Special Report – May 2014
<u>A Primer on Social Security</u>

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Hello! My name is Steve Geist, I'm a Financial Strategist and I specialize in Safe Retirement Plan Solutions that are tailored with care. More specifically, I help my clients tackle complicated retirement issues and guide them towards easy-to-understand solutions designed to safely preserve and grow their retirement wealth. Now, more than ever, people over the age of 50 are clamoring for education and advice regarding their retirement.

One way I like to teach my clients and my seminar students about Retirement is to present it as a Puzzle. And, I like to present the puzzle as containing five primary pieces. And they are:

- ✓ Puzzle Piece #1: Preserving and Safeguarding Your Accumulated Assets
- ✓ Puzzle Piece #2: Setting up a Lifetime of Guaranteed Income
- ✓ Puzzle Piece #3: Addressing Taxes in Retirement and Beyond
- ✓ Puzzle Piece #4: Having Proper Coverage for Health Care and Long Term Care
- ✓ Puzzle Piece #5: Leaving a Legacy for your Loved Ones

So in this Special Report let me present to you a primer on Social Security an important part of Retirement Puzzle Piece #2 – Setting up a Lifetime of Guaranteed Income.

According to a 2008 study by the Employee Benefits Research Institute, Social Security accounts for nearly 40% of total retirement income for those 65 years and older. With it being such a substantial portion of income during retirement years, it is important to understand how the Social Security system works in order for you to maximize your benefits.

Many people choose to begin receiving benefits prior to reaching full retirement age out of need. Other people do so because they do not fully understand the impact of their decision and the substantial <u>decrease</u> in benefits that could result. Yes, the decision of when to begin receiving benefits can be difficult. Add a spouse to the equation and account for the difference in ages between spouses, and things become even more complicated.

Coming up with the perfect answer to "<u>When should I apply for Social Security</u>?" requires you to be part actuary, part financial planner and part fortune teller. Still, you can make a better decision if you take the time to understand some of the twists in how benefits are calculated.

So let me start by addressing some common questions.

<u>Will I receive full Social Security benefits if I retire at age 65?</u>

The answer is a definite no. In fact, any person who turned age 65 in 2007 or later will receive reduced benefits if they begin taking benefits on their 65th birthday.

In the past, age 65 was the "magic" retirement age to receive full benefits. But that is no longer true.

Now, for individuals born in 1942, full retirement age is 65 years and 10 months. Those born in 1943 through 1954 must attain the age of 66 in order to receive full benefits, and individuals born after 1954 currently must reach age 67 for full benefits.

What is the earliest age someone can retire and receive Social Security benefits?

Individuals can begin receiving reduced Social Security benefits as early as age 62. But, be aware that if you elect this option, you will continue to receive these reduced benefits for the rest of your life.

This reduction will be between 25% - 30% of what you would have received at full retirement age. That's a 25-30% reduction in income. And since Social Security may be a big portion of your overall retirement income plan, does it make sense to eat that kind of loss?

By contrast, starting at age 62, for each year that you postpone applying for benefits all the way up to age 70, you get about 8% more per year in benefits. It's the easiest raise you'll ever get in your life. At that rate you will just about double your monthly Social Security income by waiting to take benefits until you're age 70.

Also keep in mind that if you're married, the decision to take Social Security benefits before full retirement…that decision can lead to significant reduction in income for both spouses.

So, again: What is the best age to begin taking benefits? This is not an easy answer and will be different for each person. Many financial planners, including me, believe that one of the best ways to ease into retirement is to live within your means and not rely on income from Social Security until you reach age 70.

Please understand that many of your other financial decisions will hinge on the choice you make. And bear in mind, the power of Social Security goes beyond the mere benefit. It's tax-favored income, it's guaranteed for life, indexed for inflation and can never be reduced.

Will I loose my Social Security benefits if I continue to work?

There are three parts to the Answer.

Part 1: If you work but you start receiving social security benefits before full retirement age, then $1 will be deducted from your benefits for every $2 in earnings you receive above the annual limit. In 2014, that limit is $15,480.

Part 2: In the year you reach your full retirement age and up to the month you reach full retirement age, $1 will be deducted from your benefits for every $3 in earnings you receive above the annual limit. In 2014 that limit is $41,400.

Part 3: Once you reach the month of your full retirement age, you can keep working, and your Social Security benefits will not be reduced no matter how much you earn.

Now it's important to note that earned income means just that; income that you earn from actively working. Earned income does not include interest, dividends or pensions.

It's also important to note that these benefit reductions are not truly lost. Your benefits will be increased at your full retirement age to account for benefits withheld due to earlier earnings.

Here's how this works: After you reach full retirement age, Social Security will recalculate your benefit amount to give you credit for any months in which you did not receive some benefit because of your earnings. In addition, as long as you continue to work, Social Security will check your record every year to see whether the additional earnings will increase your monthly benefit.

Are Social Security benefits subject to income taxation?

Well, for nearly the first fifty years of the existence of the Social Security program, Social Security benefits were treated as non-taxable income by the federal government. Then in 1984 a bill took affect that made numerous changes to the Social Security and Medicare including the taxation of Social Security benefits.

So today, Yes, Social Security is subject to income tax, just like earned and unearned income. However, being subject to taxation does not necessarily mean that income taxes will be due.

Unfortunately, the government never makes things easy. In 1984 there was one rule, whereby up to 50% of your Social Security benefits could be taxable for federal income tax purposes. In 1994 that rule changed again and now today, up to 50% of benefits are taxable at one income level and up to 85% of benefits are taxable for higher income levels.

Here's basically how it works. The percentage of your Social Security benefit that is included in your income for tax purposes is based on a formula known as Provisional Income.

Provisional Income is the sum of all income including interest and dividends from savings and investments, long and short term capital gains, income from working, interest from tax-free municipal bonds, income from pensions and interest from annuity income plus 50% of your total Social Security benefits.

So; for married taxpayers, if your Provisional Income is between $34,000 and $44,000, then 50% of your Social Security income is taxable. If you're married and your Provisional Income exceeds $44,000, then 85% of your Social Security income is taxable.

For single taxpayers, these two thresholds for Provisional Income are lower: $25,000 for 50% taxable benefits and $34,000 for 85% taxable benefits.

How can I arrange my retirement income to shelter my Social Security benefits from taxation?

Remember that several income sources included in Provisional Income are under your control. Interest income from savings, interest from corporate and government bonds, interest and capital gains from investments, municipal bond interest and wages (income from working) are all factors that you can choose to change.

And what many people may not know is that the purchase of annuities can potentially help with this problem.

More specifically, the interest earned in a Deferred Annuity that remains in the annuity and is not withdrawn is not included in the Provisional Income calculation!

As an example, let's suppose that you are retired and your income comes primarily from Social Security and pension income. Let's also suppose that you have money in a fully taxable savings vehicle such as a CD or Money Market Account. And even though you are not withdrawing any money from your savings, the interest income on that savings is causing your Social Security benefits to be subject to income taxes.

If, instead, you moved those savings into a deferred annuity, you would have the ability to defer income taxes on your interest earnings and reduce or eliminate taxes on your Social Security benefits as well. And, don't forget the fact that annuities often produce much higher interest earnings than traditional savings vehicles!

SPECIAL REPORT TIMEOUT

In case you belong to a group, club, church, association or any type of organization that invites outside speakers to give interesting talks – please know that as a community service, I would be delighted to speak at your next group meeting. And, I would speak on a topic that would be both informative and relevant to Retirement. Just call my office and let me know how I might be of service.

What impact will IRA Required Minimum Distributions have on my taxable retirement income?

One of the most overlooked planning items is the consideration of what to do if you have significant retirement accounts (IRA and 401(k)-type accounts). And you realize the withdrawals from these accounts that the government forces you to take at age 70 ½ will cause your Social Security to be taxed.

Many people might ask, “What can I do about that? After all, I have to make those withdrawals, right?” Well, yes. If you do nothing now then you will have to take those required withdrawals. So you might ask: What can I do now?

The answer comes back to a discussion of taxes. As of today, tax rates are at low levels compared to what they have been historically. So, what do you think will happen with tax rates in the coming years? If you think they might increase then the logical response could be to take withdrawals from your IRA-type accounts before you are forced to do so. One strategy to consider is to convert your traditional IRA and 401(k)-type accounts into Roth IRA accounts.

Roth IRA’s do not have required minimum distributions because you have already paid taxes when you converted from the IRA to Roth. In addition, if you have other resources and income and don’t need income from your IRA accounts, you could allow your Roth accounts to grow and compound tax-free and potentially leave a larger legacy to your heirs which they can then withdraw from tax-free over their lifetimes.

And remember – implementing this strategy will potentially reduce or eliminate the taxation of your Social Security for a long, long time. Saving taxes on Social Security is not like deferring taxes on interest. Every dollar you save or eliminate in tax on Social Security is money that *never* has to be repaid.

Savvy Social Security Strategies

The idea of guaranteed income for life that keeps pace with inflation is very appealing in a “New-Normal” age of disappearing pensions and erratic stock-market returns. There's also a growing awareness of the value of working longer and waiting to collect Social Security benefits until full retirement age or later, when those benefits are worth more.

So now, savvy retirees are beginning to learn that there are a few clever -- and perfectly legal -- little-known strategies to maximize your Social Security benefits. I’m talking about strategies that can immediately boost your household income by thousands of dollars a year and provide larger benefits later for your spouse or minor children when you die. Let me give you a couple of examples:

Strategy #1: File and Suspend

This Strategy is best suited for married couples where one spouse has substantially higher lifetime earnings than the other. So to explain this strategy let’s assume one spouse is the higher earner in the family and that the other spouse hasn’t worked outside of the home as much as the mate. That means he/she won’t have much, if any, Social Security benefit and will default to receiving his/her payments when the higher earning spouse retires and decides to start taking Social Security payments.

To use this strategy you must first understand that Social Security says the lower earning spouse cannot receive spousal benefits until the higher earning spouse files for retirement benefits. So step one: Once both spouses reach full retirement age, the higher earner should go ahead and file for his/her Social Security benefits. Step two: the lower earning spouse files for a "Spousal Benefit." Step three, the higher earning spouse then immediately suspends his/her Social Security benefit request.

By taking advantage of this "File and Suspend" strategy, the lower earning spouse can claim a 50% spousal benefit based on the earning record of the higher earning spouse. This also allows the higher earning spouse to continue working and earning <u>delayed</u> retirement credits all the way to age 70. Then when the higher earning spouse reaches age 70, he/she can re-file to start taking his/her Social Security retirement benefit. That means his/her benefits will have increased by about 8% for each year that he/she delayed collecting beyond his/her full retirement age, all the way up until age 70. Very cool strategy.

<u>Strategy #2: File a Restricted Application</u>

Under this Strategy you collect half of your spouse's benefits at your full retirement age and delay collecting your own benefit until age 70 when they will be worth more. This strategy works best for two-career couples with similar incomes and work histories

Now don't try this strategy of going for spousal benefits until you reach full retirement age. If you don't wait then you will have to claim the highest benefit available to you (whether based on your own work record or based on the earnings of your spouse).

But that rule changes once you hit your full retirement age because you are then allowed to limit your claim to spousal benefits based on your spouse's earnings. And by delaying your own retirement benefits, you will receive more of your own benefit especially if you delay your benefits all the way to age 70.

At that point, and if appropriate, your spouse could then opt to step up to <u>your larger</u> <u>spousal</u> benefit, which could be worth up to 50% of your amount, depending on your spouse's age when he/she first claimed benefits. And, if you die first, your spouse will receive a <u>survivor benefit</u> equal to 100% of the monthly amount you collected during your lifetime.

These two strategies demonstrate that Social Security is not simple. But rather, it can be a confusing system where benefit strategies can be quite complex. And, the impact of making the wrong decision can be quite costly to you, your spouse and your dependent children.

<u>Longevity and the Break Even Date for Social Security Benefits</u>

The single biggest and most difficult question to answer in determining when to take Social Security benefits is how long you're going to live. In general, the longer you will live, the more sense it could make to delay taking reduced early benefits in lieu of higher benefits that begin after delaying for a period of time. People often ask me what the <u>break-even</u> is in terms of number of years between taking benefits as soon as possible versus delaying. The answer: "It depends."

But for a general answer, let's take an example where Mary took early benefits at age 62. And as a result, Mary will receive a monthly benefit of $750 or $9,000 per year. Over a period of <u>18 years</u>, Mary (at age 80) would be paid $<u>162,000</u>. Compare that to Mary waiting to age 66 and receives $1,000 per month or $12,000 per year. Over a period of <u>14 years</u> to age 80, Mary would be paid $<u>168,000</u>. That's pretty close to the same. So, it took roughly 18 years before Mary, who delayed benefits, caught up to Mary who started right away.

Does that mean that that it takes about 18 years to break even? Again, it depends. It's an impossible question to answer. Keep in mind the way things stand today, 17% of Americans age 65 will live to be 100 years old.

So again, when should you start receiving Social Security benefits?

Your answer to this question will depend on your personal circumstances. In your evaluation, you should consider both your family's longevity as well as your own health. So while you might consider your family heritage, your own health should have at least an equal weight, if not more so, in your decision.

In thinking of your own health, there's something else to bear in mind: advances in science, medical treatments, medicine and technology are gaining speed every year at an accelerating rate. Things that might have killed us ten years ago are now routinely resolved. Medicine now keeps us alive longer than ever before and chances are, you'll live longer than you expect and longer than your parents.

According to a US Census Bureau report released November 17, 2011, "The nation's 90-and-older population nearly tripled over the past three decades, reaching 1.9 million in 2010. These findings are supported by the National Institute on Aging. Over the next four decades, this population is projected to more than quadruple.
If you're not planning for the possibility that you may live into your 90's you may be ignoring reality.

The Importance of Reading and Understanding Your Social Security Statement

For years, I would receive a Social Security statement. This statement contains information about how much money I had earned (and contributed to the Social Security program), as well as information about my estimated benefits later on, and when I could begin taking Social Security payments.

Recently, the Social Security Administration began doing away with the paper statements and started offering statements online. It's now possible to use the Internet to get access to your Social Security statement. This is convenient, because it makes it possible to access your information anytime. You have to create an account with the site, but once that's done, you have access to your Social Security statement, as well as access to information about taking benefits. You can even apply online for retirement and disability benefits.

What's in Your Social Security Statement?

For the most part, your Social Security statement is fairly basic. The two main items on your Social Security statement include:

- **Benefits**: This section is regularly updated according to how much money you have contributed over your lifetime, as well as the current law. You will find information about how much money you can expect to receive. You need a certain number of "credits" to qualify for retirement benefits, and the number you have is listed in this section. You can also see how much of a disability payment you are eligible, as well as how much your family members could expect to receive if you were to die.

- **Earnings report**: You will see how much you earned each year, as well as an estimate of how much money you've paid into the Social Security and Medicare programs. Your earnings record should be carefully reviewed for inaccuracies. If the number is too low, you could miss out on benefits down the road. If the number is too high, that could be an indication that your identity has been compromised and someone else is using your Social Security number.

SPECIAL REPORT TIMEOUT

In addition to hosting the Retirement Guy radio show, which I have done now for well over four years, I also conduct free (open to the public) educational events. I hold these workshops throughout the Denver area throughout the year. I have made these presentations to thousands of people both in and near retirement over the past several years. If you would like to meet me in person and learn about retirement, in a public setting, then please call or email me with a request for the date, time and location of my next event.

Checking the accuracy of your statement is important. If there is something wrong, contact the Social Security Administration. You want to clear things up as quickly as possible. It's much easier to fix problems now, than to try and get the full amount of benefits you are owed once retirement hits. It's also important to clear up mistakes about how much you have earned.

It doesn't take very long to review your Social Security statement. However, it's a good idea to do so. It can alert you to identity theft, as well as help you plan for the future when it comes to a successful retirement.

<u>Social Security Employees are not your retirement advisors</u>

A hard lesson about Social Security is that when it's time to claim, you <u>can not</u> depend on the Social Security Administration to be your personal adviser. It's interesting to note that the Social Security Administration reports that there are 567 ways to claim benefits and that Social Security employees cannot advice you on the best strategy to follow.

In an effort to save time and cut costs, Social Security employees generally don't give case-specific advice. So that means you are on your own to make the most important financial decision of a lifetime. You have to read the rules and do the research yourself. You also can't depend on Social Security to follow instructions you give them electronically. If you have a request that is not the most common choice, you'll need to go to the Social Security office and make the request in person.

Some other Facts and Tidbits you should know about Social Security

<u>Once you begin receiving Social Security Benefits, can you later change your mind?</u>

Yes, you can reset your Social Security benefits by submitting a request for "Withdrawal of Application." And then you can re-file later when you are older thereby allowing you to receive much higher benefits. Be aware that you can't withdraw your claim if you have been receiving Social Security benefits for 12 months or more. And you must pay back the benefits that were paid to you.

<u>35 years is the magic number</u>:

The Social Security website offers an explanation of how your benefits are calculated, but it's a little hard to follow. You can find a simpler explanation at myretirementpaycheck.org, a website sponsored by the National Endowment for Financial Education.

Your Social Security payment is figured using a complex calculation based on a 35-year average of your covered wages. Each year's wages are adjusted for inflation before being averaged. If you worked longer than 35 years, the government will use the highest 35 years. If you worked for less than 35 years, they'll average in zeros for the years you are lacking. You don't have to be a math genius to figure out the impact of that -- it drags down your average. If you can avoid zeros by working a couple of years longer, you'll increase your Social Security payment.

Divorce and Social Security

If you are divorced, but your marriage lasted 10 years or longer, you can receive benefits on your ex-spouse's record (even if he or she has remarried) if:

- You are unmarried;
- You are age 62 or older;
- Your ex-spouse is entitled to Social Security retirement or disability benefits **and**
- The benefit you are entitled to receive based on your own work is less than the benefit you would receive based on your ex-spouse's work.

Note: Your benefit as a divorced spouse is equal to one-half of your ex-spouse's full retirement amount if you start receiving benefits at your full retirement age. If you remarry, you generally cannot collect benefits on your former spouse's record unless your later marriage ends (whether by death, divorce or annulment). 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. You can choose to receive only the divorced spouse's benefits now and delay receiving retirement benefits until a later date all the way up to age 70. Once an ex-spouse passes away, you'll be treated just like a widow or widower.

More flexibility for widows and widowers:

It’s important to understand a key difference between widow/widower benefits and spousal benefits. A widow/widower can begin benefits based on his or her own earnings record and later switch to survivor’s benefits or begin with survivor’s benefits and later switch to benefits based on his or her own record -- even if the surviving spouse is filing before full retirement age. You can't do that with spousal benefits. In other words, a widow can begin drawing the full amount of her late husband's Social Security when she is as young as 60. Then she can choose to leave her own Social Security alone, allowing it to grow in value until her full retirement age -- or even age 70. This works for widowers, too.

The Current State of Affairs with the Social Security Program

By 2017 the Social Security Administration will pay out more in benefits than it takes in. The current unfunded promise by the Federal Government to pay Social Security benefits to the millions of Americans enrolled in the program is currently estimated at almost $16 Trillion.

Social Security is projected to drain its trust funds by 2033 unless Congress acts, and now there's growing concern that the looming crisis will lead to significantly reduced benefits and that another overhaul of the program may be in our near future.

With all of this bad news, it is no wonder that Americans are beginning to feel very concerned about the solvency of the Social Security program and whether or not it will be there for them in the future. However, it is opinion of many experts on this subject that Social Security will and has to be there.

Consider that nine out of ten Americans, age 65 and older receive Social Security and for 32% of these people Social Security represents 90% or more of their income. For middle class America, Social Security ends up replacing close to 40% of their pre-retirement income.

Given that the median 401(k) account balance for employees with over 20 years with the same employer within a salary range of $40,000 to $60,000 per year is a paltry $74,000 and the fact that 48% of individuals not yet retired believe they will not have enough money to maintain their current lifestyle in retirement.

Given these grim facts, how can Social Security simply be jerked off the shelf?

Imagine the economic turmoil this would cause. Many Americans would not be able to afford the basics such as food and shelter. States, like Colorado, would see their sales tax revenues plummet as many retirees would be forced to radically limit consumption.

And remember we have the largest generation in history, the baby boomers, just starting to become eligible for Social Security benefits. And Boomers know they put into this system so they certainly expect to get it back. This is not a generation of people who will pass quietly into the night. When the Boomers decide they want something they go get it.

So, without killing it, how do we fix the system? Well, here are just four remedies that have been proposed, any or all of which, while not necessarily popular, could completely remedy Social Security shortfall:

1. Increase <u>current</u> worker and employer Social Security contributions by 1%; up from 6.2% to 7.3%.
2. Boost <u>future</u> worker and employer Social Security contributions from 6.2% to 7.2% in 2022 and then up to 8.2 % in 2052.
3. Remove the Social Security tax cap on earnings which currently is as $113,700 in 2013
4. Increase the retirement age for full benefits to age 68 or age 70.

In Closing

In closing let me say that Social Security is not simple. It can be a confusing system where benefit strategies can be quite complex. And, the impact of making the wrong decision can be costly to you, your spouse and your dependent children.

And to drive this point home, let me refer to a recent survey released by Financial Engines which is the largest provider of managed accounts for employer-based defined contribution plans. This survey found that there is a huge gap between what most Americans think they know about Social Security and the actual rules governing the nation's primary retirement program.

As part of the online survey by Financial Engines, more than 1,000 near and current retirees were asked eight questions about claiming Social Security benefits.

Of those respondents who have not yet claimed Social Security, 74% scored a grade C or lower. Only 5% were able to answer all eight questions correctly.

This survey found that as a result of this knowledge gap, the typical retiree will leave as much as $100,000 in lifetime benefits on the table. The survey found that for a married couple, the difference between a smart claiming strategy and the urge to grab the money as soon as possible could reduce benefits by more than $250,000 over the joint lifetimes of both spouses. That’s significant.

In addition to identifying these costly knowledge gaps, the survey also found high interest in getting help with selecting the right household claiming strategy.

But you know, it’s not surprising that your financial advisor has maybe no discussed the complexities of Social Security with you. The vast majority of “financial advisors” are not Social Security benefit planning specialists. Their bread and butter is selling stocks, bonds or mutual funds. And collecting huge fees and commissions in the process.

Social Security planning is a specialty just like cardiology, orthopedics or laser eye surgery.

So, a couple reasons why you might want to contact me for assistance after reading this report:

One is that since I specialize in Social Security Benefit planning, you might like my help in evaluating when and how to start receiving your Social Security Benefits.

Another reason to call me is that you would like some professional advice on what role these Social Security benefits will play in your overall retirement income plan.

I wish you a long, happy and financially secure retirement. And if I can be of any assistance, please do not hesitate to contact me.

Sincerely;
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