

**Advancing your practice**

# **Social Security: How Life Insurance Can Assist Clients In Meeting Their Future Needs**



**Social Security  
Planning with  
Life Insurance  
Sales Guide**

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## Introductory Comments

A few words about Social Security and where Social Security planning fits into a client’s overall planning.

For most Americans, income during their retirement years will be addressed by three assets groups:

- Retirement Plan assets (to include Company provided pensions, IRAs and 401(k) plans)
- Social Security benefits
- Personal assets.

While important, the first two may not be able to replace personal savings. Company provided pension assets have diminished in importance for many retirees.

85% of American workers in the private sector (i.e., non-government jobs) were covered by a defined benefit pension plan in 1975, compared to only 16% in 2013.<sup>1</sup>

### Concerns also exist regarding the viability of the Social Security Program

- According to many studies, the Social Security trust fund will be able to cover its retirement and disability obligations for the next 30 years or so, after which there will be a shortfall of about 22 percent<sup>2</sup>
- The Senate Special Committee on Aging figures funds will fall short in 2037.

Sections of this guide will talk about how clients might be able to use life insurance, and the protection it offers families, as a way to help supplement these two items as part of a personal asset accumulation approach.

<sup>1</sup> National Institute on Retirement Security

<sup>2</sup> <http://www.bankrate.com/finance/retirement/5-little-known-facts-about-social-security-5.aspx>

Social Security *may* and *can* be an integral part of your client's planning. While it may not be central, it remains a cornerstone of many retirement plans. In some cases it can be used by a client as part of a wealth transfer strategy. An assessment of your clients' needs, and a comparison with available resources can help identify any shortfalls that may exist. The earlier the process begins, the more viable the opportunity to arrange their personal estate and reallocate assets to help address future needs.

**This guide will show three ways to look at a client's overall planning and offer three strategies that can help enhance, supplement or use Social Security to achieve their retirement or wealth transfer goals:**

- 1. For many clients, Social Security will represent a major portion of their retirement resources and they may benefit from strategies to maximize what they are entitled to receive, perhaps by delaying the receipt of their benefits. See *"The Social Security Bridge;"***
- 2. Some clients will need to plan for personal assets to fill the retirement income gap that will exist between their needs and what Social Security and retirement plan assets will provide See *"Supplementing Retirement Income;"***
- 3. Other clients will not need Social Security for their retirement needs, but it may be helpful in addressing their legacy plans. See *"Maximizing Social Security for Legacy Planning."***

Sadly, however, recent surveys indicate that less than 30% of all Americans have any idea of what they may be entitled to receive from Social Security. They will have no idea of the significance that Social Security may still play in their retirement and estate plans. If they wait too long, it may be too late to maximize the role Social Security might play in their retirement.

The Social Security Administration website offers substantial general benefit information, as well as, personal planning tools to access an individual's own benefit profile and benefit projections. See: <http://www.ssa.gov/myaccount/materials.html#&a0=0>

Consider the following three situations where life insurance may provide assistance to your clients in conjunction with your review of their Social Security benefits and retirement and estate planning goals.

## Strategy One – The Social Security Bridge

Do you have clients who would like to get the maximum benefit amount their Social Security profile can provide? This approach will show how life insurance can be integrated into an overall protection plan, and allow a client to maximize their overall Social Security benefits.

### This approach may be right for clients who:

- Want to maximize their Social Security benefit
- Can delay Social Security benefits until age 70 to get increased monthly benefits
- Want to retire earlier than Social Security full retirement age
- Clients who have a need for life insurance
- Wish to leave a legacy to their children



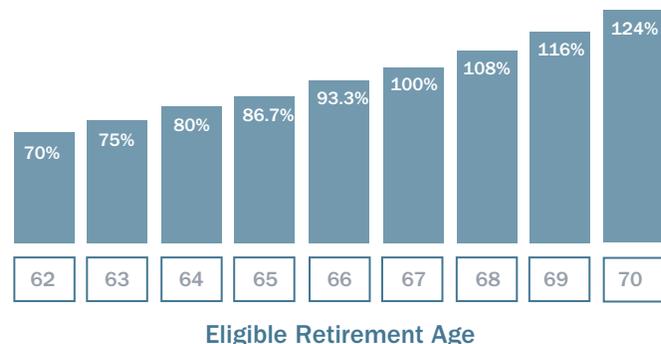
An important part of any financial plan is planning for retirement. Setting aside money in various retirement accounts will help achieve retirement goals. When assessing retirement need, one income source that you'll need to consider is the amount of Social Security benefits that will be available, based on an individual's personal profile and projected retirement age or date.

For most future recipients, "normal" Social Security full retirement age will be between 66 and 67. However, clients can access these funds as soon as they reach age 62. Conversely, they can defer receipt of Social Security benefits until age 70. Accelerating benefits, taking them prior to their full retirement age, will result in reduced benefits. Delaying receipt will result in enhanced benefits. Although timing and amounts will vary from client to client based on their birth year, on average it is about an 8% per year reduction or growth.

This can be a critical element in a client's planning. At its heart, Social Security is a fixed annuity. For clients that can defer receipt of their Social Security benefits, during the deferral period they will see year over year compounded growth at about 8% per year. Few financial instruments in 2018 are offering 8% growth.

**Retiring early can mean a 30% reduction in Social Security benefits. Retiring later, however, can increase your benefits 8% a year.**

Percentage of Social Security Benefits



## Case situation

### Chris and Linda’s Challenge

#### THE SITUATION

Chris and Linda recently met with their financial advisor. They are married, both 45-years-old, with two children and want to retire early. Based on today’s Social Security benefits schedule, Chris would qualify for the maximum Social Security benefit if he retired at the full retirement age of 67. However, he wants to retire at age 62, a point where Social Security benefits would be substantially reduced. Chris is looking for a strategy that would allow him to have access to an amount that is equal to what he would receive from Social Security at full retirement age 67, yet allow him to retire at 62 and delay triggering his actual Social Security benefit until age 70.

A cash value life insurance policy may be an excellent way to help provide for additional funds to help “bridge” the Social Security Gap. By tapping into the policy cash values in strategic years, between age 62 to age 70 (just 8 years), clients can obtain the equivalent value of their Social Security benefit. They can let their Social Security benefit grow and take their maximum benefit at age 70. All along their family has death benefit protection and later, a possible legacy.



**Using life insurance, Chris and Linda are able to retire when they want, and still delay Social Security benefits in order to get the maximum amount available to them.**

Cash Value Life Insurance Can Fill the Social Security Gap<sup>4</sup>



<sup>4</sup> Calculation: Benefit of \$32,000 per year; 85% taxed at 40% income tax rate ( $\$27,200 \times 40\% = \$10,880$  tax);  $\$32,000 - \$10,880 = \$21,120$  after tax amount of projected benefit at FRA.

### THE STRATEGY

- It is projected that Chris will be eligible for a Social Security benefit of \$32,000 per year at his full retirement age of 67 and eligible for a \$40,000 annual benefit if he delays until age 70.
- Chris and Linda need to purchase a \$500,000 life insurance policy to protect their family if something happened to Chris. A cash value life insurance policy, on Chris' life, meets both personal protection needs and helps to fund a "supplemental income stream" at Chris' age of 62.
- They will pay policy premiums for 16 years, from Chris' age 45 through his age 62. (Annual premium of \$8,809 for 16 years)
- At age 62 and until he reaches 69, Chris will plan to take \$21,120 in funds from the life insurance values, an amount equal to the "after tax" amount he could receive from Social Security at age 67, "normal retirement age" in a 40% Tax Bracket.
- At age 70 Chris can trigger his delayed Social Security benefit of \$40,000.
- Chris and Linda can leave a legacy to their two children with the remaining policy death benefit.
- Along the way, Chris can always change his mind and work longer, and they will still have cash value in their policy to enhance their retirement beyond age 70.

### WHY IT WORKS

- Life insurance is not always just about estate planning and taxes. It can be an effective tool to help provide supplemental retirement income in addition to leaving a legacy to beneficiaries.
- Chris will be able to defer taking his Social Security benefit to become eligible to receive a higher benefit amount at age 70. By taking his full retirement age Social Security benefit equivalent from the life insurance policy at his early retirement age of 62, life insurance helps "bridge the gap" between an early retirement and an increased Social Security benefit.
- All along, Chris retains the choice to change his retirement date and still have cash value life insurance protection.

Joint Age	After-Tax Social Security Equivalent from Policy	Cash Value <sup>3</sup>	Life Insurance Benefit	Delayed Social Security Benefit at Age 70
62/62	\$21,120	\$187,695	\$676,732	\$0
65/65	\$21,120	\$152,726	\$613,372	\$0
69/69	\$21,120	\$98,221	\$528,191	\$0
70/70	\$0	\$104,635	\$527,616	\$40,000

<sup>3</sup> This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration from the issuer. The basic illustration contains values using the same underwriting assumptions as this supplemental at both guaranteed charges and guaranteed interest rates and contains other important information. The values represented here are for a \$500,000 BrightLife® Grow SIUL policy on a 45-year-old male preferred non-smoker and a 45-year-old female preferred non-smoker. The values represent the cost of 16 years of premiums. The values represented here are non-guaranteed and assume current charges and a current interest rate of 5.81%. If guaranteed rates and charges are used, the policy would fail in year 20. Your values will be different based on your gender, age and health. Work with your financial professional to create an illustration that is tailored to your specific situation.

## Strategy Two – Supplementing Retirement Income

Do you have clients whose projected Social Security benefits and “traditional retirement assets” may fail to meet their retirement income needs? This approach will show how life insurance can be integrated into an overall retirement planning strategy and allow a client to coordinate their Social Security benefits, traditional retirement benefits, and personal savings with their life insurance protection.

### This approach may be right for clients who:

- Are 10 or more years away from retirement
- Have projected Social Security and “traditional retirement assets” that won’t meet their retirement needs
- Are looking for retirement planning solutions
- Are healthy and have a life insurance need
- Would like to leave a financial legacy.



Retirement protection is often a central goal for most clients. They have worked for many years and want to feel confident that they have accumulated enough wealth to maintain their standard of living in their non-working years. How much is enough? People are living longer than in previous generations. It used to be that 70% of your salary at retirement was a good rule of thumb to gauge how much people should save. But for many this number is no longer a valid indicator. In the early years of retirement, your clients might lead a much more active life with travel, visiting grandchildren, hobbies and other activities. Whereas in the later years, they might be less active, but the cost of living could have increased. Also consider that in the working years there may be a need for a source of emergency funds.

Given current health trends and an increasing dependence on personal savings, clients need to properly prepare for retirement. Consider the economic downturn. Millions of Americans either lost their jobs, their nest eggs, or both! Assets that were set aside for retirement, such as real estate or securities, were quickly reduced to a fraction of their previous value and in some cases had to be liquidated all together. Yet the need for future retirement income remains. In addition, inflation rates have been slowly rising. Would a 3% average annual inflation rate jeopardize the value of your client’s current retirement portfolio?

### WHY LIFE INSURANCE

Life insurance cash values may help with many of these planning issues. A life insurance policy that builds cash value can accomplish two goals. First, it can provide essential life insurance coverage for the family. Second, it can be another source of supplemental income for the client and their spouse in retirement. Like a 401(k), life insurance can build value, tax-deferred. What’s more, when you’re ready to access this cash, you can do it potentially tax-free.

Under current federal tax rules, clients generally may take federal income tax-free withdrawals up to their basis (total premiums paid) in the policy or loans from a life insurance policy that is not a Modified Endowment Contract (MEC). Certain exceptions may apply for partial withdrawals during the policy’s first 15 years. If the policy is a MEC, all distributions (withdrawals or loans) are taxed as ordinary income to the extent of gain in the policy, and may also be subject to an additional 10% premature distribution penalty prior to age 59½, unless certain exceptions are applicable. Loans and partial withdrawals will decrease the death benefit and cash value of their life insurance policy and may be subject to policy limitations and income tax. In addition, loans and partial withdrawals may cause certain policy benefits or riders to become unavailable and may increase the chance the policy may lapse. If the policy lapses, is surrendered or becomes a MEC, the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distribution of policy cash values.

## Case situation

### Gary and Darlene's Challenge

#### THE SITUATION

Gary and Darlene are married and both age 45. They have two high-school-aged daughters who are looking at colleges. Although they have been contributing to their employers' 401(k) plans, their financial professional has made them aware of the limitations on funding these plans. They also know that Social Security provides only a limited supplemental benefit. So, they are looking for other ways to save in a way that is tax-efficient.

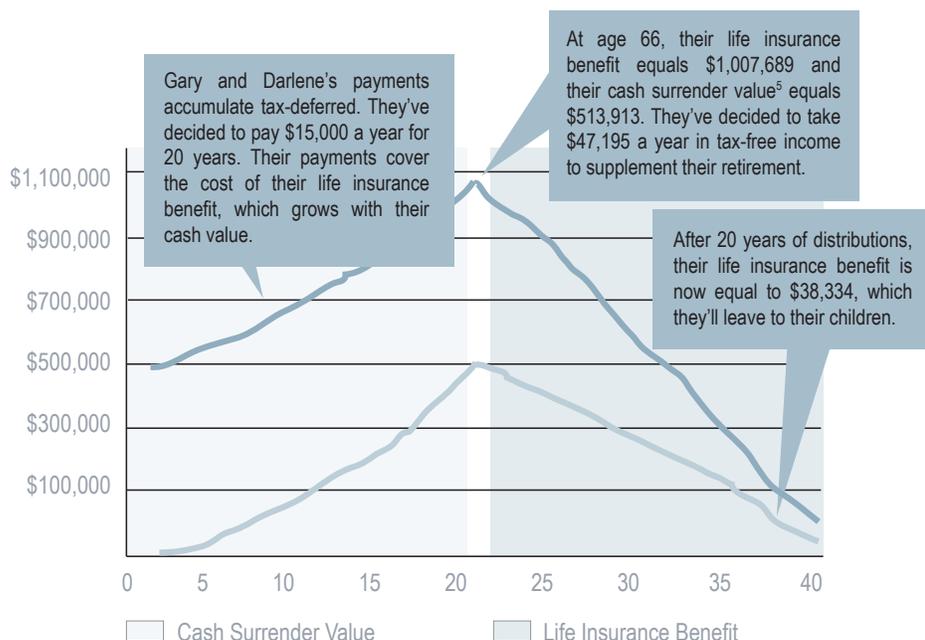
#### THE STRATEGY

- Their financial professional has suggested that Gary and Darlene consider a Survivorship IUL policy.
- If they were both to die, the policy would provide an immediate source of cash for the girls' current and future financial needs.
- While they're alive, the policy cash value could continue to grow over time to create a source of supplemental income for their retirement years.
- Assuming they pay policy premiums of \$15,000 a year for 20 years, at a 5.81% gross rate of return (which is not a guaranteed rate), their life insurance policy could provide approximately \$47,000 for 20 years, beginning when they're age 66. (In a 35% income tax bracket, \$47,000 after-tax would equate to approximately \$72,000 of before-tax income.)



#### WHY IT WORKS

- Cash value life insurance, single life or survivorship life insurance policies, can provide a cost-efficient means to accumulate assets.
- During the time prior to their retirement years, there is a life insurance benefit of \$1,000,000 to provide financial protection for their daughters.
- When they need retirement income, the policy cash values can be accessed via loans or withdrawals, as a source of supplemental income. Policy loans and withdrawals will reduce the face amount and cash value of the policy. Clients may need to fund higher premiums in later years to keep the policy from lapsing.



5 This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration from the issuer. The basic illustration contains values using the same underwriting assumptions as this supplemental at both guaranteed charges and guaranteed interest rates and contains other important information. The values represented here are for a \$528,157 BrightLife® Grow SIUL policy on a 45-year-old male preferred non-smoker and 45-year-old female preferred non-smoker. The values represent the cost of 20 years of premiums. The values represented here are non-guaranteed and assume current charges and a current interest rate of 5.81%. If guaranteed rates and charges are used, the policy would fail in year 25. Your client's values will be different based on your gender, age and health.

## Section 3: Wealth Transfer-Legacy Planning with Social Security Max

Do you have clients with substantial wealth who will not need or rely on Social Security for their own financial needs? They may be able to use life insurance to leverage this personal benefit amount and enhance the legacy they leave for their children, grandchildren, or favorite charities.

### This approach may be right for clients who are:

- Healthy and have a life insurance need or capacity for life insurance purchases
- Age 62 or older
- Qualified to receive Social Security, but do not need Social Security for retirement income
- Would like to enhance or create a financial legacy



Most clients will use their Social Security benefits to support their retirement income needs. However, some clients may have been fortunate enough to amass a comfortable retirement nest egg. Perhaps they've not even considered their Social Security benefits as a source of income when they are retired. If these benefits are "excess," the after tax funds will merely be added to the client's portfolio. As a result they may be subject to taxes on investment growth and, possibly increase their estate or other wealth transfer taxes. Legacy planning with life insurance can offer a more effective use of these excess benefits.

If your clients have children, grandchildren, or charities that are important to them, some or all of their Social Security benefits could instead be used towards a life insurance policy. This can be a very simple way to create a legacy for their family or charities.

## Case situation

# Bill and Debbie's Legacy

### THE SITUATION

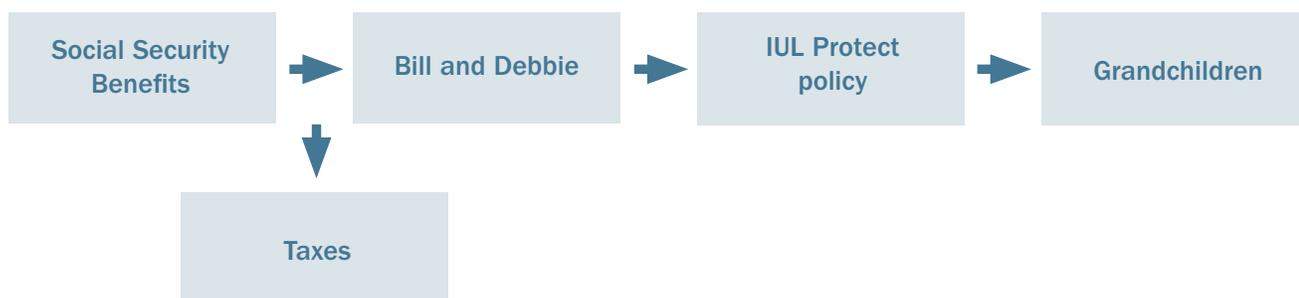
Bill and Debbie are working with their financial professional on their retirement plans. They are both turning 66 at the end of this year. During their working years, they accumulated substantial assets and both have employer provided pensions. They never even considered Social Security as a necessary source of retirement funds. They're not even sure how much they are eligible to receive.

- During their recent planning discussions with their financial professional, they uncovered that they are both eligible to receive the Social Security maximum benefit at their retirement's "normal retirement age" 66. After taxes, their financial professional estimated that together they will have a total of \$64,000 in pre-tax benefits. This equates to approximately \$40,000 in after-tax dollars available to them.

### THE STRATEGY

- Bill and Debbie decide to use half of the after tax amount available to them from Social Security, or \$20,000, as premium for a life insurance policy on their lives, to provide a benefit for their 4 grandchildren.
- They can purchase a range of policies. Depending on each client's situation one approach may be better than the others.
  - A survivorship life policy
  - A single life policy on either Bill or Debbie
  - Two single life policies, one on Debbie's life and one on Bill's life

They elected to purchase an indexed universal life policy on Debbie's life.



- They can own the policy outright, or it can also be owned by a trust, their children, or a charity. At Debbie's death the policy can complete their family legacy or may be maintained until Bill's death if he is still alive.

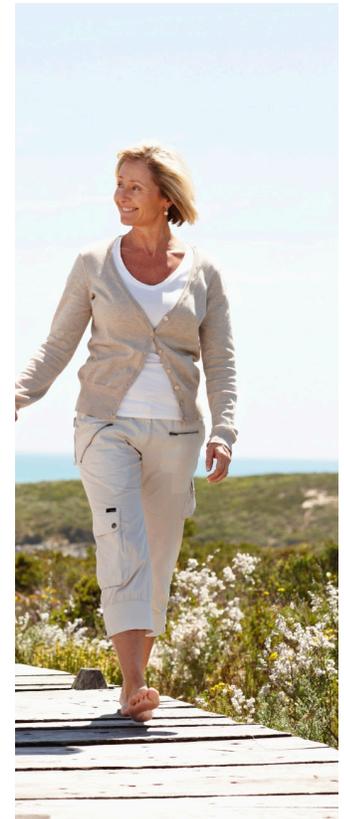
**A COMPARISON**

Here is comparison of their legacy that shows the advantage of placing \$20,000 in a life insurance policy insuring Debbie's life.

Approach	Annual Contribution	Over 20 ** years
Gift	\$20,000	\$400,000
Invest*	\$20,000	\$554,764*
Insure <sup>6</sup>	\$20,000	\$1,000,000**

\* Projected return is 5% before tax, 3.02% after tax.

\*\* Assume Social Security amounts contributed to life insurance in all years



**WHY IT WORKS**

- Bill and Debbie did not need their Social Security benefit for living expenses
- They only used a portion of the funds from Social Security for life insurance
- They can still make annual gifts to family members or charities with the remaining benefit
- They are able to leverage their legacy with use of a life insurance policy

**OTHER CONSIDERATIONS**

Please remember Cash Value life insurance does have many other considerations clients should review carefully before selecting a life insurance policy. Please keep these important point in mind:

- Clients must keep paying the required premiums for the entire premium payment period, missing or skipping premiums will negatively impact the amount of loans and withdrawals available. A life insurance policy like Bright Life Grow and Protect generally takes years to build up a substantial cash value, to be effective the policy should be held until death.
- This idea is based on a hypothetical scenario based on certain rates and charges in the policy. The rates and charges are not guaranteed and thus the actual results your client will receive will be different.
- Clients must qualify both medically and financially for the life insurance.
- How much life insurance your client can purchase and the price they pay will depend on the medical and financial underwriting.
- Generally, there are many additional charges associated with a BrightLife Grow or Protect SIUL policy including but not limited to a front end load, monthly administrative charge, monthly segment charge, cost of insurance charge, additional benefit rider costs and a 15 year surrender charge.

<sup>6</sup> This is a supplemental illustration authorized for distribution only when preceded or accompanied by a basic illustration from the issuer. The basic illustration contains values using the same underwriting assumptions as this supplemental at both guaranteed charges and guaranteed interest rates and contains other important information. The values represented here are for a \$1,000,000 IUL Protect Individual policy on a 66-year-old female preferred non-smoker. The values represented here are non-guaranteed and assume current charges and a current interest rate of 6.05%. If guaranteed rates and charges are used, the policy would fail in year 25, (age 90, via the No Lapse Guarantee). Your values will be different based on your gender, age and health. Work with your financial professional to create an illustration that is tailored to your specific situation.

## Closing Comments

Social Security is an important consideration for most of your clients as they plan for their ultimate retirement goals. However, its impact will vary widely for each client. Additionally, not all US citizens are eligible to participate in the Social Security system.

Most eligible participants do not realize the scope of their own Social Security benefits. They are not aware that the maximum Social Security benefit in 2017 available at “full retirement” age is only \$2,687 per month\* or \$32,244. The majority of eligible Social Security recipients receive less than half that amount. Although important, Social Security, along with qualified pensions, will only address a portion of retirement needs for many of your clients. Personal assets, to include life insurance, will be needed to address any shortfall.

Opening up a discussion with clients on retirement needs and Social Security long before their retirement years makes good sense. Life insurance, either single life or survivorship life, can be an invaluable planning tool for you to consider. Also, take time to review AXA’s 1040 Overlay program. It can provide another method of opening up the planning discussion.

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\* <https://faq.ssa.gov/>

# Appendix: Social Security Planning with Life Insurance Sales Guide

As mentioned within this document, recent surveys indicate that many Americans have little idea of what they may be entitled to receive from Social Security. Those clients will have no idea of the significance that Social Security may play in their retirement and estate plans or the gap that might exist. If they wait until it is too late, they will be unable to effectively address their ultimate retirement needs.

What follows is a “primer” of the major points to consider when addressing the impact of Social Security with your clients.

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## Qualifying for Social Security Benefits?

Not all workers qualify to receive Social Security benefits. Those who have been employed by the Federal Government or State Governments may be covered by other retirement funding arrangements. This group generally includes teachers in the public school systems. As a general rule, American citizens and resident aliens who have contributed into the US Social security system during their working years can qualify for Social Security benefits. Workers who have “40 quarters” (10 years) of participating years can qualify for some benefit amount on their own. Spouses and divorced spouses may also be eligible for benefits through their spouse or former spouses. Identifying your clients’ occupation, work history, employer and marital history can be helpful in assessing their Social Security profile and eligibility for benefits.

## Understanding the Basics

During working years, both covered workers and their employers contribute to Social Security on a covered worker’s behalf. Currently 6.2% of earned income, up to the annual “Social Security Contribution Base”, is withdrawn from each paycheck along with state and Federal income taxes. Employers and covered workers contribute a like dollar amount on behalf of the employee. Self-employed persons contribute to both the employer and employee portions, 12.4%.

If you work for someone else	Social Security Tax
You pay	6.2%
Your employer pays	6.2%
If you are self-employed	
You pay	12.4%

Compensation subject to the Social Security withholding referred to as the “Social Security Contribution Base” is capped each year. For 2017, the compensation maximum was capped at \$127,200 and for 2018, capped at \$128,400.

Once a covered worker is credited with 40 quarters of contributions (essentially 10 years), eligibility for benefits is sealed. However, the ultimate benefit amount is based on an assimilation of 35 years of compensation. If a covered worker has contribution credits for 403 quarters or more, but less than 35 total covered years, values for the missing years will be filled in with zeros for the final benefit calculations.

## Understanding the Process

In working with Social Security, there are certain basic terms that someone needs to know in accessing and understanding Social Security retirement benefit amounts.

### – Full Retirement Age:

Full or normal retirement age (FRA) refers to the age at which the participant will be eligible to receive 100% of their Social Security benefit. The FRA varies based on the date of birth of the participant. As example, for a covered worker born between 1943 and 1954, age 66 is the FRA. If a covered worker was born after 1960, their FRA is age 67. For birth years between 1955 to 1960, the age at which full retirement benefits are payable increases gradually to age 67. The following chart provides full retirement for given ages and demonstrates the phase for those gap years. As you can see, a covered worker becoming age 66 this year is entitled to receive 100% of their “primary insurance amount.”

Year of birth	Full retirement age
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 or later	67

### – Primary Insurance Amount (PIA):

The “primary insurance amount” (PIA) is the benefit a covered worker would receive if they elect to begin receiving retirement benefits at their “full retirement age”, FRA. If benefits begin at the full retirement age, the benefit amount is neither reduced for early retirement nor increased for delayed retirement. A special calculation formula is applied to the income levels that a covered worker was taxed on during their working years. The formula indexes the income amounts for inflation to arrive at the PIA. In 2018, the maximum PIA amount is \$2,681 per month or \$32,169 per year.

### – Early Entry:

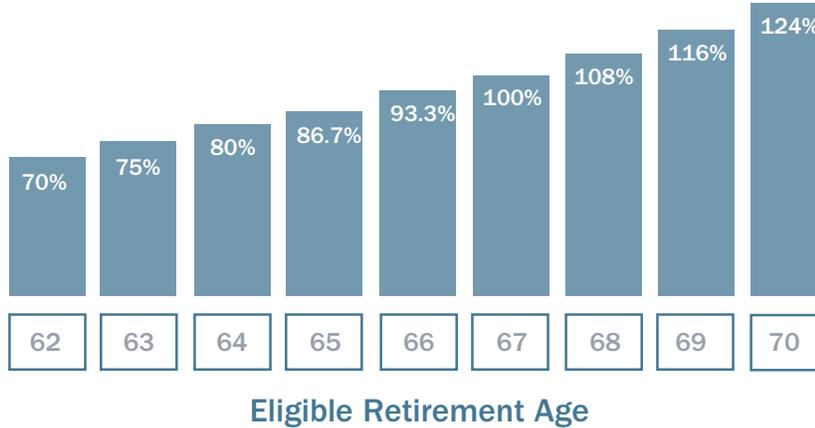
If a covered worker applies for Social Security benefits before their Full Retirement Age (FRA), their benefit will be less than 100% of the amount available at their FRA. A covered employee’s benefit is reduced by about one-half of one percent for each month they start to receive their Social Security benefit before their FRA. For example, if a covered employee’s full retirement age is 66, and they sign up for Social Security when they are 62, they would only get 75 percent of their primary insurance amount.

Additionally, it is important to note that if a covered employee starts receiving benefits prior to their FRA and they continue to work, not only are their benefits reduced for early entry into the system, their benefit may also be reduced \$1 for each \$2 dollars earned until they reach their FRA, if their earned income exceeds an earnings threshold. In 2018 that earnings threshold is \$17,040.

**– Deferred Entry:**

In contrast to early entry, if a covered employee defers receipt of their benefit to a year after FRA, up to age 70, their benefit will be increased by 8% of their PIA at their FRA for each year deferred. How much it will differ depends on the number of gap years. As an example, if normal retirement age is 67, applying for a benefit at age 62 results in a reduction of benefit amount by 30%. In contrast, delaying receipt of a benefit until age 70 will increase the benefit to 124% of the primary insurance amount.

**Percentage of Social Security Benefits**



## Divorced spouses

Divorced spouses may also have rights to a “spousal benefit” through any of their former spouses, where the divorced spouse:

- Had been married for 10 years
- Is unmarried at the time of filing for benefits,
- Is age 62 or older,
- Has divorced for two years or more from the eligible participant,
- Has an ex-spouse who is entitled to Social Security retirement benefits, and
- The benefit they are entitled to receive based on their own earnings record is less than the benefit they would receive based on their ex-spouse’s benefit base referred to as the Primary Insurance Amount (PIA).

Where you are working with divorced clients who fit the profile listed above, these rules can be important to you as part of the overall retirement plan.

## Earned income & its effect on early social security benefits

Earned income will not have a direct impact on the SS benefit amount of an eligible recipient that continues to work after their Full Retirement Age (FRA). However, if someone has earned income and elects to begin their Social Security retirement benefit prior to their FRA, their benefits may be subject to an additional reduction until they do reach their FRA.

As an example, for someone born between January 2, 1943, through January 1, 1955, their FRA for Social Security retirement benefits is age 66. Someone who reaches normal retirement age or is older, may collect 100% of their Social Security benefit amount, no matter how much they earn. However, for those triggering a benefit prior to normal retirement age and have not yet reached their FRA, there is a limit to how much they can earn and still currently receive full Social Security benefits.

During 2018, those who:

- are receiving Social Security retirement benefits, and
- have not yet reached their FRA, and
- have earned income in excess of \$17,040.

Their annual benefit will be reduced \$1 for each \$2 they earn above the \$17,040 threshold (2018). If they reach FRA during 2018, the reduction changes to a \$1 reduction for every \$3 earned in excess of \$45,360 [or \$3,780 per month]. The year following their FRA the reduction no longer applies at all.

## Income Taxation of Social Security Benefits

Some recipients of Social Security retirement benefits will have to pay Federal income taxes on their Social Security benefits themselves. This will occur if they have other substantial income (such as wages, self-employment, interest, dividends and other taxable income that must be reported on your tax return) in addition to their Social Security benefits. Note: Life insurance accumulations can be accessed through withdrawals and loans and properly structured will not trigger current income taxes.

*It should be noted that earned income delays the receipt of some benefit amounts. But once the participant reaches FRA, the Administration will re-calculate their benefit amounts and give them credit for the benefit amounts withheld.*

If a Social Security recipient:

Files a Federal tax return as an “individual” and their “combined income” is:

- between \$25,000 and \$34,000, they may have to pay income tax on up to 50 percent of their benefit amount.
- more than \$34,000, up to 85 percent of their benefits may be taxable.

Files a joint return, and they and their spouse have a “combined income” that is:

- between \$32,000 and \$44,000, they may have to pay income tax on up to 50 percent of your benefits
- more than \$44,000, up to 85 percent of their benefits may be income taxable.

No one pays Federal income tax on more than 85 percent of his or her Social Security benefits based on Internal Revenue Service (IRS) rules.

Consider the following sample cases.

## Social Security Planning Case Studies

### Case Study #1 Benefit Timing – can be affected by a client’s age, income from unrelated sources

#### a. Eligible Participant Profile

- Mark is 60 and reviewing his Social Security options with his financial advisor.
- He is married and currently both he and his spouse are both working.
- His “full retirement” age is 66.
- His “primary insurance amount” at NRA is projected to be \$2,500 per month, \$30,000 per year.

#### b. Timing

If he starts benefits at age 62, his benefit will be reduced below the PIA amount by 25%, to \$22,500 per year. If he defers until age 70, his benefit will increase by 32% of the PIA, to \$39,600 per year.

#### c. Taxation

Mark’s Social Security benefits may be subject to income tax if they exceed the stated income thresholds.

For an eligible participant that is married filing a joint return and the couple has a combined income that is:

- Between \$32,000 and \$44,000 of income, they will have to pay income tax on up to 50 percent of their benefits
- More than \$44,000, up to 85 percent of their benefits may be taxable.

Mark plans to continue to work after his FRA. The couple’s “combined income” is expected to be \$100,000 which exceeds the higher \$44,000 threshold. At this income level \$25,500 of Mark’s \$30,000 annual benefit would be subject to income tax. That is 85% of the \$30,000 because of his income level. Assuming a 25% marginal income tax bracket, Mark’s after tax benefit is reduced to from \$30,000 to \$23,625.

#### d. Earned Income reduction for benefits received prior to FRA

What if Mark triggers his Social Security benefits at age 62, prior to his FRA and continues to work? His PIA amount is \$30,000 at age 66.

- At age 62 his benefit would be reduced to \$22,500.
- Since 62 is less than his FRA, all earned income in excess of the annual threshold, will be reduced \$1 for every \$2 earned. The income threshold in 2015 is \$15,720. In Mark’s case we will assume earned income of \$50,000. His Social Security benefit received at age 62 would be reduced by \$17,140(  $\$50,000 - \$15,720 = \$34,280$ ;  $\$34,280/2 = \$17,140$ ) leaving him with only \$5,360 for the year or \$ 446 per month before tax ( $\$22,500 - \$17,400 = \$5,360$ ).

It becomes obvious that taking an early benefit while still working will not increase Mark’s cash flow significantly and may not make sense.

### Case Study #2 A Spouse’s View

It is not uncommon to find spouses who did not work outside of the home or did not have the required 40 quarters of covered earnings.

A spouse of an eligible recipient can receive up to 50% of the primary worker’s income benefit. This is in addition to the benefit received by the eligible recipient themselves.

In many cases, a spouse is fully insured under Social Security, but they are entitled to the larger of their own benefit or 50% of a spouse’s benefit.

Let's look at Bob and Sally:

a. Eligible Participant Profile

Bob and Sally are the same age and they have reached their normal retirement age

- Bob's PIA is \$2,200.
- Sally's benefit based on her own work and earnings history is \$700.
- Sally's spousal benefit is \$1,100, or 50% of Bob's, so she will be eligible to receive \$1,100, the spousal benefit, instead of \$700.
- So, under these facts, Bob will receive \$2,200 each month and Sally an additional \$1,100 in Social Security Benefits. In addition, if Bob were to die, Sally would receive Bob's higher benefit amount of \$2,200.

b. Where a Spouse's Own Benefit is larger

- Assume that Sally was actually entitled to \$1,400 based on her own work history. Since \$1,400 is greater than  $\frac{1}{2}$  of Bob's benefit of \$1,100 she can be qualified to receive the \$1,400 monthly benefit. In addition, if Bob were to die prior to Sally, she would still be eligible to receive Bob's higher benefit amount of \$2,200 instead of her own benefit of \$1,400.

### Case Study #3 Divorcee's View

Divorced spouses may also have rights to a "spousal benefit" through any of their former spouses. Mary is 66 and has reached her "full retirement age." She has been married twice. Her second husband Jim died last year. She was married to her first husband Bill for 12 years.

- Mary's PIA would be \$1,100.
- Jim's PIA would be \$1,200.
- Bill is 66 but has not filed for Social Security. His PIA amount would be \$2,663.

Mary meets the criteria for a divorced spouse to benefit from their ex-spouse's Social Security account:

- She was married for more than 10 years to Bill
- Divorced from Bill more than 2 years ago
- She is currently unmarried
- Age 62 or older
- Her ex-spouse, Bill, is entitled to Social Security retirement and
- The benefit she is entitled to receive based on her own work is less than the benefit they would receive based on their ex-spouse's PIA.

Mary's Social Security benefit will either be \$1,100, her PIA survivor benefit of \$1,200 based on Jim's account or \$1,331, the spousal benefit as an ex-spouse on Bill's account. She needs some guidance from her financial advisor on how to proceed in gathering the facts and applying for her Social Security benefit.

### How to get started?

Hopefully these brief facts and case examples were helpful to getting your thinking on track for your clients. The Social Security Administration website offers substantial general benefit information, as well as personal planning tools to access an individual's own benefit profile and benefit projections. See: <http://www.ssa.gov/myaccount/materials.html#&a0=>

To understand the Social Security benefits procedure start with a review of your client's projected Social Security retirement benefits.

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