Table of Contents

Part Two
Rules for Less Common Situations

Part Three
Social Security Planning: When to Claim Benefits

Part Four
Other Related Planning Topics

INTRODUCTION

The Benefits of Understanding Your Benefits

According to the Social Security Administration, as of 2012, Social Security benefits make up approximately 39% of the income of U.S. citizens age 65 or older. Unfortunately, it's common for retirees to make decisions regarding their Social Security benefits that cause them to miss out on tens of thousands of dollars (or sometimes even hundreds of thousands of dollars) over the course of their retirement.

Assuming that you anticipate Social Security benefits playing a meaningful role in your retirement finances, it's important for you to understand how the system works and what you can do to get the most out of your benefits.

What We'll Be Covering

This book is organized into four sections. Part 1 covers the basic rules: how retirement benefits are calculated, how spousal benefits are calculated, and how widow(er) benefits are calculated. Part 2 takes a look at the rules for a handful of slightly less common situations—when you or your spouse have a pension from government work, for instance. Part 3 discusses the question of when to start taking Social Security benefits and provides a few strategies for getting the most out of your benefits. Part 4 covers some related planning topics such as tax planning opportunities that arise as a result of the unique way in which Social Security benefits are taxed.

But Won't the Rules Change?

When Social Security was first created, it covered a much smaller group of workers; it did not provide for spousal benefits or widow(er) benefits; it did not allow for retirement benefits prior to age 65; and benefits weren't subject to federal income tax at all. In other words, Social Security originally looked quite different than it looks today.

Similarly, it's likely that the Social Security system will continue to evolve in the future. Of course, there's no way to know when the rules will change, for whom they will change, or what those changes will be. So, for lack of any other reasonable option, this book is written based on the rules as they stand now.

If, however, you're working on your retirement plan and you're intent on making some sort of downward adjustment to your projected Social Security benefits to account for the program's financial troubles, the 2012 Social Security Trustees Report may be of use.[1] The report projected that there will be sufficient funds to cover 100% of benefits promised under the current system up until 2033, at which point there will only be enough money to pay for approximately 75% of projected benefits. Does that mean that benefits will go unchanged for the next twenty years, then drop across the board, all at once, by 25%? Probably not. What actually *will* happen? Your guess is as good as mine.

Let's Keep This Brief

As with the other books in the *...in 100 Pages or Less* series, the goal of this book is a modest one: to provide an introduction to the aspects of Social Security that are most likely to factor into your retirement planning. In other words, this book is *not* intended to turn you into a Social Security expert. Nor is it intended to serve as a 100%-comprehensive guide to every aspect of Social Security.[2]

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[1] The report is available at:
http://www.ssa.gov/oact/tr/2012/tr2012.pdf

[2] For example, disability-related benefits are not covered in this book at all. If you're interested in an understandable book that *does* cover those benefits, I'd suggest reading *Social Security: The Inside Story* by Andy Landis.

PART ONE

Social Security Basics

CHAPTER ONE

Qualifying for Retirement Benefits

To qualify for Social Security retirement benefits, you must:

1. Be age 62 or older, and
2. Have earned 40 Social Security "credits" over the course of your career. [1]

Attaining Age 62

The first month for which you can receive a benefit payment is the first month in which you are age 62 for the entire month. This means that, for most people, the first month for which you can receive

[1] If you become disabled prior to age 62, it's possible to qualify for retirement benefits with fewer than 40 credits.

benefits is the month *after* the month including your 62^{nd} birthday. If, however, your 62^{nd} birthday is on the first or second day of the month, you are considered to be age 62 for that entire month.

Earning Social Security Credits

Social Security credits are earned by working at a job where you pay Social Security taxes or by earning money from self-employment. The amount of earnings needed to earn a credit is adjusted each year in keeping with wage inflation. For 2012, you receive one credit for each $1,130 of covered income that you earn during the year.

Credits are sometimes called "quarters of coverage" because you can earn a maximum of four per year. To earn four credits in a given year, however, you do not actually have to work in each of the four calendar quarters. For instance, if you earned $4,520 in January of 2012 and did not work for the rest of the year, you would still earn four credits for the year.

Chapter 1 Simple Summary

- Unless you become disabled prior to age 62, in order to qualify for Social Security retirement benefits you must be 62 years old, and you must have earned at least 40 "credits."
- You can earn a maximum of four Social Security credits per year.
- In 2012, you earn one Social Security credit for each $1,130 of income you earn that is subject to Social Security taxes.

CHAPTER TWO

How Retirement Benefits Are Calculated

The size of your monthly retirement benefit depends on:

1. Your earnings history, and
2. How old you are when you first begin taking benefits.[1]

But first we need to back up a step. In order to understand how Social Security benefits are calculated, you need to be familiar with two terms:

- "full retirement age" (FRA), and
- "primary insurance amount" (PIA).

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[1] It can depend on other factors as well, such as your current earnings if you have a job while you're collecting Social Security. But for simplicity's sake, let's start with the most basic scenario.

Your full retirement age depends on the year in which you were born (see table below). Your primary insurance amount is the amount of retirement benefits you would receive per month if you started taking them at your full retirement age. As we'll discuss shortly, your PIA is determined by your earnings history.

Year of Birth[1]	**Full Retirement Age**
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
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 or later	67

[1] If your birthday is January 1^{st}, you will be treated as if you were born in the prior year for the purpose of determining your full retirement age.

How Earnings History Affects Retirement Benefits

Your primary insurance amount is based on your historical earnings. Specifically, it's based on your "average indexed monthly earnings" (AIME). Calculating your AIME is a four-step process.

1. Adjust your earnings from prior years to today's dollars.[1]
2. Select your 35 highest-earning years.
3. Add up the total amount of earnings in those 35 years, excluding any earnings for each year that were in excess of the maximum amount subject to Social Security tax.[2]
4. Divide by 420 (the number of months in 35 years).

You do not actually have to do this calculation yourself. The Social Security Administration does it for you. It is, however, important to understand the

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[1] Specifically, earnings from years prior to the year in which you reach age 60 are adjusted for the growth in the national average wage that occurred between the year in which you earned the money and the year in which you reached age 60. Earnings from years after you reach age 60 are included in the calculation at their actual dollar amount.

[2] For historical maximums by year, see: http://www.socialsecurity.gov/planners/maxtax.htm

concept, so that you can understand how your benefit is calculated.

Calculating Your Primary Insurance Amount

For someone becoming eligible for retirement benefits (that is, reaching age 62) in 2012, his or her primary insurance amount would be:

- 90% of any AIME up to $767, plus
- 32% of any AIME between $767 and $4,624, plus
- 15% of any AIME above $4,624.[1]

Or, to put it in terms of annual income, if claimed at full retirement age, Social Security would replace:

- 90% of the first $9,204 of average annual wage-inflation-adjusted earnings, plus
- 32% of average annual wage-inflation-adjusted earnings from $9,205 to $55,488, plus
- 15% of average annual wage-inflation-adjusted earnings from $55,489 to $98,388.

[1] These figures change to account for wage inflation each year. So, for example, for somebody turning age 62 in 2013, each of these dollar amounts will probably be slightly higher.

Two noteworthy takeaways here are that:

1. Social Security replaces a higher portion of wages for lower-earning workers than for higher-earning workers, and
2. There's a maximum possible Social Security retirement benefit. (Few people reach that maximum though, because doing so would require that you earn the maximum earnings subject to Social Security tax for 35 different years.)

If You Worked Fewer than 35 Years

If you have fewer than 35 years in which you earned income subject to Social Security taxes, the calculation of your average indexed monthly earnings will include zeros. For example, if you worked for 31 years, your AIME calculation would include those 31 years of earnings, as well as 4 years of zeros.

As a result, working additional years would result in those zero-earnings years being knocked out of the calculation and replaced with your current earnings. The result isn't going to make you rich, but it's worth including in your list of considerations when deciding when to retire.

How Age Affects Retirement Benefits

If you wait until *after* full retirement age to claim your retirement benefit, the amount you receive will be greater than your primary insurance amount. For anybody born in 1943 or later, the increase is $^2/_3$ of 1% for each month you wait beyond full retirement age (up to age 70, beyond which there is no increase for waiting). This works out to an increase of 8% per year.[1]

EXAMPLE: Alan was born in 1954, so his full retirement age is 66. His primary insurance amount is $2,000. If he waits until age 70 (that is, 48 months after FRA) to claim his retirement benefit, he will receive $2,640 per month, calculated as:

- His PIA of $2,000 per month, plus
- $^2/_3$ of 1% x 48 months x $2,000.

If you claim your retirement benefit *prior* to full retirement age, it will be reduced from your primary insurance amount by $^5/_9$ of 1% for each month (up to 36 months) prior to full retirement age. This works out to a reduction of 6.67% per year. For each month in excess of 36 months, the reduction is $^5/_{12}$ of 1% (or 5% per year).

[1] The monthly rates of increase for people born prior to 1943 can be found at:
http://www.socialsecurity.gov/retire2/delayret.htm

EXAMPLE: Allison was born in 1950, so her full retirement age is 66. Her primary insurance amount is $2,000. If she claims retirement benefits at age 64 (24 months prior to FRA), her monthly benefit would be $1,733.33, calculated as:

- Her PIA of $2,000 per month, minus
- $^{5}/_{9}$ of 1% x 24 months x $2,000.[1]

If Allison instead decided to claim as early as possible, at age 62 (48 months prior to FRA), her benefit would be $1,500 per month, calculated as:

- Her PIA of $2,000 per month, minus
- $^{5}/_{9}$ of 1% x 36 months x $2,000, minus
- $^{5}/_{12}$ of 1% x 12 months x $2,000.

In short, the interaction between the size of your retirement benefits and the age at which you first claim that benefit looks like this:

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[1] Allison would actually receive $1,733 per month, because the Social Security Administration rounds all monthly benefit payments *down* to the next lower multiple of $1.

Age when you claim retirement benefits	**Amount of retirement benefit**[1]
5 years before FRA	70% of PIA
4 years before FRA	75% of PIA
3 years before FRA	80% of PIA
2 years before FRA	86.67% of PIA
1 year before FRA	93.33% of PIA
at FRA	100% of PIA
1 year after FRA	108% of PIA
2 years after FRA	116% of PIA
3 years after FRA	124% of PIA
4 years after FRA	132% of PIA

Adjusting Benefits for Inflation

Every year after you become eligible for benefits, your primary insurance amount is adjusted to keep up with inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). When your PIA is adjusted upward for inflation, it increases not only your retirement

[1] Please note that the increases and decreases are actually based on *months* before or after full retirement age, rather than years. So the actual amount you receive will probably be between two of the figures listed in this table. In addition, as mentioned above, the actual formulas use fractions rather than decimals, which could result in slightly different amounts.

benefit, but also any other benefits that are based on your PIA (e.g., your spouse's spousal benefits and/or widow/widower benefits if your spouse should outlive you).[1]

For brevity's sake, I will be writing in "today's dollars" throughout this book. In other words, rather than explicitly mentioning in nearly every single paragraph that the benefit(s) discussed would be adjusted for inflation, I will simply write what the benefit would be, as measured today. Please understand that, from there, the benefit would be adjusted annually in keeping with inflation.

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[1] Contrary to a common misconception, CPI-W *does* account for changes in the prices of food and energy.

Chapter 2 Simple Summary

- Your "primary insurance amount" (PIA) is the monthly retirement benefit you would receive if you claimed benefits at "full retirement age" (FRA).
- Your primary insurance amount is calculated based on your 35 highest-earning years (after adjusting prior years' earnings for wage inflation).
- If you claim retirement benefits prior to your full retirement age, you will receive an amount smaller than your PIA. If you wait until after your full retirement age to claim benefits, your retirement benefit will be greater than your PIA.
- Social Security benefits are adjusted on an annual basis to keep up with inflation (as measured by the CPI-W).

CHAPTER THREE

Spousal Social Security Benefits

Upon reaching age 62, even if you have no work history of your own, you can begin receiving a Social Security benefit as the spouse of somebody who is entitled to a retirement or disability benefit, provided that you meet one of three requirements:

1. You have been married to your spouse for at least one year,
2. You, together with your spouse, are the natural parent of a child, or
3. In the month before you married your current spouse, you were eligible to collect a widow(er) benefit or a spousal benefit based on another spouse's work record.

If you are not yet age 62, you can receive a spousal benefit if you meet the other applicable requirements and you have in your care a child who is entitled to child's benefits on your spouse's record (which we'll discuss in Chapter 6) and who is under age 16 or disabled.

It's important to note that you cannot claim spousal benefits until your spouse has filed for his/her own retirement benefit. However, if your spouse has reached full retirement age, he/she can file for benefits and immediately ask to have the payments suspended, thereby allowing the amount to continue to grow as if he/she had not yet filed. (This is known as the "file and suspend" strategy, and we'll discuss it more thoroughly in Chapter 11.)

In addition, you cannot claim spousal Social Security benefits if you have filed for your own retirement benefit and your own primary insurance amount is greater than one-half of your spouse's primary insurance amount.

Filing for Spousal Benefits after Full Retirement Age

If you wait until full retirement age to begin collecting spousal benefits, and you are not receiving a retirement benefit based on your own work record, your spousal benefit will be equal to 50% of your spouse's primary insurance amount.[1] Unlike retire-

[1] As we'll discuss in Chapters 6 and 7 your spousal benefit could potentially be reduced as a result of the family maximum if other people are also claiming bene-

ment benefits, spousal benefits are not increased by waiting beyond full retirement age to claim them.

EXAMPLE: Lydia's primary insurance amount is $1,800. If her husband Carl has no work record of his own and he claims spousal benefits at or after full retirement age, he would receive 50% of Lydia's PIA, or $900 per month.

Filing for Spousal Benefits prior to Full Retirement Age

If you claim spousal benefits prior to full retirement age, your spousal benefit will be reduced as a function of how many months early you claimed. The reduction will be $^{25}/_{36}$ of 1% for each month early, up to 36 months. For each month in excess of 36 months, the reduction is $^{5}/_{12}$ of 1%. Translate that into years, and you get the following table:

If you claim spousal benefits...	**You will receive:**
At full retirement age	100% of spousal benefit
1 year prior to FRA	91.67% of spousal benefit
2 years prior to FRA	83.33% of spousal benefit
3 years prior to FRA	75% of spousal benefit
4 years prior to FRA	70% of spousal benefit
5 years prior to FRA	65% of spousal benefit

fits on your spouse's work record or as a result of the Government Pension Offset if you receive a pension.

EXAMPLE: Nadia is not eligible for a retirement benefit of her own. Her husband Timothy has a primary insurance amount of $1,400. If Nadia claims her spousal benefit three years prior to reaching full retirement age, she will receive $525 per month, calculated as 75% of 50% of her husband's $1,400 PIA.

Spousal Benefits with Retirement Benefits

If you file for spousal benefits at the same time you are receiving a retirement benefit of your own, the total amount you receive is a function of how your PIA compares to your spouse's PIA.

Specifically, your spousal benefit will be calculated as:

Reduction factor (from previous table)	x	50% of your spouse's PIA, minus your PIA

Your own retirement benefit will then be added to your spousal benefit to determine the total amount you'll receive.

EXAMPLE: Catherine's primary insurance amount is $700. Her husband Michael's primary insurance amount is $1,600. If Catherine files for spousal benefits and her own retirement benefit four years prior to full retirement age, the total amount she will receive is $595, calculated as follows:

- Catherine's own benefit of $525, calculated as $700 x 75% (due to claiming four years prior to FRA), plus
- Catherine's spousal benefit of $70, calculated as:

70% (from previous table) x [(50% x 1,600) – 700]

A spousal benefit cannot, however, be negative. So, in the event that a person's spousal benefit calculation would yield a negative result (which would happen any time a person's own PIA is greater than 50% of his/her spouse's PIA), that person would receive his/her own retirement benefit and no spousal benefit.

EXAMPLE: Heather's primary insurance amount is $1,400. Her husband George's primary insurance amount is $1,500. If Heather files for her own benefit and spousal benefits, she'll simply receive her own benefit, because her PIA is greater than 50% of George's PIA.

It's also important to understand that if you are eligible for spousal benefits and for your own retirement benefit, and you file for either of the two prior to reaching full retirement age, you will be "deemed" to have filed for the other type of benefit as well. The purpose of this rule is to prevent you from being able to file for only one type of benefit, while allowing the other benefit to continue to grow.

If, however, you have reached full retirement age, you can file for just your spousal benefit by filing what's known as a "restricted application," thereby allowing your own retirement benefit to continue growing until age 70. We'll discuss this more thoroughly in Chapter 11.

EXAMPLE: Earl's full retirement age is 66. At age 64, he files for a spousal benefit on his wife's earnings record. As a result, he's deemed to have filed for his own retirement benefit as well.

If Earl had waited until age 66, he could file a "restricted application" for spousal benefits only. If he did so, his own retirement benefit could continue to grow until age 70.

Chapter 3 Simple Summary

- If you claim spousal benefits at (or after) full retirement age, your spousal benefit will be equal to the difference between 50% of your spouse's primary insurance amount and your own primary insurance amount. (Therefore, if you have no retirement benefit of your own, you will receive 50% of your spouse's PIA.)
- If you claim spousal benefits prior to full retirement age, the amount you receive per month will be permanently reduced.
- In most cases, the youngest age at which you can qualify for spousal benefits is 62.
- If you are eligible for both spousal benefits and your own retirement benefit, and you claim either one prior to full retirement age, you will be deemed to have filed for the other benefit as well.

CHAPTER FOUR

Widow(er) Social Security Benefits

If you are a widow or widower, you may be able to claim a widow(er) benefit based on your deceased spouse's work record. In most cases, in order to be eligible for widow(er) benefits:

- The marriage must have lasted at least nine months,
- You must be at least 60 years old (or disabled and at least age 50),
- You must not have remarried, unless you remarried *after* reaching age 60, and
- Your spouse must have been "fully insured" at the time of his/her death.[1]

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[1] For exceptions to these three general requirements, see section 404.335 of the Code of Federal Regulations, available at:
http://www.ssa.gov/OP_Home/cfr20/404/404-0335.htm

To be fully insured, your spouse must have earned a number of Social Security credits equal to his/her age at the time of death, minus 22, subject to two exceptions:

1. If your spouse died prior to age 28, six credits are required for fully insured status, and
2. No more than 40 credits are required, even if your spouse was older than 62 at the time of his/her death.

Calculation of Widow(er) Benefits

The amount of the widow(er) benefit will be 100% of the deceased spouse's primary insurance amount if:

- The deceased spouse was younger than full retirement age and had not yet filed for benefits, and
- The surviving spouse claims widow(er) benefits at or after his or her own full retirement age.

If the deceased spouse had claimed benefits earlier than FRA, the surviving spouse's widow(er) benefit, rather than being based on the deceased spouse's PIA, will be based on the *larger* of:

- The amount that the deceased spouse was receiving, or

- 82.5% of the deceased spouse's primary insurance amount.

EXAMPLE: Henry has a full retirement age of 66. He claims his retirement benefits at age 63, meaning his retirement benefit is 80% of his primary insurance amount.

Henry then dies at age 65. His wife Wanda (who has already reached full retirement age) claims a widow's benefit immediately. Wanda's widow's benefit will be 82.5% of Henry's primary insurance amount (because she gets the greater of 82.5% or the amount he was receiving, which was 80%).

If the deceased spouse claimed benefits after reaching FRA, the surviving spouse's widow(er) benefit will be based on the amount that the deceased spouse was receiving.

EXAMPLE: Harry claims benefits at age 68, then dies at age 69. Harry's wife Rita (who has already reached full retirement age) claims a widow's benefit immediately. Rita's widow's benefit will be equal to the benefit that Harry had been receiving at the time of his death (which will be greater than Harry's primary insurance amount, because he claimed after full retirement age).

If the deceased spouse had reached full retirement age but had not yet filed for benefits, the surviving spouse's widow(er) benefit will be based on the amount that the deceased spouse would have received if he/she had filed on the date of his/her death.

EXAMPLE: Lynn dies at age 69, having never filed for her own retirement benefit. Lynn's husband Hank (who has already reached full retirement age) immediately claims a widower's benefit. Hank's widower's benefit will be equal to the amount that Lynn would have received if she had filed for her own benefit on her date of death.

Like retirement benefits and spousal benefits, widow(er) benefits are adjusted for inflation. This inflation adjustment includes any time between the date at which the first spouse dies and the date at which the surviving spouse claims a widow(er)'s benefit.

EXAMPLE: Wendy dies at 64, having filed for benefits at age 63. Her husband Howard is 60 years old at the time of Wendy's death. Six years later, upon reaching his full retirement age of 66, Howard files for widower benefits. He'll receive the amount that Wendy was receiving, adjusted for any inflation that occurred over the six intervening years.

Claiming Widow(er) Benefits Prior to Full Retirement Age

If the surviving spouse claims widow(er) benefits *prior* to reaching full retirement age, the amount received will be reduced. Widow(er) benefits claimed at age 60 (the minimum age for widow(er) benefits) will be equal to 71.5% of the amount that would have been received if claimed at full retirement age.[1]

EXAMPLE: June dies at age 63, having never filed for benefits. As discussed previously, this means that if her husband Frank claims his widower's benefit at full retirement age, he will receive an amount equal to June's primary insurance amount. If Frank claims at age 60, however, he will only receive 71.5% of June's primary insurance amount.

The reduction in widow(er) benefits decreases proportionately as the claimant nears full retirement age. So, for example, if the surviving spouse claims widower benefits halfway between age 60 and full retirement age, the amount received will be 85.75% (that is, halfway between 71.5% and 100%) of the amount that would have been received at FRA.

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[1] Exception: If the deceased spouse had claimed retirement benefits prior to FRA and the surviving spouse claims widow(er) benefits prior to FRA as well, the widow(er) benefit will be greater than what the above would indicate. See Appendix A for details.

Full Retirement Age for Widow(er) Benefits

You may have a slightly different full retirement age for the purpose of calculating widow(er) benefits than you do for the purpose of calculating retirement benefits or spousal benefits. As compared to the FRA chart for retirement benefits (as shown in Chapter 2), the FRA chart for survivor benefits has each of the dates of birth shifted two years into the future, as follows:

Year of Birth[1]	Full Retirement Age for Widow(er) Benefits
1939 or earlier	65
1940	65 and 2 months
1941	65 and 4 months
1942	65 and 6 months
1943	65 and 8 months
1944	65 and 10 months
1945-1956	66
1957	66 and 2 months
1958	66 and 4 months
1959	66 and 6 months
1960	66 and 8 months
1961	66 and 10 months
1962 or later	67

[1] As with retirement benefits, if your birthday is January 1st, you will be treated as if you were born in the prior year for the purpose of determining your FRA.

Widow(er) Benefits Combined with Other Benefits

If a person claims widow(er) benefits at the same time that he/she is receiving a retirement benefit (or a spousal benefit) the total amount he/she receives will be the greater of the two benefit amounts.[1]

[1] Technically, if your widow(er) benefit is greater than your own retirement benefit, you receive your own retirement benefit, plus your widow(er) benefit, after reducing your widow(er) benefit by the amount of your own retirement benefit. As you'll notice, this generally results in you receiving an amount equal to your widow(er) benefit alone, though there are some cases where other rules come into play that make this distinction important.

Chapter 4 Simple Summary

- If you are a widow or widower and your deceased spouse earned a sufficient number of Social Security credits by the time of his/her death, you may be eligible for a widow(er) benefit based on his/her work record.
- In most cases, age 60 is the earliest date at which a person can claim widow(er) benefits.
- The amount of the widow(er) benefit you receive depends both on the date at which your deceased spouse began claiming benefits and on the date at which you begin claiming your widow(er) benefit.