

# WHAT CAN YOU EXPECT FROM SOCIAL SECURITY?

The Story Behind America's  
**75-Year-Old  
Safety Net**

How **Social  
Security**  
Works

# PREVIEW

Time to Get Serious  
About Your Own  
**Retirement  
Income**

# Foreword

Are you one of the 56% of retirees who believe they will eventually suffer a cut in their Social Security payments, or possibly one of the 60% of workers who doubt they will ever receive a benefit? <sup>1</sup>

Our nation's largest and most expensive social program was put in place more than 75 years ago, but it has never faced more challenges than it does today. Social Security is no longer taking in more in payroll taxes than it is paying out in benefits to retired workers.<sup>2</sup> That simple fact, along with the rising tide of retiring baby boomers, means that changes are most likely on the horizon. And while there's a good chance Social Security will survive into the future, lawmakers may be forced to address the growing benefit gap with some combination of higher taxes and reduced benefits.

If you will retire soon, it's important to understand how Social Security works today and to consider the role it might play, however small, in your financial strategy. If you still have many years yet to work, then this booklet may inspire you to understand that you may need to begin preparing now for the possibility that Social Security may not provide the level of support that you assumed it would.

In either case, your financial professional can provide information that may apply to your situation.

1) Gallup, 2010

2) Social Security Administration, 2010

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# The Story Behind America's 75-Year-Old Safety Net

The Social Security program was created in the midst of the Great Depression, when many senior citizens were left penniless and without the financial support that might have come from family members during a more prosperous time.

President Franklin D. Roosevelt pushed for a system in which workers would contribute toward their future economic security through taxes paid while they worked. Social Security was established in 1935 along with several other public assistance programs.

This popular social insurance program was never intended to fund a lavish retirement but rather to “insure the essentials” for retired workers age 65 and older by paying them a steady, modest income.

Social Security was designed to be a pay-as-you-go system, which means payroll taxes collected from workers are used to fund payments for current retirees. (The 1939 Amendments changed the program by adding payments to the spouse and minor children of a retired worker and benefits for survivors of deceased workers.) Until recently, this method didn't pose a problem for the federal government because there were always more workers than retirees — and resulting surpluses. But a whole generation of retiring baby boomers will soon begin collecting more in benefits than active workers are expected to contribute in payroll taxes (under the current formula).



## Social Security and the New Deal

The Old Age, Survivors, and Disability Insurance (OASDI) program, which is the official name of Social Security, was created as part of Franklin Delano Roosevelt's New Deal legislation during the Great Depression.

## Coming of Age

The first baby boomer to receive Social Security retirement benefits was former schoolteacher Kathleen Casey-Kirschling, who was born one second after midnight on January 1, 1946, and became eligible for early benefits when she turned 62 in 2008.

Source: Social Security Administration

## Important dates in the history of Social Security

- **August 14, 1935** — President Franklin D. Roosevelt signed the Social Security Act (H.R. 7260) into law.
- **November 1936** — The first Social Security cards were distributed in post offices around the nation.
- **January 31, 1940** — Sixty-five-year-old Ida May Fuller was issued the first monthly Social Security check for \$22.52. She lived to the age of 100 and collected a total of \$22,888.92 in benefits.
- **August 28, 1950** — President Harry S. Truman signed the 1950 Amendments, which increased benefits for the first time to compensate for inflation.
- **July 1, 1972** — President Richard M. Nixon signed a law that provided for annual automatic cost-of-living adjustments for Social Security benefits.
- **April 20, 1983** — President Ronald Reagan signed a lengthy amendment to address a short-term financing crisis. Reforms included raising payroll tax rates and increasing the retirement age to 67 in two stages for future recipients.
- **March 25, 2010** — The Congressional Budget Office projected that in the 2010 fiscal year, Social Security will pay out more in benefits than it collects in tax revenue — six years earlier than expected.

Sources: Social Security Administration, 2011; Bloomberg News, March 26, 2010



**There are currently 2.9 workers for each Social Security beneficiary. By 2041, it's expected that there will be only 2.1 workers for each beneficiary.**

Social Security Administration, 2011

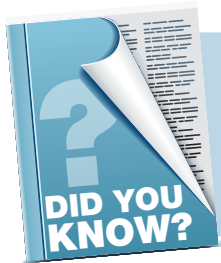
# How Social Security Works Today: Your Key Questions Answered

## How does the government determine my monthly benefit?

Over the years that you work, you earn Social Security “credits.” Your benefit is based on the average of the highest 35 years of earnings in which you paid payroll tax. To qualify for benefits, you must accumulate a minimum of 40 work credits, which equals about 10 years of work.

Since 1999, workers age 25 and older have received an annual Social Security statement in the mail, about three months before their birthday. The statement summarizes the individual’s earnings history and estimated retirement benefits at various ages. The Social Security Administration (SSA) assumes that a worker’s future earnings will remain at the same level until retirement and estimates benefits according to today’s laws. Therefore, it’s possible that current benefit estimates may be inaccurate — especially for workers who have many years left until retirement or experience a period in which they are not working.

*Note: Beginning in the second quarter of 2011, Social Security statements will no longer be mailed (but mailed statements may continue for workers age 60 and older who are not receiving benefits). For an estimate of your projected benefits, go to [www.ssa.gov/estimator](http://www.ssa.gov/estimator).*



**Social Security beneficiaries received a COLA every year from 1975 to 2009, but there was no COLA in 2010 or 2011 because inflation was too low to trigger an increase.**

Social Security Administration, 2011

## What is COLA?

Social Security benefits are indexed to inflation, so your benefit may increase as the cost of living climbs from year to year. At the present time, the automatic cost-of-living adjustment (COLA) is equal to the percentage increase (if any) in the average Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the third quarter of the last year in which a COLA became effective to the third quarter of the current year.

## When can I start collecting Social Security income?

The earliest you can claim benefits is age 62, although you will collect less each month than if you had waited until full retirement age, when you would be eligible for 100% of your monthly benefit. Full retirement age ranges from 65 to 67, depending on the year you were born.



**At the beginning of 2011, the average monthly Social Security benefit for retired workers was \$1,177.**

Social Security Administration, 2011

## By how much would my benefit be reduced at age 62?

Year of birth	Full retirement age	Monthly benefit reduction at age 62
1943–54	66	25.00%
1955	66 and 2 months	25.83%
1956	66 and 4 months	26.67%
1957	66 and 6 months	27.50%
1958	66 and 8 months	28.33%
1959	66 and 10 months	29.17%
1960 & later	67	30.00%

Source: Social Security Administration, 2011

## When is the best time to claim benefits?

It depends on how long you are willing and able to remain in the workforce, your health, your financial situation, and other factors. If you are married, it's also important to keep your spouse's age and eligibility for benefits in mind, as well as how long he or she might survive you, as you decide when each of you should file.

If you live an average life expectancy, you will receive roughly the same amount in lifetime benefits regardless of whether you

begin collecting benefits at age 62, full retirement age, or age 70. This is because the longer you wait to begin collecting benefits, the higher your monthly benefit will be, but the shorter the time period over which you will receive benefits.

If you claim benefits at age 62, the amount you receive each month could be reduced to 70% of your full retirement benefit. For each month you wait to claim benefits after age 62, your monthly benefit increases slightly, so that at full retirement age you would be entitled to 100% of your full retirement benefit. For each month you wait to claim Social Security after full retirement age, your monthly benefit will continue to increase until you reach age 70, when you could be entitled to receive up to 132% of your full benefit (depending on date of birth).

A worker retiring in January 2011 could receive these maximum monthly benefits:

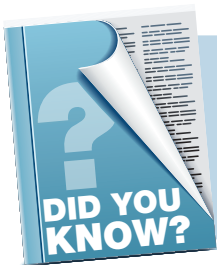
Age 62	Age 66	Age 70
\$1,803	\$2,366	\$3,193

Source: Social Security Administration, 2011

### How does my spouse's income affect my benefits?

If a husband and wife both collect benefits, the lower earner is eligible for the greater of his or her own earned benefit or half of what the higher earner would receive at full retirement age.

In the event of a divorce (for a marriage lasting at least 10 years), an individual who is age 62 or older and has not remarried is eligible for benefits based on the former spouse's employment record. These payments have no effect on the former spouse's benefits or on his or her subsequent spouse's benefits.



**The number of Americans who opt to take early benefits has been rising. In 2009, 42% of 62-year-olds claimed benefits, up from 38% in 2007.**

*SmartMoney*, March 7, 2011

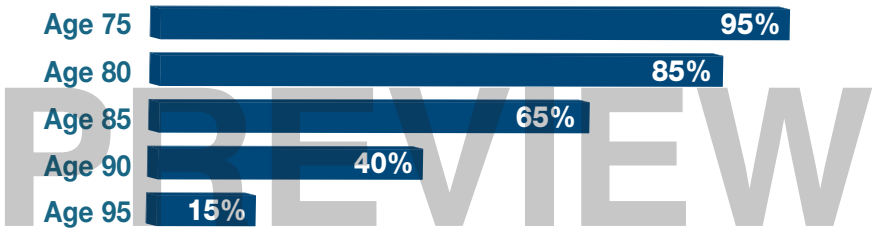
Widowed individuals receive the greater of their own or their spouse’s benefits if they are at least 60 years of age. The amount is reduced by up to 28.5% if taken before the recipient’s full retirement age.

Wives typically outlive their husbands by an average of about seven years, and many widows opt to receive their husband’s higher benefit payment instead of their own. A husband who waits to claim Social Security until age 66 (instead of 62) could increase the amount his wife receives as his survivor by more than 20%, or by as much as 60% if he can delay benefits until age 70.

Source: Center for Retirement Research, 2009

### Odds Are You’ll Live a Long Time

Chances that one member of a married couple (both age 62) will live to:



Source: Center for Retirement Research, 2009

### How much is taken out of my wages to pay Social Security and Medicare payroll taxes?

	Social Security tax	Medicare tax
<b>Worker pays:</b>	6.2%*	1.45%
<b>Employer pays:</b>	6.2%	1.45%
<b>Self-employed pays:</b>	12.4%*	2.9%

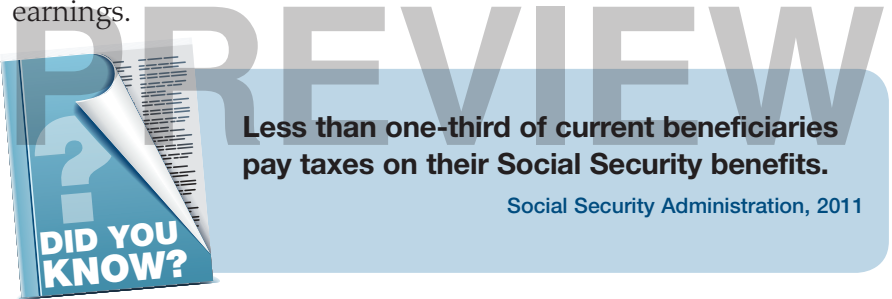
\*In 2011, as a result of the 2010 Tax Relief Act, the employee’s share of the Social Security payroll tax was temporarily reduced from 6.2% to 4.2% (on up to \$106,800 in taxable wages). The employer’s share did not change. The Social Security payroll tax for self-employed people also fell temporarily by 2% to 10.4%. This payroll tax reduction is in effect for one year only.

## If I take early Social Security benefits and decide to work, will my payments be affected?

The reduction in benefits known as the Retirement Earnings Test (RET) applies only if you claim Social Security payments prior to full retirement age. When this happens, one dollar in benefits will be deducted for each two dollars you earn above the annual limit (\$14,160 in 2011).

In the calendar year in which you reach full retirement age, one dollar in benefits is deducted for each three dollars you earn above a higher annual limit (\$37,680 in 2011) until your birthday month. Once you reach full retirement age, there is no reduction of benefits. These earnings limitations do not apply to investment income such as interest or dividends, only to wages earned through employment.

The RET shouldn't really be considered a penalty. Your benefit will be recalculated after you reach full retirement age and you will receive credit for any benefits you did not receive due to your earnings.



**Less than one-third of current beneficiaries pay taxes on their Social Security benefits.**

Social Security Administration, 2011

## Are my Social Security benefits taxable?

Up to 50% of your benefits may be taxable if you are a single filer with a "combined income" between \$25,000 and \$34,000, or a married filer with a combined total income between \$32,000 and \$44,000.

Up to 85% of your Social Security benefits may be taxable if your combined income exceeds these thresholds.

"Combined income" includes your adjusted gross income plus any tax-exempt interest and one-half of your Social Security benefit. Keep in mind that some states may tax Social Security benefits, whereas other states exempt them.

# Future Shortfalls Are Easy to Foresee

The 2010 Annual Report from the Social Security Trustees suggests that the long-term financial prospects of the program are still a matter of concern for future retirees. Revenues for 2010 deteriorated further in the face of widespread unemployment and a significant reduction in the payroll tax receipts that fund the U.S. government's single largest social program.

In 2010, Social Security outlays exceeded tax revenues for the first time since the program was amended in 1983. The trustees also predict that revenues will stay roughly equal with outlays over the next few years, but growing numbers of retiring baby boomers will begin to overwhelm the system as their numbers increase more rapidly than do the number of workers paying into the system.

By 2015, payments are expected to exceed tax revenues on a regular basis, and the combined OASDI trust funds will be drained completely by 2037 if no changes are made. Going forward, tax income would cover only about 75% of scheduled benefits.<sup>1</sup>



**Seventy-seven percent of Americans believe that the costs of entitlement programs will create major economic problems for the nation if they are not addressed.**

Gallup, 2010

## Potential fixes could mean problems

The projected financial shortfalls, along with troublesome federal budget deficits and the growing national debt, suggest it is highly likely that Social Security will undergo some major changes in the coming years. Policy options include increasing payroll taxes, reducing benefits, raising the retirement age, and limiting cost-of-living increases.<sup>2</sup>

1) Social Security Administration, 2010

2) Congressional Budget Office, 2010

In 2010, a bipartisan presidential commission on reducing the national debt proposed a number of measures related to Social Security, including:

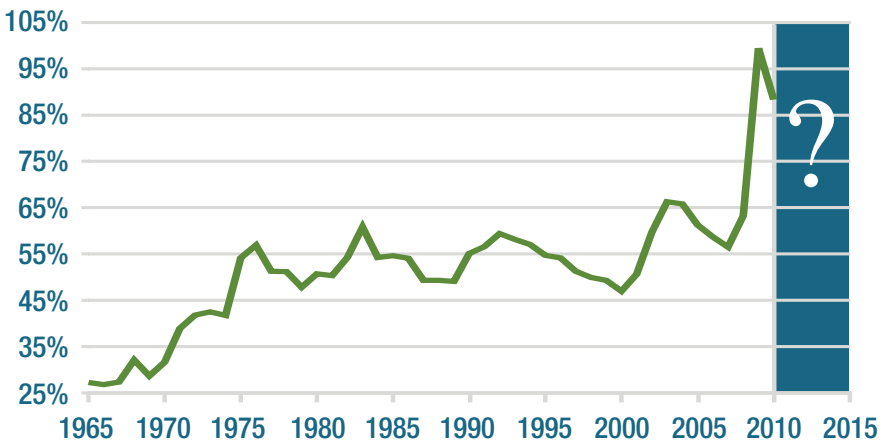
- Raising payroll taxes on higher incomes
- Stepping up the retirement age to 69 by 2075 (with a hardship exemption for some people who cannot work past age 62)
- Reducing benefits for most retirees in later decades but increasing benefits for lower-income recipients

Because there is little consensus on the part of lawmakers or the public, a solution that results from political negotiations could possibly combine several measures.

Source: *The New York Times*, November 10, 2010

## How will we pay for the growth of mandatory entitlement spending?

Some experts believe that the growth of mandatory entitlement spending (the largest programs are Social Security and Medicare) will result in higher tax rates in the future. This graph provides historical data on mandatory entitlement spending as a percentage of federal tax receipts.



Source: Congressional Budget Office, 2010

## No popular solution in sight

Here's how U.S. workers view these possible (but so far hypothetical) changes to Social Security.

<b>Reducing current rate of benefits gradually, with larger reductions for higher earners than for those with lower incomes</b>			
<b>Strongly favor</b>	<b>Somewhat favor</b>	<b>Somewhat oppose</b>	<b>Strongly oppose</b>
<b>28%</b>	<b>27%</b>	<b>17%</b>	<b>26%</b>
<b>Raising full retirement age by one year</b>			
<b>Strongly favor</b>	<b>Somewhat favor</b>	<b>Somewhat oppose</b>	<b>Strongly oppose</b>
<b>18%</b>	<b>27%</b>	<b>18%</b>	<b>37%</b>
<b>Raising the payroll tax paid by workers from 6.2% to 7.2%</b>			
<b>Strongly favor</b>	<b>Somewhat favor</b>	<b>Somewhat oppose</b>	<b>Strongly oppose</b>
<b>17%</b>	<b>23%</b>	<b>17%</b>	<b>41%</b>
<b>Reducing current rate of benefits by 5% for all new recipients</b>			
<b>Strongly favor</b>	<b>Somewhat favor</b>	<b>Somewhat oppose</b>	<b>Strongly oppose</b>
<b>8%</b>	<b>15%</b>	<b>25%</b>	<b>48%</b>

Source: Employee Benefit Research Institute, 2010



Nearly half of people ages 56 to 62 are at risk of having their retirement incomes fall short of what they need even for basics like food, housing, and transportation.

*SmartMoney*, March 2011

# Time to Get Serious About Your Own Retirement Income

Considering the uncertain outlook for Social Security, it might be a good idea to prepare for retirement based on the assumption that your Social Security benefits might not provide a significant source of income. This doesn't mean to imply that you won't receive any Social Security benefits. But your retirement is too important to allow it to become overly dependent on a program with such an uncertain future.



**Social Security provides about 37% of the incomes of Americans age 65 and older with household incomes of \$55,889 or more.**

Social Security Administration, 2010

By leaving Social Security out of your retirement income projections, you are likely to approach your preparations with a different outlook. If you think that you can always fall back on Social Security, you could be lured into a false sense of security, which might cause you to save too little of your current income and invest too conservatively (or too aggressively) for your risk profile. If it turns out that drastic changes are necessary to keep Social Security solvent, and those changes include significantly lower benefits, it might be too late for you to do anything to overcome a potential income shortfall.

Look at it this way: If you were considering a potential investment that was facing financial problems similar to those facing Social Security, would you allow your retirement lifestyle to depend on the future performance of that potential investment?

Although most American workers don't have a choice about whether to contribute to Social Security, they do have the option to prepare for a retirement that doesn't hinge on the success of an uncertain federal program.

Of course, this won't be easy. In a survey comparing the expectations of workers with the experiences of retirees, workers overestimated the degree to which they would be able to rely on various sources of retirement income (see chart).

### Sources of Retirement Income: Expected vs. Actual

		Major source	Minor source
<b>Social Security</b>	Workers	33%	45%
	Retirees	68%	23%
<b>Employment</b>	Workers	24%	53%
	Retirees	5%	17%
<b>Employer-sponsored retirement plan</b>	Workers	44%	29%
	Retirees	24%	27%
<b>Other savings and investments</b>	Workers	26%	39%
	Retirees	19%	31%
<b>IRA</b>	Workers	29%	37%
	Retirees	17%	31%
<b>Employer-sponsored traditional pension or cash-balance plan</b>	Workers	29%	26%
	Retirees	30%	20%

Source: Employee Benefit Research Institute, 2011

Only 33% of workers expect Social Security to be a major source of retirement income, yet 68% of current retirees report that Social Security is a major source of income for them. This may mean their other sources of retirement income did not provide what they were expecting. Imagine what kind of lifestyle they might face if Social Security wasn't there for them.

Fortunately, it is — but will it be there for you? The longer you have until retirement, the more likely it is that Social Security will undergo changes that could affect your retirement income and lifestyle.

## Begin Preparing Now

Given the uncertain future of Social Security, it might be a good idea to base your retirement preparations on the assumption that the social insurance program won't be a major source of your income. If it turns out that your assumption was correct, then you may not have to cut back on your retirement lifestyle. And if you were wrong about Social Security, then you may have more income than you expected.

Your financial professional can help you recalculate your retirement-needs projection and look for potential ways to help build a financial future that does not depend heavily on Social Security.

# PREVIEW

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KIT-000-07-100000