

## THE MONEY MARATHON: WHAT DOES A PERSON NEED TO KNOW ABOUT SOCIAL SECURITY BENEFITS? NOVEMBER 2009

There are several questions and complexities relating to Social Security benefits that I thought would be helpful to review.

### WILL SOCIAL SECURITY BENEFITS ALWAYS BE AVAILABLE?

My answer to this question is YES. No one knows for sure the answer to this question, but politically it would be next to impossible to take away benefits from people at retirement age. In a worst case situation, if we as a country make no changes to the existing program, the current system covers all obligations until 2037. At that time, even if nothing else is done, payroll taxes would cover 75% of Social Security obligations for many years after this. I do think that Social Security's long term funding deficit needs to be addressed at some point. My guess would be that at some point we will continue to raise the eligibility age for full retirement from the current age of 66 going to age 67 for retirees born after 1960 (it used to be 65) to age 70. This can make a big difference in the funding shortfall. This solution makes sense to me in that when Social Security was established many years ago with a retirement age of 65, the average life expectancy was approximately 70. Today's life expectancy has increased by more than 10 years and so it makes sense for the solvency of the system to move the retirement age back to age 70. I would guess this change would not affect people currently over 55 years of age.

### HOW MUCH OF MY INCOME WILL SOCIAL SECURITY REPLACE?

As a very general rule of thumb, I tell people that if they do not want to count on Social Security they need to save 20 times their current income. At a 5% withdrawal rate, this would allow a person to withdraw 100% of his current income. Example: \$50,000 income times 20 equals \$1,000,000 of needed retirement saving. A 5% annual withdrawal from \$1,000,000 equals \$50,000. If a person counts on Social Security as mentioned above, as I think he should, then Social Security will replace about 50% of his income. In the previous example, that would be \$25,000 from Social Security and \$25,000 from withdrawal from savings which means saving 10 times a person's pre-retirement income instead of 20 times. So in the example above, a person with \$50,000 of income should expect to save \$500,000 to replace his income with Social Security and withdrawals from investment income. As I mention this is a very general rule of thumb. The ratio at which Social Security replaces a person's income decreases as income increases from approximately a 50% replacement ratio for income of \$25,000 to 40% at \$40,000 to less than 30% at \$90,000. This ratio of income would increase for a couple with a non employed spouse because the spouse can draw up to 50% of the retirement benefits of the working spouse.

## HOW MUCH OF A SOCIAL SECURITY BENEFIT WILL A PERSON RECEIVE?

Generally, to be eligible for Social Security benefits a person must have 40 quarters of credit for work. A quarter of credit is earned for each amount earned of approximately \$1000 earned in a year up to four credits per year. How much a person will be paid at retirement is based on a complex formula that is based on a person's highest 35 years of earnings. The current maximum monthly benefit is \$2326 for a person retiring today. Currently Social Security taxes are paid on income of up to \$106,000. If a person's income has been at the maximum level of income for Social Security taxes or above for many years, he would expect to receive the maximum benefit. Remember that a spouse can be paid a benefit up to the maximum based on that spouse's own income history. Even if a spouse has earned no income, that spouse can draw up to 50% of the employed spouse's benefit. A divorced spouse that has not remarried is eligible for benefits if that spouse was married for at least 10 years.

## SHOULD A PERSON TAKE BENEFITS AT AGE 62, 66 OR AGE 70?

At age 62, a person will receive only 75% of full retirement benefits. This increases a little over 6% a year until full retirement age. If a person waits past full retirement age the benefit increases 8% a year up until age 70 at which time a person would receive 132% of his full retirement benefit. Generally, if a person is in good health and can afford to wait, he is better off waiting. He will receive a larger payment for a shorter period but the break even period is usually age 81. So if a person expects to live to be 90 he would be better off waiting until age 70 to take his Social Security. (Updegrave, Walter, "What You Need to Know About Social Security," Money Magazine, October 2009) It is a more complicated question for couples but generally to maximize benefits, the higher paying spouse should wait as long as possible and the lower paid spouse should take benefits sooner. One of the reasons for this is that the lower paying spouse is entitled to the higher spouse's benefit at death so delaying that payment can help protect the maximization of income in several situations. A popular strategy is where the higher paid spouse files for retirement and then suspends payment until a later age which allows the lower paying spouse to withdraw based on half of the higher earning spouse benefit and still have the higher spouse and survivor spouse benefit grow. (Green, Kelly, "Spouse Social Security Strategy Has Its Limits", Wall Street Journal, September 26, 2009) It should be noted that early benefits before full retirement age are reduced by \$1 for every \$2 dollars of earnings earned in a year above \$14,160. This money is not actually lost. The amount that is taken away prior to full retirement age is added back beginning at full retirement age. Again, if a person lives a reasonably long life he will get this back and more.

## WHEN ARE BENEFITS TAXED?

If half of couple's social security and all of their other income is over \$32,000 per year (\$25,000 for singles) then 50% of their Social Security will be taxed. Over \$44,000 income under this formula (\$34,000 for singles) and 85% of Social Security benefits will be taxed.

## CHECK YOUR ANNUAL STATEMENT OF BENEFITS

Finally, every year a person will receive a statement of potential benefits from Social Security. This is packed with information including the history of the person's earnings, how much has been paid into Social Security, projected retirement benefits and disability benefits and whether or not a person meets eligibility requirements. Be sure and review this to make sure there are no errors. This statement will help a person learn about these important benefits.

Remember, every investor's situation is unique, and it is important to review your specific situation with a financial professional.

Ed Douglas is a Certified Financial Planner/Consultant, Chairman Emeritus of Citizens Bancshares and author of two books, "Making a Million With Only \$2000-Every Young Person Can Do It" and his new book "The Money Marathon: 7 Simple Steps to Financial Freedom" available at [www.eddouglas.com](http://www.eddouglas.com). Ed may be contacted at [ed@eddouglas.com](mailto:ed@eddouglas.com) or 660-646-2066.