adjusted gross income plus on-half of the Social Security benefits received exceeds the base amount
Modified adjusted gross income $27,000

Plus one-half of Social Security benefits: $5,000
Total: $32,000
Minus base amount: $25,000
Excess $7,000

Step 3: Determine what amount must be included in gross income:
One-half of Social Security benefits received: $5,000
or
One-half of excess amount: $3,500

John must include the excess amount of $3,500 in his taxable income.

The Earnings Test

The Earnings Test is an area of Social Security that confuses many people. Simply speaking, Social Security withholds benefits if your earnings exceed a certain level ($14,160 and if you are under your FRA, which is between 65 and 67, depending on when you were born. The $14,160 is the retirement earnings test exempt amount. If that amount is exceeded, Social Security will withhold $1 in benefits for every $2 of earnings.

Here is an example to illustrate how this works:

Bob is 63 years old and is collecting $1,500 per month ($18,000 per year) in Social Security benefits. He is also still working and is earning $30,000 a year at his job. Since Bob is under his full retirement age, he must go through the Earnings Test.

1. Subtract the earnings test exempt amount from his yearly earnings.

$30,000 - $14,160 = $15,840

2. Divide that amount over the exempt level by two.
$15,840 / 2 = $7,920

3. The amount determined in step two is how much of Bob's Social Security benefits will be withheld.
$18,000 - $7,920 = $10,080

So instead of receiving $18,000 per year in Social Security, he will only receive $10.080. If you earn $14,160 or less, your Social Security benefits will not be impacted. If you make between $60,000 and $70,000 you will have all of your Social Security benefits withheld.

However, once you reach full retirement age, you are no longer subject to the Earnings Test and are free to earn as much income as you would like—or are able to—and not have any Social Security benefits withheld.

Filing Taxes

A question that often comes up in my Social Security Planning seminars is how a spouse's earnings impact their Social Security benefits since they file their taxes jointly. The following example shows how this situation works.

Bob and Jane are both 62 years old. Bob plans to continue working, potentially until he is 70. Jane is looking to retire and start taking collecting her Social Security benefit now and wants to know if Bob's earnings will impact the amount of she receives.

Even though Bob and Jane file their taxes jointly, The Earnings Test for Jane would be based off of her W-2 and not off their joint tax return. In other words, the amount of money that Bob earns is irrelevant to Jane's Social Security benefits.

Conclusion

The important thing to remember about Social Security is that everyone is in a unique situation. For many people, Social Security typically represents about 20-40 percent of one's income during retirement.