BAIRD

Private Wealth Management

A Guide to Understanding Social Security Retirement Benefits

This comprehensive guide answers all of your questions on how Social Security works and strategies to maximize your benefits.

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SOCIAL SECURITY ELIGIBILITY REQUIREMENTS

Workers who pay Social Security taxes on their wages earn credits toward Social Security benefits. A worker born in 1929 or later must obtain 40 credits to become fully insured and be entitled to receive retirement benefits under the Social Security program. For 2019, a worker receives one credit for every $1,360 received in earnings, and a maximum of 4 credits can be earned in any calendar year. If a person works for 10 years and earns the required wages to obtain their full 4 credits each year ($5,440 for 2019), that person will be considered fully insured and eligible for benefits. This is true even if the person never again holds eligible employment or is self-employed. If a worker is fully insured, the following individuals are eligible for Social Security benefits based on that person's earnings record:

- The insured worker age 62 or older.
- The spouse of an insured worker who:
    - is age 62 or older, or
    - cares for a child under the age of 16, or
    - cares for a child over the age of 16 who is disabled and who would be entitled to benefits based on the worker's Social Security earnings record.
- The divorced spouse of an insured worker who is age 62 or older, was married to the worker for at least 10 years and is not remarried at the time of filing for benefits.
- The divorced spouse of a fully insured worker who has not yet filed for benefits (i.e., is still working) if both are age 62 or older, were married for at least 10 years, and have been divorced for at least two continuous years.
- The dependent, unmarried child of a retired worker if the child is:
    - under the age of 18, or
    - under the age of 19 and a full-time elementary or secondary school student, or
    - age 18 or over and suffers from a disability which began before the age of 22.
- The surviving spouse (including a surviving divorced spouse) of an insured worker who is age 60 or older.
- The disabled surviving spouse (including a surviving divorced spouse, in some cases) of an insured worker who is age 50-59. The disabled surviving spouse must meet specific disability requirements to qualify.

- The surviving spouse (including a surviving divorced spouse) at any age who is caring for an entitled child under the age of 16, or a child who was disabled before the age of 22.
- The dependent parents of a deceased worker at age 62 or over.

Any individual who is covered under these requirements is eligible for not only retirement benefits, but also survivor and disability benefits.

DETERMINING YOUR BENEFIT AMOUNT

Social Security benefits are based on a worker's lifetime earnings, whether as an employee or while self-employed. However, not all earnings can impact a worker's benefits. There is a maximum amount of earnings that are counted towards a worker's earnings history. For 2019, that amount is $132,900, and any earnings over that amount do not affect Social Security benefits. The actual earnings are adjusted to account for changes in average wages since the year the earnings were received. These adjusted earnings amounts are then compared, and the 35 years in which the worker's adjusted earnings were highest are used to calculate the Average Indexed Monthly Earnings (AIME). A formula is then applied to the AIME by the Social Security Administration to arrive at the worker's basic benefit, or Primary Insurance Amount (PIA). This is the amount to be received at Full Retirement Age (FRA).

WHEN CAN A WORKER BEGIN RECEIVING BENEFITS?

Once a worker reaches their FRA, they can begin receiving an unreduced Social Security retirement benefit. FRA varies depending on your year of birth, and in general has been gradually increasing as life expectancies have increased. See the table below for Full Retirement Ages.

Year of Birth	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 and Later	67

A worker who is fully insured can begin receiving a reduced benefit as early as age 62. If benefits are taken early, the retiree's monthly payment is permanently reduced from the FRA amount. This reduction is equal to 5/9 of 1% per month for the first 36 months in which an early benefit is claimed, and 5/12 of 1% for each additional month beyond that. If a spouse begins receiving benefits before their FRA, the benefit reduction is 25/36 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.

The following table shows the cumulative reduction in benefits by starting at various ages prior to Full Retirement Age (assuming FRA is 67). These reductions would be less for someone with an earlier FRA. The spousal benefit reduction also incorporates the 50% reduction in maximum benefits for a non-working spouse.

Worker Whose FRA is 66		Spouse Whose FRA is 66		Worker Whose FRA is 67		Spouse Whose FRA is 67	
Age	**Approximate Reduction in Benefit**	**Age**	**Approximate Reduction in Benefit**	**Age**	**Approximate Reduction in Benefit**	**Age**	**Approximate Reduction in Benefit**
62	25%	**62**	65%	**62**	30%	**62**	67.5%
63	20%	**63**	62.5%	**63**	25%	**63**	65%
64	13.3%	**64**	58.3%	**64**	20%	**64**	62.5%
65	6.7%	**65**	54.2%	**65**	13.3%	**65**	58.3%
66	0%	**66**	50%	**66**	6.7%	**66**	54.2%
67	n/a	**67**	n/a	**67**	0%	**67**	50%

Retirement benefits can also be deferred until age 70. By delaying benefits beyond the FRA, the worker's annual benefit increases by 8% per year (2/3 of 1% per month) over the FRA amount. These increases are also known as delayed retirement credits.

Age	Approximate Increase in Benefits	
	Worker Whose FRA is 66	**Worker Whose FRA is 67**
67	8%	n/a
68	16%	8%
69	24%	16%
70	32%	24%

In addition to the reduction or increase in benefits due to accelerating or deferring the start date, benefits are also subject to an annual cost of living adjustment.

MAXIMUM FAMILY BENEFITS

The maximum family benefit is the largest amount that can be paid to a family (worker, spouse, eligible children, and dependent parents) based on one person's earnings record. Typically, a worker and their family are limited to receiving 150-180% of the benefit the worker is currently receiving. If the total benefit payments exceed the family maximum amount, the worker's benefit is not reduced—rather, the other beneficiaries receiving a benefit will have their benefit reduced.

Benefits payable to a divorced spouse or surviving divorced spouse are not subject to the family maximum. In turn, a benefit paid to a divorced spouse or surviving divorced spouse does not cause a reduction in other beneficiary's benefit payments.

Beneficiaries receiving payments that are to be aggregated when determining the family maximum will have their benefits proportionately reduced so that the total monthly payments fall within the applicable limits. Individual benefit reduction rates are determined according the following set of rules:

- If the worker on whose earnings record the benefits are based is living, the worker's benefit is subtracted from the family maximum amount. The remaining amount is divided amongst the other individuals entitled to receive benefits based on the worker's earnings history.
- If the worker is deceased and all benefits are paid on the same percentage of PIA, the family maximum is divided equally amongst all entitled beneficiaries.

- If the worker is deceased and all benefits are paid on a different percentage of PIA, the family maximum is paid proportionately based on each beneficiary's original benefit rate.

If a member of the family ceases to be entitled to benefits, the remaining beneficiary's benefit will increase accordingly.

LEAVING THE UNITED STATES

If a person receiving retirement benefits is a U.S. citizen, that person can travel or live in most foreign countries without affecting Social Security retirement benefits. There are several countries, however, where Social Security payments cannot be sent. If there is a concern as to whether or not payments can be received in a certain country, the Social Security Administration should be contacted to verify a particular country's status.

OTHERS WHO CAN BENEFIT FROM A RETIREE'S WORK HISTORY

Spousal benefits

An individual is entitled to benefits based on their own working history or that of their spouse (hereafter referred to as a "spousal benefit"). In general, a spousal benefit is equal to 50% of the worker's full retirement age benefit. There are a few key points to consider with a spousal benefit:

- To receive benefits, a spouse must be legally married to the worker at the time the application is filed for at least one continuous year immediately before the day of application.
- If a person is entitled to divorced spouse's benefits in the month before marriage to the new spouse, the 1-year marriage requirement is waived when applying for the new spouse's spousal benefits.
- A spouse can begin receiving a spousal benefit as early as age 62. However, beginning the benefit prior to their Full Retirement Age (FRA) will result in a permanent reduction in benefits.
- A spousal benefit cannot begin until the working spouse has filed for their benefit. Therefore, even though the spouse has reached age 62, they may be limited to taking benefits on their own work history until the working spouse also begins receiving benefits.
- Once the working spouse begins receiving benefits, their spouse can switch from receiving their own benefit to a spousal benefit.
- When applying for spousal benefits, if the lesser earning spouse is eligible for benefits based on their own work history, those benefits will be paid first. If the spouse is also eligible for spousal benefits, those will be added on to the benefit paid based on their own work history.
- An individual may decide that benefits based on their own working history will be larger than taking benefits based on their spouse's income. In that case, the individual would elect to receive their own benefit. However, a retiree cannot receive a benefit based on their own work history AND a spousal benefit at the same time, if their own benefit is greater. They can only receive the larger of the two.
- At FRA, if an individual's own benefit is higher than the spousal benefit, that person may file a restricted application. Doing so allows the individual to receive only the spousal benefit amount while continuing to defer their own benefit, which would increase due to delayed retirement credits (DRCs), and they switch over to their higher benefit later on. **This option is being phased out and is only available to someone born on 01/01/1954 or before.**
- Spousal benefits do not receive DRCs, which further increase a Social Security benefit for individuals that decide to defer receiving a benefit beyond FRA.
- Same-sex couples who are legally married are also entitled to spousal Social Security benefits.

Divorced spouse's benefits

A divorced spouse is entitled to receive a spousal benefit based on their ex-spouse's earnings history if:

- the worker is entitled to receive retirement benefits (meaning they are age 62 and fully insured, but don't actually have to be receiving benefits yet),
- the divorced spouse was married to the worker for at least 10 years before the date the divorce became final,
- the couple has been divorced for at least 2 years (If your ex-spouse has not applied for retirement benefits, but can qualify for them, you can receive benefits on his or her record if you have been divorced for at least two years),
- the divorced spouse has filed an application for divorced spouse's benefits,
- the divorced spouse is not entitled to a retirement benefit based on his or her earnings record that is greater than the ex-spouse's benefit (unless the divorced spouse is filing a restricted application at full retirement age or later, which is discussed in more detail later)
- the divorced spouse is age 62 or older, and
- the divorced spouse is not married.

If the worker spouse is actually receiving benefits prior to the divorce, the two-year waiting period (item 3 above) is waived.

If a divorced individual claims Social Security benefits before FRA, that person will automatically receive the largest benefit that they are entitled to between their own benefit and the divorced spouse's benefit. If the individual waits until FRA or later, they also have the ability to file a restricted application and receive spousal benefits only while delaying their own benefit, which would earn DRCs until age 70. The individual could then switch to their own benefit later on. Note that the ability to file a restricted application is only available to individuals born on 01/01/1954 or before.

If the divorced spouse has experienced multiple divorces over his or her lifetime, the divorced spouse can claim retirement benefits based on any one of the former spouse's earnings history, assuming the above requirements are met. However, one worker is limited to providing retirement benefits to four ex-spouses based on his or her earnings record.

A divorced spouse's benefit is paid independently of other family benefits does not count towards the family maximum limit.

Survivor's Benefits

The following benefits can be paid to the survivors of a deceased, fully insured worker:

- A monthly benefit for a widow(er) or a surviving divorced widow(er) who is at least 60 years of age (Widow(er)'s benefit)
- A monthly benefit for a disabled widow(er) between the ages of 50-60 (Disabled Widow(er)'s benefit)
- A monthly benefit for a widow(er), regardless of age, who is caring for at least one child, under age 16 or disabled before the age of 22, of the deceased worker (Mother's/Father's benefit)
- A monthly benefit for each child who is (1) under the age of 18, (2) over age 18 but disabled before reaching the age of 22, or (3) under the age of 19 and attending a full time elementary or secondary school (Child's benefit)
- A monthly benefit for a parent who is age 62 or older and who was dependent upon the deceased worker for support (Parent's benefit)

- A lump sum death payment of $255 can be paid to (in order of priority):

  1. The widow(er) of the deceased worker who was living in the same household as their spouse;
  2. The widow(er) (excluding a divorced spouse) who is entitled to benefits based on the worker's earnings history for the month of death;
  3. Children who are entitled to benefits based on the worker's earnings history for the month of death.
  4. If no surviving widow(er) or child survives, then no lump sum is paid.

Widow(er)'s Benefit

The surviving spouse is entitled to a widow(er)'s benefit based on the deceased worker's earnings if all the following apply:

- The surviving spouse is age 60 or older, or is between the ages of 50-59 and disabled,
- The deceased worker was fully insured,
- The surviving spouse is not entitled to a retirement benefit based on his or her earnings history that is larger than the deceased worker's,
  - If the surviving spouse has a benefit on their own work history, they will have the ability to choose to receive the lower of the two benefits for a period of time and switch to the higher amount later on (discussed later)
- The surviving spouse has filed an application for benefits
- The survivor spouse must have been married to the deceased worker at the time of his or her death and for at least nine months immediately prior to the day in which the worker died, unless one of the a number of exceptions applies. These exceptions include if the worker's death was accidental or if it occurred in the line of duty as an active member of a uniformed service.
- The surviving spouse is not married, except under special circumstances where the surviving spouse is caring for a child or remarriage occurs after age 60.

Once a widow(er) has attained the age of 60, he or she may apply for a reduced benefit at any time, or can wait until Full Retirement Age. If the widow(er) reaches FRA or older when benefits begin and the deceased worker was not yet collecting a benefit, he or she will receive a monthly benefit equal to 100% of the deceased worker's PIA plus any delayed retirement credits that have accumulated up until the date of death. If the deceased worker was already receiving benefits that started before he or she reached FRA, the surviving spouse would receive an amount equal to that same reduced benefit the worker would have been receiving, if living (but not less than 82.5% of the PIA).

If the surviving spouse is paid a reduced widow(er)'s benefit, no benefit increase will be allowed upon reaching FRA unless the survivor can switch to their own, higher benefit at that time. The reduced survivor benefit is payable for as long as the surviving spouse remains entitled to the widow(er)'s benefits.

The monthly payment of a widow(er) or surviving divorced spouse who remarries <u>after</u> he or she attains age 60 is allowed to continue. A widow(er) who remarries <u>before</u> age 60 will stop receiving payment of survivor's benefits unless that subsequent marriage ends prior to the ex-spouse's death.

The widow(er) could receive a smaller monthly payment, if other family members are entitled to benefits, due to the family maximum limit.

When the widow(er) files for a benefit, he or she will have a choice between their own benefit or the survivor's benefit, regardless of the age at which they file for the benefit. The widow(er) may wish to choose the lower benefit first, allowing the other benefit to continue to grow. If their own benefit is delayed, it would receive delayed retirement credits from full retirement age until age 70. If the survivor benefit is delayed, no delayed retirement credits will be received.

Divorced Widow(er)'s Benefit

A widow(er) is entitled to receive surviving divorced spouse's benefits on the deceased's earnings record provided if the divorced spouse meets **all** of the following requirements:

- They were married for at least 10 years,
- The surviving spouse is at least 60 years of age, or is between the ages of 50-59 and disabled,
- The deceased spouse was fully insured,
- The surviving divorced spouse is not married, if under the age of 60 (if the survivor remarried after age 60, the remarriage does not affect eligibility for survivor benefits as an ex-spouse),
- The surviving divorced spouse is not entitled to a retirement benefit based on his or her earnings history that is larger than the deceased worker's,
- If the surviving spouse has a benefit on their own work history, they will have the ability to choose to receive the lower of the two benefits for a period of time and switch to the higher amount later on (discussed later)
- An application for widow(er)'s benefits has been filed.

The surviving divorced spouse's benefit is the same monthly amount as the widow(er)'s benefit, and is paid independently of benefits for the family of the former spouse. Options for claiming this benefit are the same as those for a survivor who was currently married as long as the marriage requirements were met. However, this benefit is not subject to reduction based on the family maximum limit, nor does it affect the payments received by the former spouse's family.

Child's Benefit

If a worker dies either fully or currently insured, each child who meets the relationship requirements is entitled to a child's benefit worth 75% of the deceased worker's PIA. The following qualifications must be met for a child to receive this benefit:

- The child must meet the following age requirements:
- Under the age of 18, or
- Under the age of 19 and a full-time elementary or secondary school student, or
- Age 18 or over and suffers from a disability which began before the age of 22.
- The child must be a dependent at the time of the deceased parent's death. The child is considered a dependent if the child has not been legally adopted by someone other than the worker, and
- Is the legitimate child of the worker,
- An illegitimate child who would have the right to inherit intestate property from the worker as a child,
- The child of a void or voidable marriage,
- The child of an invalid ceremonial marriage, or
- The legally adopted child of the worker.

If a child is employed and earns over $17,640 in 2019, his or her benefit will be reduced by $1 for every $2 of wages earned. Earnings of the surviving parent will not affect the child's benefit.

The child's benefit ends at:

- Death,
- Age 18 (or age 19 if attending a full-time elementary or secondary school),
- When disability ceases if benefits are being collected due to that disability, or
- When married, unless the child is over the age of 18 and collecting benefits based on a disability.

Benefits for Same-Sex Couples

Same-sex couples who are legally married are entitled to the same Social Security benefits provided to married couples. To determine benefit eligibility, the marriage start date is the actual date of the marriage. The length of marriage requirement is one year for spousal benefits, nine months for survivor benefits, and 10 years for divorced-spouse benefits.

THE IMPACT OF WORKING WHILE RECEIVING BENEFITS

If an individual plans to continue to work while receiving Social Security benefits and they are under full retirement age, their Social Security benefit might be reduced. For the purposes of the earnings limits discussed below, if the worker is self-employed, only the net self-employment earnings are counted. Any income counts for the year in which the income was received, not when it was earned. If the worker is employed by someone else, only the wages count towards the earnings threshold, and they count in the year they are earned, not necessarily the year they are paid (accumulated sick or vacation pay, bonuses, etc.). An employee's contribution to a pension or retirement plan also counts towards a worker's employment earnings, if the contribution amount is included in the employee's gross wages.

- <u>If the individual collecting retirement benefits is under Full Retirement Age:</u> When the worker starts receiving Social Security payments, $1 in benefits will be deducted for every $2 he or she earns above an earnings limit ($17,640 for 2019). This limit is adjusted each year for inflation.
    - **Example:** Bill earns $64,000 per year as an employee. He will turn 65 in October 2019. He also is collecting Social Security retirement benefits. According to the Social Security rules, his FRA is 66. In 2019, when Bill is 65, his excess earnings will be $46,360 ($64,000 - $17,640). His reduction in benefits will be $23,180 ($1 reduction in benefits for every $2 over the $17,640 threshold).
- <u>In the year the worker reaches Full Retirement Age:</u> In this case, $1 in benefits will be deducted for every $3 he or she earns above the limit of $46,920, but only counting earnings before the month the worker reaches the FRA. This limit is adjusted each year for inflation.
    - **Example:** Mark turns 66 in October 2019. From January through September of that year, he earned $48,000. His excess earnings to that point would be $1,080 ($48,000 - $46,920). His reduction in benefits for those 9 months would be $360 ($1 reduction in benefits for every $3 over the $46,920 threshold).
- <u>Starting with the month the worker reaches Full Retirement Age:</u> There is NO limit on earnings after reaching FRA.
    - **Example:** As of October 2019, Paul reaches his FRA. He could continue to work and earn as much as he wanted without any reduction in retirement benefits.
- For purposes of these three prior rules, earned income only includes wages, bonuses, commissions, etc. It does not include investment income, capital gains, retirement plan distributions, pensions, alimony, worker's

compensation, unemployment benefits, or other sources of unearned income. If you are self-employed, only your net earnings from self-employment are counted.

- If a worker is at full retirement age or younger and stops working mid-year, employment income prior to collecting benefits is not counted, and the earnings test is applied on a monthly basis ($1,470 per month in 2019) for the remainder of the first year.
- Spousal Benefits: A spouse can lose some or all of their monthly benefits if the worker is under Full Retirement Age and has earnings exceeding the thresholds discussed above. Also, if the spouse is under FRA and has earnings above the thresholds mentioned above, their monthly benefit will be reduced.
    - When both the worker and the spouse have earnings in excess of the earnings limitation, their total Family Maximum Benefit will also be reduced.
- Divorced spouse's benefits: If the worker has excess earnings above the previously discussed thresholds, this would not cause a reduction in the divorced spouse's benefit, assuming the divorced spouse has been divorced from the worker at least two years or whose former spouse was entitled to receive benefits before the divorce. However, if the divorced spouse who is collecting the benefit has excess earnings, his or her benefit will be reduced accordingly.
- Survivor's benefits: The same earnings tests apply here as they do to standard retirement benefits. However, a person receiving dependent's or survivor's benefits and has excess earnings will not see his or her excess earnings charged against the benefits payable to other dependents or survivors. For example, a child's benefit will not be reduced if the mother has excess earnings.
- Child's/Dependent benefits: If the worker has excess earnings above the previously discussed thresholds, it would cause a reduction in the dependent's benefit. However, a dependent's wages will only reduce his or her own benefit.

If a Social Security benefit is lost due to employment income, the reduction is not applied ratably to each check received throughout the year. Instead, the worker would not receive checks at all in the early part of the year then, once the total benefit reduction has been reached, the worker would start receiving monthly checks for the full monthly benefit amount later in the year. Those months in which a check was not received will not count as months where Social Security was claimed. This means that, once you reach full retirement age, your benefit amount will be recalculated as if you had not claimed Social Security during those months.

- **Example:** Bob retired at 62 and started collecting a Social Security benefit of $1,500 per month. Bob works part-time and will earn $29,640 in 2019. This is $12,000 above the allowable earnings threshold, so Bob's Social Security benefit will be reduced this year. Bob will not receive a Social Security check for the first 8 months of the year ($12,000/$1,500), but will receive a check for $1,500 each of the last 4 months of the year. If we assume that Bob continues earning the same income and ignore inflation adjustments to Social Security benefits and the earnings threshold, when Bob reaches his full retirement age at 66, he will receive an increase in his monthly benefits at that time. The Social Security Administration will consider Bob to have started collecting benefits at age 64 and 8 months, rather than at age 62 and 0 months, and increase his monthly benefit check accordingly at that time. If Bob lives long enough, he will fully recover the benefits that were withheld due to his excess employment income.

Special Payments

After a worker retires, there are certain circumstances under which that individual might receive payments for work done before receiving Social Security benefits. These income sources are considered Special Payments and will not affect your Social Security, if they are for work done before you retired and started collecting a benefit.

Income received after retirement counts as a special payment if the last thing a person did to earn the payment was completed before the individual stopped working.

Types of Special Payments include bonuses, accumulated vacation or sick pay, severance pay, back pay, standby pay, sales commissions and retirement payments. It also includes deferred compensation reported on a W-2 for one year, but was earned in a previous year. The deferred compensation amounts may be shown on an individual's W-2 in the box labeled nonqualified plan.

If the worker was self-employed, any net income received after the first year the person retired counts as a special payment if the services to earn the payment were performed before being entitled to receive Social Security benefits. Special Payments for self-employed individuals might include income derived by an owner of a business who does not perform significant services in that business, agricultural program payments, income from carryover crops.

If a retiree receives a special payment which causes their income to exceed the earnings limit, contact the Social Security Administration and notify them that a special payment was received. That income will not count as a part of the recipient's total income for the year.

TAXATION OF BENEFITS

The amount of Social Security benefits that are taxable varies based on the taxpayer's level of Modified Adjusted Gross Income (MAGI):

- For single taxpayers with MAGI below $25,000 (and $32,000 for married couples filing jointly), Social Security benefits are tax free.
- Up to 50% of Social Security retirement benefits may be taxable in years that MAGI is between $25,000 and $34,000 for a single taxpayer, and between $32,000 and $44,000 for a married couple filing jointly.
- Up to 85% of benefits may be taxable in years that MAGI is in excess of $34,000 for a single taxpayer and in excess of $44,000 for a married couple filing jointly.

For purposes of this rule, Modified Adjusted Gross Income is defined as (1) Adjusted Gross Income as it is calculated on a tax return (including all investment income, capital gains, retirement income, etc.) after adding back any deductions for student loan interest, tuition and fees plus (2) tax-exempt interest plus (3) half the Social Security benefits themselves.

IRS Instructions to Form 1040 contains a worksheet which will help a recipient of Social Security calculate his or her tax liability.

WINDFALL ELIMINATION PROVISION (WEP) AND GOVERNMENT PENSION OFFSET (GPO)

Not all types of employment require employees to pay into the Social Security system. If a person worked for an employer that did not withhold Social Security taxes from their paycheck, such as a government agency or an employer in another country, and a pension was earned while working for one or more of these employers, that pension may reduce any Social Security benefits that worker may have earned from another employer. There are two provisions in the Social Security rules that can affect workers in this situation. The Windfall Elimination Provision (WEP) is a formula that recalculates, but does not eliminate, the benefits earned by the worker. The Government Pension Offset (GPO) applies to the benefits earned by a spouse, ex-spouse or surviving spouse, and can result in total elimination of the benefit.

When might benefits be affected by the WEP?

The Windfall Elimination Provision might apply if:

- The worker reached age 62 after 1985, and
- The worker first became eligible for a monthly pension from an employer that did not withhold Social Security taxes after 1985.

How is the worker affected?

An individual who receives a pension from non-Social Security-covered wages may also have wages that are covered by Social Security. In those cases, the worker's retirement benefit is calculated using a modified formula.

A worker's Social Security retirement benefit is based on his or her Average Indexed Monthly Earnings(AIME). The Social Security Administration will separate that person's AIME into three amounts and apply a different factor to each amount. Under the WEP modified formula, one of those factors is adjusted based on the number of years of covered employment. Those with fewer years of covered employment receive a lower factor, and therefore a lower retirement benefit.

For example, to calculate the normal retirement benefit for a someone who turns age 62 in 2019 and collects retirement benefits under the normal retirement benefit calculation, the first $926 of average monthly earnings is multiplied by 90%, the next $5,583 by 32%, and the remainder by 15%. The sum of the three amounts equals the total monthly retirement payment. The modified formula requires that the 90% factor is adjusted depending on the number of years of "substantial earnings" for the worker in question. For 2019, a worker must have earned in excess of $24,675 to be considered "substantial". The following table shows how the 90% factor is adjusted based on the number of years in which the worker had "substantial earnings".

Years of Substantial Earnings	Percentage Used in Calculation
30 or More	90%
29	85%
28	80%
27	75%
26	70%
25	65%
24	60%
23	55%
22	50%
21	45%
20 or Less	40%

The Windfall Elimination Provision reduces a worker's benefit in the first year of eligibility before the annual cost-of-living adjustment (COLA) is added to your benefit.

The maximum reduction amount that can be applied by the Windfall Elimination Provision is limited to one-half of a worker's pension from non-covered employment. The amount of the pension is determined by looking at the pension amount that is paid in the first month of concurrent entitlement to both Social Security and the pension from non-covered employment.

Exceptions to the Windfall Elimination Provision

The WEP will not be applied in the following situations:

- A worker receives Survivor's benefits based on someone else's work history.
- A worker has 30 or more years of substantial earnings under the previously discussed methodology.

- A worker's only pension is derived from railroad employment.
- A federal worker who was first hired after December 31, 1983.
- The worker was only employed in a job where he or she did not pay Social Security taxes occurred before 1957.
- A worker was employed on December 31, 1983 at a non-profit organization that did not withhold Social Security taxes at first, but began withholding Social Security from the worker's pay after that point.

What counts as a "pension" for the WEP?

The following rules apply to government retirement plans when determining whether or not they are considered "pensions" for the purposes of the WEP:

- If employer contributions or employer and employee contributions are used to determine the payment, the pension will generally be subject to the WEP.
- If only employee contributions are involved and the payment amount is based on these contributions plus interest, it is subject to the WEP only if it is the primary retirement plan.
- Withdrawals of retirement funds made after the employee is eligible to receive a pension are considered a lump-sum pension for WEP purposes. The lump sum amount will be prorated over an individual's lifetime.
- Payments received from defined contribution plans (401(k), 403(b), 457 plans, etc.) if the plan is the primary retirement plan. If the plan is a supplemental plan, the payments are subject to the WEP when the plan payments contain employer or both employer and employee contributions. If the plan is funded solely by employee contributions, the WEP will not apply.
- Payments from optional savings plans (the Federal Thrift Savings Plan for Civil Service Retirement System (CSRS) employees) are not considered a pension.
- Pension payments that include voluntary employee contributions, that are separate and in addition to, the regular pension payment are not subject to WEP.

The WEP will apply once the individual becomes eligible for a monthly pension or a lump sum in lieu of a monthly pension the first month that the worker meets all requirements for payment. The pension-paying agency, not the Social Security Administration, determines pension eligibility and entitlement.

When might benefits be affected by the GPO?

The GPO is very similar to the WEP in that it adjusts retirement benefits for those who are also receiving a pension from a federal, state or local government and who did not pay Social Security taxes. The difference is that the GPO rules apply to those receiving benefits on someone else's earnings history, such as spouse, divorced spouse or surviving spouse benefits.

What is the amount of the reduction?

The benefit received by the spouse, widow(er), or divorced spouse will be reduced by two-thirds of the government pension received. For example, if a spouse receives a monthly civil service pension of $1,000, two-thirds of that, or $667, must be deducted from that person's monthly Social Security benefit. If the spouse is scheduled to receive $800 per month in Social Security, that amount will be reduced to $133. This would be received in addition to the unreduced $1,000 monthly pension amount. Under the GPO, it is possible to have Social Security retirement benefits completely eliminated.

If a lump sum payment option is available, the Social Security Administration will still calculate the reduction as if you chose to get monthly benefit payments.

Exceptions to the Government Pension Offset

Generally, the GPO will not apply to Social Security benefits if:

- The recipient is receiving a government pension that is not based on his or her earnings.
- The recipient, for five years before retiring, is in a position that was covered under Social Security and the position is also covered by the same government pension plan as their non-Social Security-covered position.
- The recipient is a state or local employee whose government pension is based on a job where Social Security taxes were paid:
  - on the last day of employment and the worker's last day was before July 1, 2004, or
  - during the last five years of employment and the worker's last day was July 1, 2004 or later.
- The recipient is receiving a pension that is based wholly on service performed as a member of a uniformed service, whether on active or inactive duty.
- The recipient was a federal employee (including Civil Service Offset employees) who paid Social Security taxes on their earnings.
- The recipient was a federal employee who switched from the Civil Service Retirement System to the Federal Employees' Retirement System (FERS) on or before June 30, 1988. If the switch was made after June 30, 1988, five years under FERS is required to be exempt.
- The recipient received or was eligible to receive a government pension before December, 1982 and met all the requirements for Social Security spousal benefit in effect in January 1977, or
- The recipient received or was eligible to receive a federal, state, or local government pension before July 1, 1983 and was receiving ½ of their support from their spouse.

SOCIAL SECURITY PLANNING CONSIDERATIONS

One of the biggest decisions a retiree and their family will face is when to start collecting Social Security retirement benefits. There are several basic issues that every worker should consider to help determine the appropriate age.

Continuing to Work While Receiving Benefits

While workers are eligible to begin benefits at age 62, many find that they are continuing to work well beyond that age. Until a worker reaches Full Retirement Age, income earned as an employee or while self-employed can greatly reduce, and even eliminate, retirement benefits. Once a worker reaches FRA, however, that person can have unlimited earnings and not see his or her Social Security benefit reduced. While the FRA varies based on your year of birth, it is generally between ages 65 and 67.

If a worker retires early, starting Social Security can be an easy way to replace a portion of that lost income stream. Immediate replacement of income should be weighed against the permanent reduction that takes place by taking a benefit before full retirement age.

If a worker decides to stop working yet defers benefits until a later age, the worker should also consider whether or not they have other income that can provide support until Social Security benefits are collected.

Health/Family History

The general rule of thumb on when to start receiving Social Security benefits is that the longer you expect to live, the better off you are deferring the start of your payments. If a worker or retired individual is in relatively poor health and expects his or her life expectancy will be shorter than average, it will likely be beneficial to start receiving Social Security benefits as soon as possible. On the other hand, individuals in relatively good health should consider delaying benefits as long as possible, as the likelihood of that person living the necessary number of years to collect more from the larger annual benefit is greater. Family health history also comes into play in this decision.

Other Retirement Income Sources

Having other sources of retirement income beyond Social Security can allow a retiree to defer the start of benefits, which can ultimately lead to a larger annual benefit. For example, personal investment accounts, an employer pension, or even part-time work during retirement can all help bridge the expense gap during the early years of retirement. When using investment accounts as an income source while deferring Social Security, there is an opportunity cost to consider. On the one hand, using personal savings in the early years of retirement allows you to take advantage of the delayed retirement credits you receive for deferring Social Security beyond your Full Retirement Age. On the other hand, perhaps that delayed retirement credit will be less than the investment return you could have earned on your personal savings. Unfortunately, there's no way to predict which option will provide you the best return. In addition, using personal savings sooner also eliminates liquidity that otherwise would be available for any unexpected expenses that may arise in the future.

Other Family Members May Be Entitled to a Benefit

A spouse, minor or disabled children, and dependent parents can all potentially be eligible to collect benefits based on one worker's earnings history. If that worker begins collecting a Social Security benefit, other family members may also be entitled to receive benefits, up to the family maximum. Taking benefits early and allowing other family members to receive benefits, even if for a relatively short time, could be more advantageous than deferring retirement and collecting a larger annual benefit later. Receiving more income earlier should be weighed against waiting and receiving a higher amount later. Survivor benefits could also be reduced if benefits are claimed early. It is important to consider the circumstances of each particular family's situation carefully before a decision can be made regarding when to begin benefits in this case.

Oftentimes, taking a benefit before full retirement age just to trigger dependent benefits does not lead to the highest cumulative benefit received by the family, due to the lifetime reduction in that individual's benefit coupled with the fact that any widow(er)'s benefit would also be reduced.

Medicare Considerations

- **Automatic Enrollment in Medicare.** If someone is collecting Social Security and have also attained age 65, they will automatically be enrolled in Medicare Parts A (hospital insurance) & B (coverage for doctor visits). While an individual can decline Part B if they have coverage through another provider, they are required to be enrolled in Part A at this point. While the vast majority of people do not have to pay a monthly premium for Part A, if they have a Health Savings Account through an employer plan, they will no longer be eligible to make contributions to that plan (employee or employer).
- **Hold Harmless Rule.** There is a special rule for Social Security recipients, called the "hold harmless rule," that ensures that Social Security checks will not decline from one year to the next because of increases in Medicare Part B premiums. The hold harmless rule applies to most, but not all, Social Security recipients. Most people who receive Social Security disability or retirement benefits and Medicare Part B (coverage for doctor visits) are eligible for protection under this rule. Whether this rule comes into play in a particular year depends on the amount of COLA and the Medicare Part B premium increase. To receive this protection, you **MUST** have your Medicare Part B premiums withheld from your Social Security check.
- Individuals who **do not** qualify for the hold harmless provision include:
    - New Medicare beneficiaries,

- Higher-income beneficiaries (modified adjusted gross income greater than $85,000 for individuals and $170,000 for couples), and
- Beneficiaries whose Part B premiums are paid by the state through one of the Medicare Savings Programs (MSPs) due to Medicaid eligibility.

ADVANCED PLANNING STRATEGIES AND OPPORTUNITIES

The complexity of the Social Security retirement system can make determining when you receive a retirement benefit, and which benefit to take, seem overwhelming. The following planning ideas introduce some additional strategies that have been used successfully to help a worker and his or her family maximize their Social Security benefits over a lifetime.

Many of the advanced planning strategies often take advantage of two techniques, which are important to define. They are filing and suspending and filing a restricted application. **With the passing of the Bipartisan Budget Act of 2016, the ability to file and suspend was eliminated and the ability to file a restricted application is being phased out.**

- **File and suspend.** Once a worker reaches full retirement age, he or she may file for benefits and immediately suspend them. Doing so opens up the worker's own record to allow for others to collect a benefit (spouses, children, etc.), but because the worker is not actually collecting Social Security, their own benefit continues to earn delayed retirement credits (DRCs). DRCs increase a person's benefit by 8% annually. The last day to file and suspend under the previously described rules was 04/29/2016. Anyone who filed and suspended by then was grandfathered under the old rules. Going forward, this strategy is no longer available.
- **Filing a restricted application.** A person entitled to spousal benefits may file a restricted application after attaining full retirement age as long as they have not previously filed for benefits. In filing a restricted application, the spouse is restricting the benefit they will receive to spousal benefits only. Doing so allows the individual to collect a spousal benefit while their own benefit continues to earn DRCs until age 70. To be eligible for spousal benefits, the other spouse must have already filed for their benefit. This strategy is only available to individuals born on 01/01/1954 or before. Anyone born after that date is no longer allowed to use this filing option.

Using a Restricted Application

If there is no immediate need for income, waiting to collect a Social Security benefit allows the amount a person will ultimately receive to grow considerably. However, typically no Social Security income is received while a person waits for the benefit to grow. A married couple can take advantage of filing a restricted application, which would allow one spouse to collect a spousal benefit while allowing their own benefit to continue to grow. The working spouse would have to file for their own benefit first before the other spouse could file for the spousal benefit.

- **Example:** A husband and wife are both 66 years old and were born before 01/02/1954. The wife's benefit at full retirement age is $2,000 per month, while the husband's is $1,500. Assuming normal life expectancies and no immediate need for income, if they both wait to file until age 70, they will maximize their cumulative Social Security benefits received. He would receive $1,980 per month and she would receive $2,640 per month. If they are worried about living that long or would like to receive some income before they both reach age 70, one person could file a restricted application at their full retirement age of 66. In this case, the strategy that would lead to the next best outcome would be for the husband to file for his benefit at 66 while the wife files a restricted application at the same time. He would receive $1,500 per month while she would receive a spousal benefit of $750 per month. At age 70, she could then switch over to her own benefit and receive $2,640 per month going forward. The caveat to this strategy is that, in this case, the husband has to file for his benefit before age 70, giving up his delayed retirement credits. Balancing the desire to start income early with maximizing both people's Social Security benefits is critical in deciding which path to take.

Options for Altering Your Social Security Benefit After Filing

Because of the difficulty in picking the right start date for Social Security benefits, some retirees decide to begin their benefits as soon as they're eligible. After a period of time, they realize they would have been better off waiting to start. There are two little known provisions in the Social Security rules allows retirees a "do over" when it comes to their decision on a start date.

Under the first provision, you can **withdraw your Social Security claim**, pay back the total Social Security amount collected (without interest or penalties), claim a tax credit or deduction for any income taxes paid, and then re-file for the larger benefit amount that you would be entitled to at that later age.

- A retiree is limited to one Social Security application withdrawal per lifetime, and this withdrawal must occur within 12 months of the first month of entitlement.
- The process for stopping your Social Security benefits and then starting them at a later date is described below:
- A retiree who is currently receiving Social Security benefits would submit the Request for Withdrawal of Application form (Form SSA-521) to the Social Security Administration. This would then stop all retroactive, current, and future benefits.
- The retiree would need to pay back all benefits collected up to that point. The amount that needs to be paid back is simply the total of all benefits received up until that point. No interest or penalties are required to be added to that amount.
- Any income tax that was originally paid on the benefits could be recovered by either claiming a tax credit or an itemized deduction in future years.
- At a future date, the retiree would re-apply for retirement benefits. The benefit received would be based on the retiree's age at that time and also factor in any additional employment income that may have been earned over that time period.

The second option is to **voluntarily suspend** receipt of benefits. This option is only available to individuals that have reached their full retirement age. By suspending benefits, the individual is able to earn delayed retirement credits for the months that their benefit is suspended. The delayed retirement credits are added to the amount the individual was previously receiving. While voluntarily suspending benefits will increase the amount individual was receiving, it will not restore the benefit to their originally-projected age 70 amount. During the period when benefits are suspended, the individual would also need to pay their Medicare premiums another way and would not be eligible for the protection against premium increases offered by the Hold Harmless provision. If someone suspends after the previously mentioned 04/29/2016 deadline, benefits paid to other beneficiaries (spouses, children, etc.) will also cease to be paid.

Combining a Widow(er)'s Benefit with a Surviving Spouse's Own Retirement Benefit

A widow(er) has the ability to determine the best way to maximize their Social Security benefits by deciding when to take their own retirement benefit and when to take a surviving spouse's benefit. A widow(er) may decide to take the surviving spouse benefit for a period of time and then later apply for a full retirement benefit based on their own earnings history.

For example, a surviving spouse who has worked her whole life could claim the widow's benefit as early as age 60. She could then re-file and replace the widow's benefit with the higher benefit based on her earnings history at any point up until age 70. This higher benefit amount would then last for the rest of her life.

It is also possible to do the opposite and take their own retirement benefit for a period of time and switch to the surviving spouse benefit at a later age. The surviving spouse would not want to make the switch any later than her full retirement age, as the widow(er)'s benefit does not earn delayed retirement credits.

If the widow(er) is still working and under full retirement age while collecting benefits, the individual's Social Security benefit (own or survivor's) will be reduced if they earn employment income above the earnings threshold.

Spousal Benefit vs. Widow(er)'s Benefit when Re-Marriage Occurs

There is an advantage to being able to receive a widow(er)'s benefit when compared to receiving a spousal benefit. Part or all of a spousal benefit could be lost if the divorced spouse's new spouse is under full retirement age and works, earning more than the Social Security limits. The widow(er)'s benefit, however, is unaffected by the new spouse's earnings.

Strategies for Minor Children when a Parent Begins Collecting Retirement Benefits

Older individuals who are widowers or divorced and later get remarried could marry into a family with younger children or start a second family. If the worker retires and begins receiving Social Security benefits, eligible dependent children will also receive a benefit worth up to 50% of the retired worker's PIA. This benefit can be reduced by the family maximum.

The proceeds received could be used to fund college savings accounts, such as a 529 plan. This could potentially stretch the Social Security benefit even further by offering tax free growth if the proceeds of the account are used for qualified education expenses.

Receiving a Lump Sum Payment After Voluntarily Suspending Benefits

NOTE: The below strategy is only available for people who suspended benefits prior to 04/30/2016. Anyone suspending benefits on 04/30/2016 or later will not be able to take advantage of the below option.

If a worker voluntarily suspends their Social Security benefit at or after Full Retirement Age (FRA), the worker could reinstate suspended benefits, which would allow the individual to receive all of the suspended benefits as a lump sum payment. However, the worker would not receive delayed retirement credits from age 66 through their current age. When their benefit resumes, the monthly amount would be reset to their benefit amount at age 66, rather than their current age.

- **Example:** Brad files for Social Security benefits and immediately suspends receipt of his monthly check at age 66. At age 69, Brad becomes ill and incurs a large, unforeseen medical expense. Because of his illness, Brad would now benefit more from receiving a lump sum cash payment than receiving a higher monthly Social Security benefit going forward. Brad chooses to reinstate his voluntarily suspended benefits. This results in Brad receiving a lump sum payment of all benefits he would have collected from age 66-69. Going forward, his monthly Social Security benefit will be based on the amount he would have received at age 66, adjusted for inflation. The cost of receiving the lump sum payment is that he will not receive the delayed retirement credits he would have earned by waiting until age 69 to start collecting benefits.

This option minimizes the risk of waiting to receive benefits. If a retiree chooses to delay claiming retirement benefits in order to earn delayed retirement credits, they run the risk of not living long enough beyond the delayed retirement age to receive enough of the larger payments to make up for missing out on the benefits they would have received at an earlier age. This option allows for a worker to delay receiving benefits in hopes of receiving a higher monthly payment later while also ensuring that a surviving spouse will receive the highest possible survivor benefit, yet still allows for them to change their mind and receive a lump sum payment if their circumstances should change before age 70. For single individuals, this strategy reduces, but does not eliminate the risk of dying prematurely. For married couples, it adds flexibility to their planning strategies if they choose to delay receipt of benefits beyond full retirement age.

If you have questions or need more information, please contact your financial advisor.