Social Security Primer

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The Social Security Cliff Is Coming
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Thinking about retirement, for almost all Americans, means thinking about Social Security. Even for relatively wealthy people, Social Security will be a large portion of retirement income. Yet, most people with whom I speak have almost no insight into the amount and structure of their future benefits.

1. **How to estimate your Social Security benefit.** The Social Security Administration (SSA) formerly mailed a hard copy of historical earnings and conditional estimated benefits to all wage earners every year. That information is now online. Every American should know how to log in to check the earnings history to ensure its accuracy. The website is ssa.gov/myaccount/. At the web site, you'll find your earnings history according to SSA and some estimates of future cash benefits. You'll also find a link to your social security statement, a PDF version of the document you formerly received by mail. The future benefit estimates do not include wage index adjustments and cost living adjustments that will affect future benefits, so for younger people there's lots of uncertainty. For most people, these estimates will be enough, but you should also know, at least in general, how to calculate your benefit.

2. **Social Security determines your benefit using your income from your 35 highest earning years.** Taxes paid beyond 35 years are a gift to your fellow citizens. Years with no earnings are averaged in as zero. Earnings in each relevant year are multiplied by an inflation factor specific to that year. (For this year, earnings from 1984 are multiplied by 3.23, for example, for a person born in 1958.) Then, the 35 inflation-adjusted numbers are added together then divided by 420 (35 years x 12 months = 420). Social Security calls the resulting number your Average Indexed Monthly Earnings (AIME). Next is a big adjustment to benefit low earners, the so-called "bend points." The first $1,174 of AIME is multiplied by .90, the next $5,904 by .32 and all AIME above $7,078 is multiplied by .15. Adding those three numbers together gives you your Social Security benefit, your Primary Insurance Amount (PIA), at Full Retirement

Age. For everyone born in 1960 or later, that's 67. You can claim your benefit early for a 7% per year discount down to age 62; you can delay until age 70 receiving a 8% per year bump until then. Some consequences:
1) Having at least 35 years when you made SOME income is important -- you get 90% of the first $14 thousand of income added into the calculation of your AIME - the annual amount under the first bend point.
2) Working extra years, if you already have 35 years of upper-middle-class earnings won't help you much. Replacing a year when you made an indexed $90 thousand (in your top 35) with a year in which you made $114 thousand will only add 17% as much to your AIME as replacing a "zero" year with $14 thousand of income.

3. **Married couples figure their earned Social Security benefit separately.** But, if one member of the couple had minimal earned income, he or she receives up to 50% of the other spouse's benefit. Many people forget or undervalue this feature. The details are complex and need an article of their own, but the extra benefit for a spouse with very limited work history is significant.

A quick example. Phil has made an inflation adjusted income of $75,000 per year for 35 years and is retiring at his full retirement age, as defined. His wife Gladiola, who is the same age and will be claiming benefits at the same time, has never worked outside the home. If this pair were to reach full retirement age this month, Phil's AIME would be approximately $6,250 and his bend-point-adjusted monthly benefit (PIA) would be about $2,680. Gladiola, with no earnings history, would receive about $1,340. The couple would receive about $48,000 per year. Real world retirees will tell us that some of this may be taxed depending on other income and that Medicare Part B payments will be deducted as well. But $48,000 will buy some groceries, particularly if the mortgage has been paid off and the kids are fully independent.

Working fewer years hurts. The same couple, if Phil worked only 25 years, will only receive about $34,000 in annual benefits. Making more than $75,000 per year does help, but not proportionally because the additional earnings are soon above the top "bend point," so the benefit only rises by 15% of each dollar of incremental AIME.

Using the 4% rule applied to a saved "nest-egg", you'd have to have over $1 million dollars to throw off the $48,000 that Phil and Gladiola will receive. So, you must have very substantial savings before Social Security does not constitute a very large share of your retirement income.

It's often reported that Social Security is going broke. Social Security was devised as a "pay-as-you-go" system. After decades when benefits were less than current Social Security taxes, the US now pays out more Social Security dollars than it receives, covering the shortfall by liquidating the Treasury Bonds held in the Social Security trust fund. But, that supply will be exhausted in about 2033 (when your humble scribe turns 74 and will need the dough). Neither political party wants to talk much about the problem. Some on the right want to raise the Full Retirement Age further; some on the left want to increase the amount of earned income subject to Social Security tax without adjusting benefits (effectively creating a new “bend point” above which your incremental benefit percentage is 0%). Even after 2033, Social Security tax collections will cover about 70% of the benefits owed to beneficiaries. Middle class people over 50 today will likely be unscathed, but younger workers and high-income folks should be attentive to the political conversation and wary of subtlety and indirection.

The complexity of the foregoing is just one more reason for being a Truxton Wealth client. We’ll help you do these calculations and help you sharpen your focus on what your retirement income might look like. ▪