

Social Security benefits: A short primer

Although Social Security benefits aren't likely to make up a sizable part of your retirement income, your planning wouldn't be complete without getting a good grasp on how much you'll be receiving and, if you plan to work part-time after retirement, the impact of your earnings on your benefits.

Full benefits? When? It depends.

Many people continue to believe mistakenly that they can start receiving full Social Security benefits at age 65. That's no longer true. Because of longer life expectancies, the Social Security law was changed in 1983 to increase the full retirement age in gradual steps.

For example, if you were born in 1938, full benefits are available at age 65 and two months. Then normal retirement age for those born between 1938 and 1942 rises by two months for each year of that time frame. For those born between 1943 and 1954, full benefits are available at age 66. Starting for those born in 1955, the two-months-a-year schedule is back in place until 1960, when normal retirement age will freeze at age 67.

Receiving benefits early

You can begin receiving Social Security benefits as early as age 62. If you do begin receiving benefits early, they will be permanently reduced, based upon the number of months that you receive checks before you reach full retirement age.

For example, if your full retirement age is 66, and you retire at age 62, there is about a 25% reduction in your benefits.

As a general rule, early retirement will give you about the same total Social Security benefits over your lifetime as retirement at the normal age, but in smaller amounts so as to take into account the longer period during which you will receive them.

Starting benefits after normal retirement age

Social Security benefits are increased by a certain percentage if you choose to delay receiving them. These increases will be added in automatically from the time that you reach your full retirement age until you start taking your benefits, or until you reach age 70. The percentage varies depending on your year of birth.

For example, if you were born in 1943 or later, 8% per year (2/3 of 1% per month) will be added to your benefit for each year that you delay signing up for Social Security beyond your full retirement age.

If you decide to delay your retirement, the Social Security Administration strongly urges you to sign up for Medicare at age 65. In some circumstances medical insurance costs more if you delay applying for it.

Working while collecting benefits

You may continue to work and still receive retirement benefits. Your earnings in or after the month that you reach your full retirement age will not affect your Social Security benefits. However, your benefits will be reduced if your earnings exceed certain limits for the months in the calendar year before you reach normal retirement age.

Example: In 2007, if you're under full retirement age, \$1 in benefits will be deducted for each \$2 in earnings that you have above the annual limit of \$12,900. In the year that you reach your full retirement age, your benefits will be reduced \$1 for every \$3 that you earn over a different annual limit, \$34,490 in 2007, until the month that you reach full retirement age. Then your earnings will no longer affect the amount of your monthly benefits, no matter how much you earn. The annual limits increase each year as average wages increase.

The question of tax

About 20% of the people who get Social Security have to pay federal income tax on a portion of their benefits (up to a maximum of 50%). The calculation is complicated but goes like this: First, you add one-half of your benefits and your other income and compare it to a base level—\$32,000 for married couples filing a joint return, \$25,000 for singles. (Generally, “other income” is defined as adjusted gross income as reported to the IRS plus tax-exempt interest.) The taxable portion of your benefits is either one-half of your benefits or one-half of the “excess” over the base level, whichever is less. That amount is then taxed at your marginal tax rate.

Read your Statement

Each year—usually about three months before your birthday—you receive a Social Security Statement that provides a record of your earnings, estimates of your Social Security benefits for early retirement, full retirement and retirement at age 70. It also provides an estimate of the disability benefits that you could receive if you become severely disabled before you're eligible for full retirement, as well as estimates of the amount of benefits paid to your spouse and other eligible family members as a result of your retirement, disability or death.

The Social Security Statement can be a valuable tool to help you in planning for retirement. It can serve another purpose as well. Because the Statement includes a full record of when you contributed to Social Security as well as the amounts that you contributed, you have an opportunity to spot and correct any inaccuracies prior to the time that you want to begin receiving benefits.

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Any developments occurring after January 15, 2007, are not reflected in this article.