Social Security – The Basics

Summary

This article discusses three types of Social Security benefits: the worker's retirement benefit, the family benefit (spouse and children), and the survivor's benefit and various limitations that may apply.

Related Information

Timing is (Still) Everything – Social Security Strategies After the Bipartisan Budget Act of 2015 (01/16).

Introduction

As part of a financial plan, Social Security can be an important component of many individual's income in their retirement years. Understanding the various claiming options and potential limitations is essential to maximize this guaranteed source of income. This article will outline three types of Social Security benefits: the worker's retirement benefit, the family benefit for both spouse and children, and the survivor's benefit. This article will also provide details on a few of the limitations, including the earnings limit and the family maximum.

The benefits

1. The worker's retirement benefit. Individuals who have worked in the Social Security system and have earned 40 credits[1] are generally eligible for a retirement benefit. This benefit, payable at an individual's Full Retirement Age (FRA), is known as the "Primary Insurance Amount" (PIA).[2] One of the most common questions asked by workers nearing retirement is "when should I apply for Social Security benefits?" Each retiree's situation is unique, but there are three main options for a worker as it relates to his or her own retirement benefit:

   a. *Taking the benefit early*. Age 62 is the earliest that an individual can start taking retirement benefits. Taking benefits early will result in a permanent reduction in benefits.[3] For example, an individual with a FRA of 66 can expect benefits to be reduced by 25% if applying at age 62. Taking the benefit early can also be affected by the "earnings limit," as discussed later.

   b. *Taking the benefit at FRA*. FRA is 65 for those born before 1938 and it gradually rises to age 67 for those born in 1960 and later. For individuals born between 1943 and 1954,

[1] A credit or "quarter" is recorded for every $1,260 you earn during any year (2016 figure). You can only earn a maximum of four credits per calendar year.
[2] The PIA is calculated based on the individual's highest 35 years of earnings.
[3] The reduction factor applied to the PIA is 5/9 of 1% for each of the first 36 months before FRA, plus 5/12 of 1% for each month in excess of 36 months.

FRA is age 66. Taking benefits at FRA means individuals will receive 100% of their retirement benefit.

c. *Postponing taking the benefit beyond FRA*. Delayed Retirement Credits (DRCs) are earned for each month an individual postpones taking benefits beyond FRA up to age 70. For each year an individual delays, the benefit will increase by 8% per year.

There is no advantage to waiting past age 70 to file for Social Security benefits. DRCs stop accruing after age 70, meaning the benefits don't get larger just because you are waiting beyond age 70 to claim it. What's more, if an individual delays and then seeks to recover payments that were missed, Social Security will only pay benefits for the previous 6 month period.

The following chart illustrates the difference in the amount of benefit available for a worker with a monthly retirement benefit of $1,500 and an FRA of 66:

Retire early at age 62	$1,125 per month
Retire at FRA (age 66)	$1,500 per month
Retire at age 70	$1,980 per month

2. The family benefit (spouse and children). A retired worker's spouse and children might be eligible for benefits on the retired worker's earnings record. [4] *The retired worker must have filed for benefits before spousal or children benefits can begin*.

a. *Spousal benefits.* The maximum amount the spouse can get is 50% of the retired worker's PIA if the spouse applies for spousal benefits at FRA. Spousal benefits can begin as early as the spouse's age 62, although spousal benefits will be permanently reduced if she applies before her FRA.[5] Spousal benefits do not earn DRCs if the benefit is delayed beyond the spouse's FRA.

When an individual applies for benefits, it is considered a "deemed filing." The spouse will receive her own retirement benefit, plus a spouse's benefit limited to the excess (if any) by which 50% of the retired worker's PIA exceeds her own retirement PIA benefit. The spouse's benefit is then added to her own retirement benefit. Social Security does this automatically – it is not a matter of choice when benefits are claimed.[6]

To make a long story short, the spouse's benefit will automatically be the higher of: i) her own benefit or ii) half of the retired worker's benefit (the spousal benefit). And, it will be reduced if she files early (i.e. before her FRA).

[4] To make it easier on the reader, particularly with regard to the use of "his or her," we're assuming a male "retired worker" and a female "spouse."
[5] If the spouse applies for the spousal benefit at age 62, she will receive a permanently reduced benefit of 32 ½% to 35% of the other spouse's PIA. For an individual age 62 in 2015, the benefit is reduced to 35%. As the FRA gradually increases to 67, the percentage of the worker's PIA payable to the spouse at age 62 will gradually decrease to 32 ½% for people attaining 62 in 2022 and later.
[6] Under the Bipartisan Budget Act of 2015, all filings will be "deemed" filings for anyone who turns age 62 in 2016 or later. Under the previous law, a filing was a "deemed" filing only if that individual filed before FRA. Individuals who are age 62 or over by December 31, 2015 are grandfathered under the previous law. *See Timing is (Still) Everything – Social Security Strategies After the Bipartisan Budget Act of 2015* (01/16) for more details on the law change.

Example 1. Harold, who is age 64 with an FRA of age 66, decides to apply for his Social Security benefit. His benefit at his FRA would be $2,500 per month. Because he applies two years early, his benefit will be reduced by 13.34% (5/9 of 1% x 24 months) and he will receive $2,165 per month. Shirley, his spouse, who is age 62 and also has an FRA of age 66, also decides to apply for her benefit. Her PIA is $600 per month, but her spousal benefit is $1,250 per month (50% of $2,500 per month). Her own benefit is lower than her spousal benefit, so she will get the higher spousal amount ($1,250 per month), but it will be reduced because she is taking it 4 years early. She will receive $875 per month on account of the reduction.

Example 2. Same facts as above, except that Harold decides not to apply for his benefit. Shirley begins taking her benefit at age 62. Since Harold hasn't applied, Shirley is not eligible to take a spousal benefit. And because Shirley is applying early, her benefit will be reduced. She will receive 75% of $600, or $450, per month. Now, let's assume that Harold applies for his benefit at age 68, receiving his full benefit plus two years of DRCs. His benefit will be $2,500 x 116% or $2,900 per month. Because Harold has now applied, Shirley is now eligible to collect her spousal benefit of $1,250 per month (the spousal benefit does not receive DRCs, so the most Shirley can receive is half of Harold's PIA benefit of $2,500 per month). However, because she applied for her own benefit early, her spousal benefit will also be reduced. Social Security will take half of Harold's PIA, or $1,250, and subtract Shirley's PIA of $600, to come up with a spousal benefit of $650. This will be added to her existing $450 benefit, to give her a total spousal benefit of $1,100 per month. In other words, the $150 reduction she took when applying early at age 62 permanently carries over to her spousal benefit.

If a retired spouse is under age 62, she can receive benefits if she is caring for an eligible child[7] who is under age 16 (or any age, if disabled before age 22). She is eligible for spousal benefits equal to 50% of the retired worker's PIA.

A divorced spouse can also claim a spousal benefit if the marriage to the retired worker lasted for at least 10 years and the divorced spouse is currently unmarried. In this instance only, the retired worker does not have to have filed for his own benefit first. The only requirement is that the retired worker be of an age where he *could* file for benefits (i.e., age 62).

b. *Eligible Children's benefits*. Additionally, each eligible child of a retired worker is entitled to a benefit of 50% of the retired workers PIA (up to the family maximum, see below).[8]

3. The survivor benefit (for spouse and children). Upon the death of one spouse, the surviving spouse might be entitled to receive a survivor benefit. The surviving spouse, at her FRA, is entitled to a survivor benefit equal to 100% of the insured worker's PIA *on his date of death*, if higher than the benefit the surviving spouse is currently receiving**. This means that a retiree who delays Social Security benefits beyond FRA will not only increase his own worker benefit, but will also increase the survivor benefit for the surviving spouse. Essentially, the value of delaying Social Security continues to benefit the couple, as the surviving spouse will now receive the higher benefit.**

[7] An eligible child includes an individual's natural child, adopted child, stepchild (must be dependent on that individual for at least 50% support), and dependent grandchild (parents must be deceased or disabled). The child must be unmarried and either (i) under age 18, (ii) up to age 19 if in high school, or (iii) any age, if disabled before age 22.
[8] A maximum family benefit limit can apply if more than two people receive payments on the same Social Security record.

A surviving spouse can receive survivor benefits as early as age 60. However, if the surviving spouse whose FRA is 66 applies at age 60, the survivor benefit will be reduced to 71.5% of the deceased spouse's PIA.

A surviving divorced spouse also qualifies for a survivor's benefit, provided that the couple was married for at least 10 years. If the surviving spouse or surviving divorced spouse remarries before age 60, benefits are not payable unless (and until) the subsequent marriage ends.

Remarriage after attaining age 60 does not prevent or stop entitlement to benefits. The benefit is the same as that payable to a surviving spouse.

Additionally, each eligible child is entitled to survivor benefits equal to 75% of PIA (up to the family maximum, see below).

A few limitations

1. <u>The earnings limit</u>. Individuals who receive any of the benefits described above (retirement, family or survivor) prior to the month in which they attain FRA will be subject to the earnings limit. If the individual earns more than the exempt amount, the benefit (and anyone who is collecting a benefit off of his or her record) will be reduced. If the individual is under his FRA throughout the entire calendar year, $1 in benefits will be withheld for every $2 earned above the earnings limit for that year ($15,720 for 2016)[9].

   In the year the individual attains FRA, the rules are more liberal – he can earn more ($41,880 in 2016) in the months before attaining FRA with no reduction in benefits. If earnings exceed this limit, then $1 of benefits is withheld for every $3 earned over this limit.

   Once an individual attains FRA, there is no withholding of benefits regardless of how much that individual earns.[10]

2. <u>Maximum family benefit</u>. The amount of benefits that family members can receive based on the earnings record of one worker is limited.[11] If the sum of the family benefits based on one earnings record is more than the maximum, the benefits of the family members will be reduced proportionately to bring the total within the limit. The worker's own retirement benefit, however, will not be reduced. Note that the amount payable to a divorced spouse or surviving divorced spouse is not included in the family maximum (her benefit neither counts against the maximum, nor would it be reduced due to its application), unless the surviving divorced spouse qualifies only on the basis of caring for a child of the worker.

Conclusion

Social Security is one of the few guaranteed sources of income in retirement. Therefore, it is important that advisors discuss with their clients the alternative methods and strategies to assure that clients receive the largest benefit possible through their retirement years.

---

[9] Again, this limit applies to any benefit. If a survivor benefit is being received by a 17 year old child – far below FRA – the child's benefits will be reduced if he or she exceeds the earnings limit.
[10] Senior Citizens Freedom to Work Act of 2000.
[11] The formula used to compute the family maximum is similar to that used to compute the PIA.

This publication is not intended as legal or tax advice. This information was compiled by the advanced planning attorneys of The Northwestern Mutual Life Insurance Company. It is intended solely for the information and education of Northwestern Mutual Financial Representatives, their customers, and the legal and tax advisors with whom they work. It must not be used as a basis for legal or tax advice, and is not intended to be used and cannot be used to avoid any penalties that may be imposed on a taxpayer. Northwestern Mutual and its Financial Representatives do not give legal or tax advice. Taxpayers should seek advice based on their particular circumstances from an independent tax advisor. Tax and other planning developments after the original date of publication may affect these discussions.

Northwestern Mutual is the marketing name for The Northwestern Mutual Life Insurance Company, Milwaukee, WI and its subsidiaries

Northwestern Mutual®