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PRIMER ON THE SOCIAL SECURITY SYSTEM

This is to provide an overview of the Social Security system: How you qualify; what benefits are available; taxability; and a look at medicare, disability, and SSI.

Here are some interesting statistics: As of 1997, there were 53 million people collecting Social Security; 33 million were on Medicare; and 94% of all employees of record are paying social security and medicare tax from their income earned.

How You Earn Social Security Credits

The Social Security system is basically funded through a tax on earnings whether you work for someone else, or for yourself. This tax is comprised of two components: The Social Security portion is 6.20%, and the Medicare portion is the remaining 1.45%. Further, this tax is charged to both employee, and employer (for self-employed people, a similar treatment is used in which the self-employed is also considered the employer, hence paying nearly both sides).

The Social Security portion is "capped" out in that this tax stops once the earnings reach \$76,200 for 2000. However, the Medicare portion is not "capped." You pay it no matter how much you earn.

How Your Retirement Benefits Are Calculated

In effect, you pay into Social Security just like a pension. For the average retiree, how much one gets in Social Security benefits depends on a complicated formula which involves the length of time worked, amount contributed into Social Security, the age when one retires, and how many years one contributed the maximum Social Security payments.

For most retirees, a certain number of quarters of coverage paid into the Social Security are required to get the maximum benefits. For people who reach age 62 from 1991 or later, they normally need 40 quarters—or ten years—of coverage. For maximum benefits, the more of these 40 quarters in which the retiree had contributed the maximum into Social Security, the better it is, everything else being equal. So, the more you pay into Social Security, the higher on the benefit chart you will be.

Note: You can get a very good estimate of how much Social Security you qualify for from the Social Security Administration. It is planning to automatically send this to you on a periodic basis. If you do not get it, you can request it. To do this, call Social Security (800-772-1213) and request a "Personal Earnings and Benefits Estimate Statement" form. You will get back in the mail in a few weeks a form which shows your earnings to date on an annual basis, and estimates of the monthly benefit you will receive at various allowable retirement ages.

This report shows a record of your earnings history. Errors can – and do – occur. It's your responsibility to spot these errors and notify Social Security within a reasonable amount of time. Otherwise, you could get less benefits than you deserve. A good rule of thumb: Get this report every three years or so to check the earnings figures while they are still fresh in your mind.



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Applying For Social Security Benefits

For most people considering collecting Social Security retirement, there is a choice of ages: 62 or 65 depending on whether one wants full benefits at 65, or reduced benefits at the earlier age of 62. However, beginning in year 2000, the full benefit age will begin rising, until it reaches age 67 by year 2027.

How much your full benefit is reduced by taking the earlier 62 age retirement depends on a number of factors, but as a guide, you can figure your monthly benefits will be reduced by 20% if you retire at 62, 14% at 63, and 7% at 64.

Conversely, if you do not start taking benefits at 65, but wait, the monthly check you will eventually receive from Social Security will be increased on an average of 3% for each year you are eligible to get Social Security, but elect not to take it and continue working instead. This calculated credit will begin to rise over the next 15 years or so until it eventually becomes 8% instead of 3%.

You can get some very good estimates from the Social Security Administration as to the specific amounts you will receive at retirement when you get close to the two age choices to help you decide. Some other factors to consider in determining which age to choose: Will you be receiving any other types of pensions? Do you have other sources of retirement such as savings? Will your spouse continue to work? Will you continue to work, full or part-time?

Remember, once you elect early, reduced benefits at 62, there is no going back. So review it carefully. The trade-off is getting earlier benefits, although reduced amounts.

Once you start receiving Social Security benefits you will receive a fixed amount each month. This may increase periodically since Social Security has a form of "inflation adjustor" built in. A formula is used to determine how much to increase your benefit if the official cost of living increases and/or the average wage rate increases. For last year, 1999, this cost of living increase amounted to 1.1%.

How To Apply For Benefits

Applying for benefits is fairly easy. You should start the process two months in advance so your checks will start arriving on your first retirement month and you have no "gaps" in your income stream. However, if you are a little late in applying, you will get all the benefits to which you are entitled from the first month you are entitled—you just may have to wait longer to get them.

The process involves filling out a few simple forms and verifying such information as your age, Social Security number, recent past earnings statements, marriage/divorce papers, and recent tax return. It usually involves only one relatively quick interview with a social security administrator, and in many cases, can be done through the mail.

If you have been working for yourself, then it can be a little more complicated, but not necessarily so. Sometimes you need to provide a little "proof" that you are really retiring from your business. Are you selling it? Turning it over to other family members? Closing it down? All they are trying to do is make sure you are really retiring, not playing some game.



Taxability And Earning Limitations

Once you start collecting Social Security benefits there are two possible limiting factors that involve future income and earnings.

The first issue relates to benefit recipients who continue to work after signing up for Social Security benefits. Even though you are receiving these retirement benefits, you can still earn a certain amount of money without it affecting your benefits. However, beyond a certain amount, you may have to start giving back some of the benefits.

People under age 65 collecting these benefits can earn up to \$10,080 per year without giving back any of their Social Security. Beyond this amount, they must refund \$1 for every \$2 they make above this annual exemption amount.

People from age 65 to 69 can earn up to \$17,000 per year without giving back any retirement benefits. Beyond this amount, they must refund \$1 for every \$3 they earn.

People age 70 or higher can earn any amount without giving back any of their Social Security benefits.

This calculation is performed on a monthly basis for the first year in which you retire, to account for the transitional year in which you may have earned more than these amounts prior to the month you retire.

The second issue deals with whether or not your Social Security benefits are subject to federal income tax. The answer is: It depends!

In general terms, a portion of your benefits (up to 85% of them) may be subject to federal (and state) income taxes if your total adjusted income exceeds certain levels (1999 rules): \$34,000 for a single individual, and \$44,000 for a married couple.

As you can see, these two issues, how much one can earn after collecting Social Security, and how much tax one may have to pay on the Social Security received, can have a major impact on when one should apply for these benefits. This is where some financial planning ahead of time may be quite beneficial!

Medicare

Medicare relates to the health insurance portion paid by the federal government for those who are 65 or older, people with kidney failure, or those categorized as disabled.

There are two components. First is the hospital insurance part which assists in paying various inpatient hospital, nursing home, hospice, or home health care costs. There are various deductibles and limitations on reimbursements depending upon the number of days of required care.

The second component is the "Part B" or Medical Insurance portion. After a deductible, this program pays up to 80% of allowable medical costs associated with physician-related services such as visits, tests, therapy, and home health care, to name a few.



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Note the term "allowable." Basically, that means Medicare medical insurance will pay for what are considered "ordinary, necessary, and customary" fees—which may be lower than your doctor is charging. Unless your caregiver is "accepting assignment (that is, taking only what Medicare will pay)," you must pay the differential. In addition, there are various medical-type costs Medicare generally doesn't cover, such as eyeglasses, normal custodial care, most drugs, and various dental costs, to name a few.

This is why many people buy private "Medigap" policies after they become eligible for Medicare. Since Medicare doesn't necessarily cover 100% of all costs, the Medigap policy is designed to "pick up" the bulk of the unpaid part.

There is a choice of these policies available varying in cost and coverage from a very basic to a very comprehensive plan to help you cover the charges that Medicare won't pay.

Medicaid

Medicaid is a government funded program to assist in paying various medical bills for eligible low income people of any age. The requirements vary somewhat but they are based on certain monthly income and poverty level requirements.

Since this is primarily a state-responsible program assisted by the federal government, requirements can vary from state to state. Normally, anyone qualifying for Supplemental Social Security Income will also be eligible to receive Medicaid.

Social Security Disability Benefits

For those who qualify as disabled under the Social Security Administration guidelines, a monthly disability check may be available. In fact, as of last year's statistics, there were over 3.4 million recipients of this program.

In addition to a disability check, qualifiers can receive Medicare coverage as well after a 24 month "waiting" period. Those disability persons with certain kidney problems may get the Medicare coverage without this waiting period.

Similar to receiving Social Security benefits, in order to qualify for a disability benefit, one must have earned enough work credits based on the age at which the disability is recognized by the Social Security Administration. For people age 31 or older as of the present 2000 year, they need to have at least 5 years of these credits during the past 10 years. However, disability due to blindness has an easier formula to reach this 5 year credit qualifier.

People who qualify as disabled earlier than age 31 may require less work credits and work credit years. Conversely, the formula increases with the recipient's age, until at age 62 or older it requires a full 10 years of work credits to get the maximum disability check.

"Disability" as far as the Social Security Administration is concerned can be a far more stringent definition than with private concerns. In a nutshell, to receive a disability check from the government, two tests must be met:



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You have a physical or mental condition that stops you from performing ANY substantial work.

This condition will last at least 12 months, or will lead to death.

To prove your disability you will have to show medical evidence from a qualified source regarding these qualifying tests. In addition, the Social Security Administration can (and frequently does) require a "second opinion" from medical sources they recommend. Also, your disability is reviewed periodically – every four years or so on average – to see to it your condition has not improved enough to suspend the disability benefits.

What main conditions may qualify a person to seek Social Security Disability? The general categories are as follows:

- Blindness in which your CORRECTED vision is no more than 20/200.
- Pulmonary diseases, and other "progressive diseases.
- Certain arthritic conditions.
- Brain abnormalities, and certain mental illness.
- Cancer that cannot be controlled.
- Kidney problems, certain digestive illnesses.
- Loss of speaking ability, loss of limb functions.
- Certain Aids-related illnesses.

Applying for Disability: Like Social Security, you need to apply for disability with a written application. It is a detailed statement of your condition with required back-up.

The claim will be reviewed, and it averages 3 months for this processing in most cases. Your disability checks are paid on the sixth month of the recognized disability date—unless you are under 22, in which case there may be no "deductible" period.

The amount of disability payment depends upon your qualifying work credit formula. Generally speaking, the amount of benefit is similar to the one a worker retiring at 65 would receive from Social Security. The notable exception here concerns disability due to blindness. In this case, the qualifying work credit formula is much more lenient to get maximum benefits.

Can you work once you receive Social Security disability benefits? For most people, the answer is NO. However, there are exceptions involving part-time work, especially for those who are blind. Your Social Security benefits administrator makes a decision in each case on an individual basis.

Conclusion

Social Security, Medicare, Medicaid, and Disability benefits are important mainstays to millions of Americans. Sadly for many, these benefits represent the main source of financial survival. It is sad because these benefits rarely cover all the normal financial requirements to live a secure, comfortable life.

However, it is far better than many other countries. If there is any "moral" to the Social Security System, it is that one should realize early on that Social Security should be considered a supplemental plan, not the main one—and save accordingly.



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