

Maximizing Your Social Security Benefits

SSR4/24/V1

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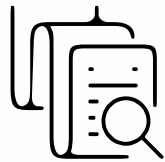
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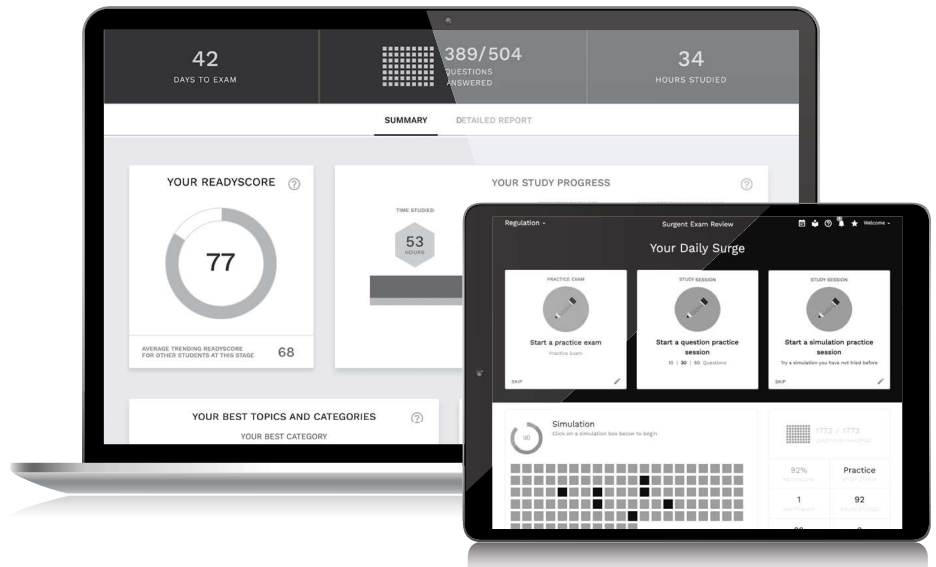
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Eligibility for Benefits

Learning objectives

Upon reviewing this chapter, the reader will be able to:

- Determine when an individual is eligible to receive Social Security benefits;
- Understand the Social Security credit system and how credits are earned;
- Differentiate Social Security retirement benefits for workers, spouses, divorced spouses, and children;
- Identify eligibility, entitlement, and the amount of payment of survivors' benefits, father's or mother's benefits, parents' benefits, and lump-sum death benefits; and
- Describe disability benefits including entitlement conditions, the amount of the benefit, termination of benefits, the period of disability, and provisions relating to substantial gainful activity.

I. Introduction to Social Security benefits

A. Eligibility versus amount of benefit

The first step in understanding the Social Security system is to separate the eligibility requirements from the calculation of the amount of benefits.

1. Eligibility for benefits

An individual qualifies for Social Security benefits based on a credit system. Credits are accumulated by working as an employee or as a self-employed individual. There are different amounts of credits and rules on when the credits must be earned for different types of benefits. Also, an individual can qualify to receive benefits because of his or her current or former relationship to an eligible worker. This chapter discusses the credit system, qualifications by a worker for various benefits, and relationships to insured workers that may qualify an individual for benefits. Credits determine the right to draw benefits, but not the amount of the benefits. The Social Security Administration still refers to credits as “quarters of coverage.”

2. Amount of benefits

The amount of benefits an individual receives is determined by mathematical calculations based on the individual's 35 highest years of inflation-adjusted earnings. Earnings are adjusted for inflation using the national average wage indexes for the years in the worker's work history. They are adjusted to the year that the worker reaches 60 years of age. For certain types of benefits, the formula is changed because the worker is not yet 60 years old. The steps to the formula are:

- a. Adjust the worker's wages or self-employment income for inflation for their entire work history prior to turning 60 years old to the year that they turn 60 years old by comparing the national wage index for each year to the national wage index for the year that they turn 60.
- b. Take the highest 35 years, add them together, and divide by 420 (35 years converted to months). This is the Average Indexed Monthly Earnings (AIME).
- c. Multiply the AIME by a formula of “bend points.” This is the Primary Insurance Amount (PIA). The PIA is the amount that the worker draws at full retirement age.
- d. Adjust the PIA for early retirement or delayed retirement.
- e. Calculate any benefits for other individuals that are eligible to draw based on the eligible worker's account based on the kind of relationship that exists.

II. The Credit System

A. Social Security credits

1. Earning credits

- a. Social Security credits are earned by working at a job covered by Social Security.
- b. To earn credits **for the years before 1978**, a person must have:
 - (i) Earned at least \$50 in wages for employment covered under the law in any calendar quarter beginning January 1, April 1, July 1, or October 1;
 - (ii) Earned at least \$100 in annual wages paid for agricultural labor for years after 1954 and before 1978; or \$50 in wages paid for agricultural labor in any calendar quarter in 1951 through 1954;
 - (iii) Earned at least \$400 in annual net earnings from self-employment in taxable years 1951 through 1977; or
 - (iv) Earned the maximum taxable wages for that year. (See below for maximum taxable wages.)
- c. To earn credits **for the years after 1977**, the SSA Commissioner determines the amount of earnings that will equal a credit for each year. The amount of earnings is determined by using a formula in the Social Security Act that reflects a national percentage increase in **average wages**. This amount is published in the *Federal Register* on or before November 1 of the preceding year. The amount is \$1,730 per credit for 2024. A worker earns a credit for each multiple of \$1,730 for 2024.¹ Therefore, if a worker earns \$6,920 of qualified Social Security income in 2024, the worker will receive four credits. If she earns \$6,919, she will earn three credits. Partial credits are not awarded.
- d. The maximum number of credits that may be earned each year is four. The credits are based on total earnings, which may consist of nonagricultural wages, military wages, railroad compensation, agricultural wages, and self-employment income.
- e. If self-employment income is not reported on a calendar-year basis, (a fiscal year taxpayer) it is assigned to each of the calendar quarters in the taxable year. This is done in proportion to the number of months completely included in each year. The month that the taxable year ends is considered to be completely within the taxable year. This is done to allocate the income to the income between the two calendar years over which the fiscal year overlaps. It does not mean that the self-employed worker has to have earnings in each quarter. It is an allocation method. For example, if a self-employed worker has a fiscal year that ends on September 30, 2024, his self-employment income would be allocated between 2023 and 2024. Since one quarter is in 2023, and three quarters are in 2024, 25 percent of the income would be allocated to 2023 and 75 percent would be allocated to 2024. Then, the self-employment earnings allocated to each year would be combined with other Social Security earnings for that year, and the credits would be calculated based on that total.
- f. "Calendar quarter" is a period of three calendar months ending March 31, June 30, September 30, or December 31 of any year. Even if the worker meets the earnings requirement for Social Security credits, he or she cannot earn a credit for a calendar quarter if the calendar quarter:

¹ Adjustments can be found at <https://www.ssa.gov/news/press/factsheets/colafacts2024.pdf>.

- (i) Begins after the quarter that the worker died;
- (ii) Has not started yet; or
- (iii) Is within a prior period of disability that is excluded in figuring benefit rights. However, the beginning and ending quarters of the prior disability period may be counted as credits if the earnings requirements described above are met in these quarters.

The following table shows the amount of wages needed to obtain a credit of coverage.

| Year | Amount of wages or self-employment income necessary to obtain a quarter of coverage |
|------|---|
| 1978 | \$250 |
| 1979 | \$260 |
| 1980 | \$290 |
| 1981 | \$310 |
| 1982 | \$340 |
| 1983 | \$370 |
| 1984 | \$390 |
| 1985 | \$410 |
| 1986 | \$440 |
| 1987 | \$460 |
| 1988 | \$470 |
| 1989 | \$500 |
| 1990 | \$520 |
| 1991 | \$540 |
| 1992 | \$570 |
| 1993 | \$590 |
| 1994 | \$620 |
| 1995 | \$630 |
| 1996 | \$640 |
| 1997 | \$670 |
| 1998 | \$700 |
| 1999 | \$740 |
| 2000 | \$780 |
| 2001 | \$830 |
| 2002 | \$860 |
| 2003 | \$890 |
| 2004 | \$900 |
| 2005 | \$920 |
| 2006 | \$970 |
| 2007 | \$1,000 |
| 2008 | \$1,050 |
| 2009 | \$1,090 |
| 2010 | \$1,120 |
| 2011 | \$1,120 |
| 2012 | \$1,130 |
| 2013 | \$1,160 |
| 2014 | \$1,200 |
| 2015 | \$1,220 |
| 2016 | \$1,260 |
| 2017 | \$1,300 |
| 2018 | \$1,320 |
| 2019 | \$1,360 |
| 2020 | \$1,410 |
| 2021 | \$1,470 |
| 2022 | \$1,510 |
| 2023 | \$1,640 |
| 2024 | \$1,730 |

Source: Amount of Earnings Needed to Earn One Quarter of Coverage, Quarter of Coverage; <https://www.ssa.gov/news/press/factsheets/colafacts2024.pdf>

Note:

The credits are not tied to quarters after 1977. A worker can earn \$6,920 in January of 2024, not work anymore in 2024, and receive four credits. However, the legal term that the Social Security Administration still uses is “quarter of coverage.” There are times when a worker may not earn four quarters, as noted above. For instance, if the worker dies during the third quarter, they may only accumulate two credits, or “quarters of coverage.”

2. Credits based on wages earned after 1936

Credits are the “building blocks” SSA uses to find out whether an individual has the minimum amount of covered work to qualify for each type of Social Security benefits. If one stops working before one has enough credits to qualify for benefits, those credits will stay on the individual's record. If the individual returns to work later, one can add more credits so as to qualify. However, no benefits can be paid if one does not have enough (at least 40) credits.

- a. Credits earned are based on wages earned after 1936 and up to and including the calendar quarter that the worker dies. Before 1978, credit was obtained as of the first day of that quarter. As long as the total wages paid to the worker in that quarter amounted to at least \$50, it does not matter on which date the \$50 total was first reached.
- b. Under the revised definition of “credit” in effect after 1977, the number of credits assigned to a calendar year depends on the amount of earnings credited to that year. This is true regardless of the type of earnings credited. If the total earnings for the calendar year equals four times the designated amount reflected on the previous chart, each quarter is a credit.
- c. If less than four credits are earned in a year, the credits are assigned to a specific quarter when needed to meet insured status or to increase the amount payable. Credit is effective on the first day of the quarter that it is assigned.
- d. Employers now report earnings just once a year. Credits are now based on total wages and self-employment income during the year, no matter when one does the actual work. One could work all year to earn four credits, or one might earn enough for all four in a much shorter length of time.

3. Credits based on self-employment

- a. Beginning after 1950, credits can be earned based on self-employment income earned in taxable years.
- b. Before 1978, four credits were acquired for every taxable year that at least \$400 was earned in self-employment income.
- c. After 1977, a person acquires one credit for each designated amount of self-employment income (or self-employment income plus wages) wholly or partly in a taxable year. If less than four credits are earned, they will be assigned to the person's benefit.

Note:

Coordination of Social Security systems of the United States and a foreign country: If a person worked under the social security system of a foreign country, the periods of work may be taken into account toward meeting U.S. insured status requirements for retirement, survivors, and disability insurance programs if:

- The **totalization agreement**, the security agreement between the U.S. and the foreign country, provides for foreign periods of coverage;
- The person has at least six credits earned under the U.S. program; and
- The person would not be insured for benefits without taking the foreign periods into account.

If a person qualifies for benefits based on combined coverage, the amount payable is based on the person's primary insurance amount (discussed elsewhere in the materials). It is reduced to reflect the fact that foreign coverage was used to make the benefit payable.

B. Requirements

1. In general

In order to qualify for Social Security benefits, either the individual or the person on whose earnings record the individual claims benefits must have worked a certain amount of time in employment covered by Social Security. This work requirement is called **insured status**. The number of Social Security credits earned is used to determine whether a person has fully insured status, currently insured status, or insured status for establishing a period of disability. A person earns Social Security credits (previously called "quarters of coverage") for a certain amount of work covered under Social Security.

2. Fully insured status

Fully insured status is required for most benefits. A person can obtain covered credits and count them in any year.

- a. To be fully insured, a person must earn at least one credit for each calendar year after the person turned 21 and the earliest of the following:
 - (i) The year before the person turns age 62;
 - (ii) The year the person dies; or
 - (iii) The year the person becomes disabled.
- b. In determining the number of years to be used in computing credits, any year (all or part of a year) that was included in a period of disability is not counted.
- c. At least six credits are needed in order to be considered for fully insured status. No more than 40 credits are required, regardless of one's date of birth.

3. Permanently insured status

The number of credits needed to be permanently fully insured is 40 credits both for men and women. Once a worker has 40 credits, they will qualify for old age benefits when they reach the age of eligibility, even if they never work again. For other types of benefits, there are rules about how recently credits were earned. We will discuss those rules for each benefit type.

4. Currently insured status

- a. Currently insured status is required for young widows and surviving children.
- b. A person is currently insured if he or she has at least six quarters of coverage during the full 13-quarter period ending with the calendar quarter in which he or she:
 - (i) Died;

- (ii) Most recently became entitled to disability benefits; or
 - (iii) Became entitled to retirement insurance benefits.
- c. To determine the 13-quarter period, calendar quarters, all or part of which are in an established prior period of disability, are generally not counted. However, the first or last quarter of the prior period may be counted if the quarter is used as a credit.

Note:

Currently insured status is important for widows and surviving children of a worker who has not yet earned 40 credits.

C. Disability insured status

1. In general

A person has disability insured status if: (i) he or she has at least 20 credits during a 40-quarter period (**the 20/40 rule**); (ii) the 40-quarter period ends with the quarter that the person is determined to be disabled; and (iii) the person is fully insured in that quarter.

2. Special insured status -- Disabled before age 31

- a. **“Special insured status”** allows an option to the 20/40 rule. Individuals disabled before age 31 can qualify for disability insurance benefits or establish a period of disability.
- b. The special insured status requirements are met if, in the quarter the disability is determined to have begun or in a later quarter, the individual:
 - (i) Has not yet turned 31;
 - (ii) Is fully insured; and
 - (iii) Has credits in at least one-half of the quarters during the period beginning with the quarter after the quarter the person turned 21 and ending with the quarter that the person became disabled. The credits **must** be earned in this period. If the number of elapsing quarters is an odd number, the next lower even number is used.
- c. A minimum of six credits is needed in order to have special insured status. If a person became disabled before the quarter he or she turned 24, the person must have six quarters of coverage in the 12-quarter period ending with the quarter the disability began.
- d. A person over age 31 may obtain special insured status if he or she:
 - (i) Had a previous period of disability established before age 31;
 - (ii) Met and currently meets the special insured requirements (as set out above); and
 - (iii) Currently does not meet the 20/40 rule or fully insured status requirements.
- e. A person disabled because of blindness may qualify for entitlement to disability benefits if he or she is fully insured. Blind workers are not required to meet the 20/40 rule or special insured status tests.

3. Periods of disability and insured status

An established period of disability is not counted in determining the number of credits needed to be fully or currently insured. It is also not counted when computing the benefit amount. A period of disability is not excluded in computing a person’s (or survivors’) Social Security benefits if including it would be more beneficial for the person. For example, the period of disability is counted if the person has potential credits in his or her disability period and if the potential credits would qualify the person for another benefit formula that would increase the person’s benefit rate or would give him or her insured status.

D. Social Security earnings

1. In general

Social Security credits are awarded based on “social security earnings” from wages as an employee or from self-employment income. In this section, we cover earnings that qualify. The following definitions of Social Security wages and self-employment income are used for the purposes of earning credits and the calculation of benefits.

2. Social Security wages

Wages means remuneration paid for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include that part of remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs) equal to the contribution and benefit base with respect to employment has been paid to an individual during any calendar year with respect to which such contribution and benefit base is effective, is paid to such individual during such calendar year;²

- a. “Wages” does not include the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer that makes provision for his or her employees generally (or for his or her employees generally and their dependents) or for a class or classes of his or her employees (or for a class or classes of his or her employees and their dependents), on account of:
 - (i) Sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, only payments that are received under a workmen’s compensation law are excluded from wages);³
 - (ii) Medical or hospitalization expenses in connection with sickness or accident disability;⁴ or
 - (iii) Death, but not to a payment for group-term life insurance to the extent that such payment is includable in the gross income of the employee;⁵

Note:

The contribution and benefit base is the taxable wage base under the Internal Revenue Code, discussed elsewhere in these materials.

- b. Wages do not include any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of six calendar months following the last calendar month in which the employee worked for such employer;⁶
- c. Wages do not include any payment made to, or on behalf of, an employee or his beneficiary:

² 42 U.S.C. §409(a)(1)(I).
³ 42 U.S.C. §409(a)(2)(A).
⁴ 42 U.S.C. §409(a)(2)(B).
⁵ 42 U.S.C. §409(a)(2)(C).
⁶ 42 U.S.C. §409(a)(3).

- (i) From or to a qualified trust for deferred compensation, unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust;⁷
 - (ii) Under or to a qualified annuity plan;⁸
 - (iii) Under or to a bond purchase plan;⁹
 - (iv) Under or to a qualified tax-sheltered annuity contract, other than a payment for the purchase of such contract that is made by reason of a salary-reduction agreement (whether evidenced by a written instrument or otherwise);¹⁰
 - (v) Under or to an exempt governmental deferred-compensation plan;¹¹
 - (vi) To supplement pension benefits under a plan or trust described in any of the foregoing provisions to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement, but only if such supplemental payments are under a plan that is treated as a welfare plan under ERISA;¹²
 - (vii) Under a simplified employee pension;¹³
 - (viii) Under a cafeteria plan if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that §125 would not treat any wages as constructively received;¹⁴
 - (ix) Under a SIMPLE plan, other than any elective contributions made by the employee;¹⁵ or
 - (x) Under a §457 plan.¹⁶
- d. Wages do not include the payment by an employer (without deduction from the remuneration of the employee) of the federal income-tax withholding, or any payment required from an employee under a state unemployment compensation law¹⁷ with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor;
- e. Wages do not include remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business or for domestic service in a private home of the employer;¹⁸
- (i) It also does not include cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer (including domestic service), if the cash remuneration paid in such year by the employer to the employee for such service is less than the applicable dollar threshold (as defined in Code §3121(x)) for such year;¹⁹
 - (ii) It also does not include cash remuneration paid by an employer in any calendar year to an employee for service not in the course of the employer's trade or business, if the cash remuneration paid in such year by the employer to the employee for such service is less than \$100. The term "service not in the course

⁷ 42 U.S.C. §409(a)(4)(A).
⁸ 42 U.S.C. §409(a)(4)(C).
⁹ 42 U.S.C. §409(a)(4)(D).
¹⁰ 42 U.S.C. §409(a)(4)(E).
¹¹ 42 U.S.C. §409(a)(4)(F).
¹² 42 U.S.C. §409(a)(4)(G).
¹³ 42 U.S.C. §409(a)(4)(H).
¹⁴ 42 U.S.C. §409(a)(4)(I).
¹⁵ 42 U.S.C. §409(a)(4)(J).
¹⁶ 42 U.S.C. §409(a)(4)(K).
¹⁷ 42 U.S.C. §409(a)(5).
¹⁸ 42 U.S.C. §409(a)(6)(A).
¹⁹ 42 U.S.C. §409(a)(6)(B).

of the employer's trade or business" does not include domestic service in a private home of the employer and does not include domestic service performed in the home;²⁰

- f. Wages do not include remuneration paid by an employer in any year to an employee for a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by him, if the cash remuneration paid in such year by the employer to the employee for such service is less than \$100;²¹
- g. Wages do not include remuneration paid to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable as a moving expense (determined without regard to §274(n));²²
- h. Wages do not include tips paid in any medium other than cash,²³ nor cash tips received by an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is \$20 or more;²⁴
- i. Any payment or series of payments by an employer to an employee or any of his or her dependents that is paid upon or after the termination of an employee's employment relationship because of death, or retirement for disability, and under a plan established by the employer that makes provision for his employees generally or a class or classes of his employees (or for such employees or class or classes of employees and their dependents), other than any such payment or series of payments that would have been paid if the employee's employment relationship had not been so terminated;²⁵
- j. Wages do not include any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died;²⁶
- k. Wages do not include any payment made by an employer to an employee, if at the time such payment is made such employee is entitled to disability insurance benefits and such entitlement commenced prior to the calendar year in which such payment is made, and if such employee did not perform any services for such employer during the period for which such payment is made;²⁷
- l. Wages do not include remuneration paid by an organization exempt from income tax in any calendar year to an employee for service rendered in the employ of such organization, if the remuneration paid in such year by the organization to the employee for such service is less than \$100;²⁸
- m. Any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income as an educational benefit or dependent care payment;²⁹

²⁰ 42 U.S.C. §409(a)(6)(A).
²¹ 42 U.S.C. §409(a)(8).
²² 42 U.S.C. §409(a)(9).
²³ 42 U.S.C. §409(a)(10)(A).
²⁴ 42 U.S.C. §409(a)(10)(B).
²⁵ 42 U.S.C. §409(a)(11).
²⁶ 42 U.S.C. §409(a)(12).
²⁷ 42 U.S.C. §409(a)(13).
²⁸ 42 U.S.C. §409(a)(14)(A).
²⁹ 42 U.S.C. §409(a)(8).

- n. The value of any meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income;³⁰ or
- o. Any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income as a scholarship or statutory fringe benefit.³¹
- p. Nonqualified deferred compensation under a nonqualified deferred compensation plan is taken into account for Social Security purposes as of the later of when the services are performed, or when there is no substantial risk of forfeiture of the rights to such amount. Any amount so taken into account as wages (and the income attributable thereto) is not thereafter treated as wages for Social Security purposes.³²

Note:

By way of anticipation, because nonqualified deferred compensation is generally wages (though not income) to the individual before an individual receives retirement benefits, an individual does not lose benefits on account of such income when he or she receives Social Security benefits.

3. Net earnings from self-employment

Net earnings from self-employment means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed under the Internal Revenue Code that are attributable to such trade or business, plus his or her distributive share (whether or not distributed) of the ordinary net bottom-line income or loss from any trade or business carried on by a partnership of which he or she is a member; except that in computing such gross income and deductions and such distributive share of partnership ordinary net income or loss, the following will be excluded or included as noted.

- a. Excluded are rentals from real estate and from personal property leased with the real estate (including such rentals paid in crop shares), together with the deductions attributable thereto, unless such rentals are received in the course of a trade or business as a real estate dealer; except that the preceding provisions shall not apply to any income derived by the owner or tenant of land if:
 - (i) Such income is derived under an arrangement, between the owner or tenant and another individual, which provides that such other individual shall produce agricultural or horticultural commodities on such land, and that there shall be material participation by the owner or tenant (as determined without regard to any activities of an agent of such owner or tenant) in the production or the management of the production of such agricultural or horticultural commodities; and
 - (ii) There is material participation by the owner or tenant (as determined without regard to any activities of an agent of such owner or tenant) with respect to any such agricultural or horticultural commodity.³³

³⁰ 42 U.S.C. §409(a)(8).

³¹ 42 U.S.C. §409(a)(8).

³² 42 U.S.C. §409(j).

³³ 42 U.S.C. §411(a)(1).

- b. Also excluded are dividends on any share of stock, and interest on any bond, debenture, note, or certificate, or other evidence of indebtedness, issued with interest coupons or in registered form by any corporation, unless such dividends and interest are received in the course of a trade or business as a dealer in stocks or securities.³⁴
- c. “Net earnings” further excludes any gain or loss:
- That is considered as gain or loss from the sale or exchange of a capital asset;³⁵
 - From the cutting of timber, or the disposal of timber, coal, or iron ore, if §631 of the Internal Revenue Code of 1986 applies to such gain or loss;³⁶ or
 - From the sale, exchange, involuntary conversion, or other disposition of property if such property is neither stock in trade or other property of a kind that would properly be includable in inventory if on hand at the close of the taxable year, nor property held primarily for sale to customers in the ordinary course of the trade or business.³⁷
- d. The deduction for net operating losses is not allowed.³⁸
- e. If any of the income derived from a trade or business (other than a trade or business carried on by a partnership) is community income under community-property laws applicable to such income, all of the gross income and deductions attributable to such trade or business shall be treated as the gross income and deductions of the husband unless the wife exercises substantially all of the management and control of such trade or business, in which case all of such gross income and deductions shall be treated as the gross income and deductions of the wife.³⁹ Issues regarding same sex couples were greatly impacted by the *Obergefell* decision, which is discussed below.
- f. If any portion of a partner’s distributive share of the ordinary net income or loss from a trade or business carried on by a partnership is community income or loss under the community property laws applicable to such share, all of such distributive share shall be included in computing the net earnings from self-employment of such partner, and no part of such share shall be taken into account in computing the net earnings from self-employment of the spouse of such partner.⁴⁰
- g. Amounts received by a partner pursuant to a written plan of the partnership, which meets such requirements as are prescribed by the Secretary of the Treasury or his delegate, and which provides for payments on account of retirement, on a periodic basis, to partners generally or to a class or classes of partners, such payments to continue at least until such partner’s death, are excluded if:
- Such partner rendered no services with respect to any trade or business carried on by such partnership (or its successors) during the taxable year of such partnership (or its successors), ending within or with his taxable year, in which such amounts were received;⁴¹
 - No obligation exists (as of the close of the partnership’s taxable year referred to in the preceding paragraph) from the other partners to such partner except with respect to retirement payments under such plan;⁴² and

³⁴ 42 U.S.C. §411(a)(2).

³⁵ 42 U.S.C. §411(a)(3)(A).

³⁶ 42 U.S.C. §411(a)(3)(B).

³⁷ 42 U.S.C. §411(a)(3)(C).

³⁸ 42 U.S.C. §411(a)(4).

³⁹ 42 U.S.C. §411(a)(5)(A).

⁴⁰ 42 U.S.C. §411(a)(5)(B).

⁴¹ 42 U.S.C. §411(a)(9)(A).

⁴² 42 U.S.C. §411(a)(9)(B).

- Such partner's share, if any, of the capital of the partnership has been paid to him in full before the close of the partnership's taxable year.⁴³
- h. In lieu of the deduction provided by §164(f) relating to deduction for one-half of self-employment taxes, there is allowed a deduction equal to the product of:
 - The taxpayer's net earnings from self-employment for the taxable year (determined without regard to this),⁴⁴ and
 - One-half of the sum of the rates for OASDI and Medicare imposed by the Code for such year.⁴⁵
- i. Also excluded is the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.⁴⁶
- j. The deduction for health insurance costs of self-employed individuals is not allowed.⁴⁷
- k. If the taxable year of a partner is different from that of the partnership, the distributive share that he is required to include in computing his net earnings from self-employment shall be based upon the ordinary net income or loss of the partnership for any taxable year of the partnership ending within or with his taxable year.

4. Self-employment income

The term "self-employment income" means the net earnings from self-employment derived by an individual;⁴⁸ except that such term does not include that part of the net earnings from self-employment which is in excess of an amount equal to the contribution and benefit base which is effective for such calendar year, minus the amount of the wages paid to such individual during such taxable year;⁴⁹ or the net earnings from self-employment, if such net earnings for the taxable year are less than \$400.⁵⁰

5. Partner's taxable year ending as result of death

In computing a partner's net earnings from self-employment for his taxable year that ends as a result of his death (but only if such taxable year ends within, and not with, the taxable year of the partnership), so much of the deceased partner's distributive share of the partnership's ordinary income or loss for the partnership taxable year as is not attributable to an interest in the partnership during any period beginning on or after the first day of the first calendar month following the month in which such partner died is included. For these purposes:

- In determining the portion of the distributive share which is attributable to any period specified in the preceding sentence, the ordinary income or loss of the partnership shall be treated as having been realized or sustained ratably over the partnership taxable year;⁵¹ and
- The term "deceased partner's distributive share" includes the share of his estate or of any other person succeeding, by reason of his death, to rights with respect to his partnership interest.⁵²

⁴³ 42 U.S.C. §411(a)(9)(C).
⁴⁴ 42 U.S.C. §411(a)(11)(A).
⁴⁵ 42 U.S.C. §411(a)(11)(B).
⁴⁶ 42 U.S.C. §411(a)(12).
⁴⁷ 42 U.S.C. §411(a)(15).
⁴⁸ 42 U.S.C. §411(b).
⁴⁹ 42 U.S.C. §411(b)(1)(I).
⁵⁰ 42 U.S.C. §411(b)(2).
⁵¹ 42 U.S.C. §411(g)(1).
⁵² 42 U.S.C. §411(g)(1).

6. Regular basis

An individual is deemed to be self-employed on a regular basis in a taxable year, or to be a member of a partnership on a regular basis in such year, if he had net earnings from self-employment of not less than \$400 in at least two of the three consecutive taxable years immediately preceding such taxable year from trades or businesses carried on by such individual or such partnership.⁵³

7. Crediting income to calendar years

For the purposes of determining average indexed monthly earnings, average monthly wage, and quarters of coverage the amount of self-employment income derived during any taxable year shall:

- a. In the case of a taxable year that is a calendar year or that begins with or during a calendar year and ends with or during such year, be credited to such calendar year;⁵⁴ and
- b. In the case of any other taxable year, be allocated proportionately to the two calendar years, portions of which are included within such taxable year, on the basis of the number of months in each such calendar year that are included completely within the taxable year. For these purposes, the calendar month in which a taxable year ends shall be treated as included completely within that taxable year.⁵⁵

Mini-Case 1: A self-employed person has a fiscal taxable year beginning June 1, 2023, and ending May 31, 2024. His \$6,000 self-employment income is allocated \$3,500 (7/12) to calendar year 2023 and \$2,500 (5/12) to 2024.

III. Benefits

A. Summary of requirements for insured status and benefit eligibility

This chart summarizes the various ways that an individual may qualify for benefits based on his or her own Social Security record or by relationship to an eligible worker. These various statuses will be discussed in detail through the remainder of the chapter.

| Summary of Insured Status Requirements ⁵⁶ | |
|---|---|
| Monthly Social Security benefits can be paid to... | If the worker... |
| A retired worker age 62 or over. | Is fully insured (40 credits). |
| A disabled worker under normal retirement age. | Would have been fully insured had he or she turned 62 in the month the disability began. The worker also needs 20 credits out of the 40 calendar quarters ending with the quarter that the disability began. Note: This does not apply in the case of a person disabled because of blindness. See §507. |
| A worker disabled before age 31 who does not have sufficient credits to meet 20/40 requirement. Note: Special insured status may apply to a worker who becomes disabled after age 31, provided the individual had a period of disability prior to age 31. | Has credits in one-half of the quarters elapsing in the period after turning 21 and up to and including the quarter of becoming disabled. The worker needs at least six credits; or if disabled in a quarter before turning 24, he or she needs six credits in the 12 calendar-quarter period immediately before becoming disabled. |

⁵³ 42 U.S.C. §411(g).
⁵⁴ 42 U.S.C. §412(b)(1).
⁵⁵ 42 U.S.C. §412(b)(2).
⁵⁶ *Social Security Handbook*, §211.

| | |
|---|--|
| Worker disabled due to blindness. | Has at least one credit for each year after turning 21 (or 1950, if later) up to the year the qualifying credit is earned. Must have a minimum of six credits. |
| The spouse of a person entitled to disability or retirement insurance benefits, if he or she is: (i) age 62 or over (may be divorced spouse in certain circumstances); or (ii) caring for a child who is under age 16, or a child under a disability that began before the child reached age 22 and entitled to benefits. | Is fully insured or insured for disability benefits, whichever is applicable as shown above. |
| A dependent, unmarried child of a person entitled to disability or retirement insurance benefits if the child is: (i) under 18; (ii) under 19 and a full-time elementary or secondary school student; or (iii) age 18 or over and under a disability that began before the child turned 22. | Is insured for retirement or disability benefits, whichever is applicable, as shown above. |
| A widow(er) (may be surviving divorced spouse in certain circumstances) age 60 or over. | Is fully insured. |
| A widow(er) and, under certain conditions, a surviving divorced spouse, if the widow(er), or divorced spouse is caring for a child entitled to benefits if the child is under 16 or disabled. | Is either fully or currently insured. |
| A disabled widow(er) (may be surviving divorced spouse in certain circumstances) age 50 or over but under age 60 whose disability began within a certain period. | Is fully insured. |
| A dependent, unmarried child of a deceased worker if the child is: (i) under 18; (ii) under 19 and a fulltime elementary or secondary school student; or (iii) age 18 or over and under a disability that began before the child turned 22. | Is either fully or currently insured. |
| The dependent parents age 62 or over of the deceased worker. | Is fully insured. |

B. Retirement (old-age) benefits

1. In general

To qualify for old-age benefits, an individual must satisfy three requirements:

- The individual is fully insured;
- The individual had reached age 62; and
- The individual has filed an application for such benefits or was qualified for disability insurance benefits for the month preceding the month in which he attained retirement age.⁵⁷

2. Retirement age

Although an individual may retire at age 62, the benefit will be reduced. The reductions to benefits for early retirement are discussed in Chapter 2.

- a. The **early retirement age** means age 62 in the case of an old-age, spouse's insurance benefit, and **age 60** in the case of a surviving spouse's insurance benefit.⁵⁸

⁵⁷ 42 U.S.C. §402(a)(1)-(3).

⁵⁸ 42 U.S.C. §416(l)(2).

Note:

Bear in mind that “early retirement” only has meaning if the individual on whose earnings records benefits are to be based is fully insured. The amount of the benefits may be reduced, as explained later, for an early retiree, but the retiree who is eligible by reason of the requisite number of credits or quarters receives some benefits; those who retire at full retirement age but lack the requisite quarters or credits receive nothing.

- b. The **full retirement age** (or normal retirement age) is defined as a fixed age that depends on when the individual attains the early retirement age.
- (i) For those who attained early retirement age after December 31, 1999, and before January 1, 2005, it is 65 years of age plus the number of months in the age increase factor for the calendar year in which such individual attains early retirement age;⁵⁹
 - (ii) For those who attained early retirement age after December 31, 2004, and before January 1, 2017, it is 66 years of age;⁶⁰
 - (iii) For those who attained early retirement age after December 31, 2016, and before January 1, 2022, it is 66 years of age plus the number of months in the age increase factor for the calendar year in which such individual attains early retirement age;⁶¹ and
 - (iv) For those who attained early retirement age after December 31, 2021, it is 67 years of age.⁶²

Note:

The age increase factor for any individual who attains early retirement age in such calendar year is equal to two-twelfths of the number of months in the period beginning with January 2000 and ending with December of the year in which the individual attains early retirement age.⁶³
The age increase factor for any individual who attains early retirement age in such calendar year is equal to two-twelfths of the number of months in the period beginning with January 2017 and ending with December of the year in which the individual attains early retirement age.⁶⁴

| Full Retirement Age for Workers and Spouses Born after 1937 | |
|--|------------------------------------|
| If birth date is | Then full retirement age is |
| 1/2/38-1/1/39 | 65 years and 2 months |
| 1/2/39-1/1/40 | 65 years and 4 months |
| 1/2/40-1/1/41 | 65 years and 6 months |
| 1/2/41-1/1/42 | 65 years and 8 months |
| 1/2/42-1/1/43 | 65 years and 10 months |
| 1/2/43-1/1/55 | 66 years |
| 1/2/55-1/1/56 | 66 years and 2 months |
| 1/2/56-1/1/57 | 66 years and 4 months |
| 1/2/57-1/1/58 | 66 years and 6 months |
| 1/2/58-1/1/59 | 66 years and 8 months |
| 1/2/59-1/1/60 | 66 years and 10 months |
| 1/2/60 and later | 67 years |

⁵⁹ 42 U.S.C. §416(l)(1)(B).
⁶⁰ 42 U.S.C. §416(l)(1)(C).
⁶¹ 42 U.S.C. §416(l)(1)(D).
⁶² 42 U.S.C. §416(l)(1)(E).
⁶³ 42 U.S.C. §416(l)(3)(A).
⁶⁴ 42 U.S.C. §416(l)(3)(B).

| Full Retirement Age for Widow(er)s born after 1939 | |
|--|-----------------------------|
| If birth date is | Then full retirement age is |
| 1/2/40-1/1/41 | 65 years and 2 months |
| 1/2/41-1/1/42 | 65 years and 4 months |
| 1/2/42-1/1/43 | 65 years and 6 months |
| 1/2/43-1/1/44 | 65 years and 8 months |
| 1/2/44-1/1/45 | 65 years and 10 months |
| 1/2/45-1/1/57 | 66 years |
| 1/2/57-1/1/58 | 66 years and 2 months |
| 1/2/58-1/1/59 | 66 years and 4 months |
| 1/2/59-1/1/60 | 66 years and 6 months |
| 1/2/60-1/1/61 | 66 years and 8 months |
| 1/2/61-1/1/62 | 66 years and 10 months |
| 1/2/62 and later | 67 years |

Note:

The gap between early retirement age and full retirement age is growing because the early retirement age is fixed while the full retirement age is increasing to older age levels.

3. When do benefits begin?

Old-age insurance benefit is paid for each month, beginning with the first month in which such individual meets the three criteria specified above if the individual has reached the full retirement age.⁶⁵

Note:

However, in the case of an individual who has attained age 62, but has not attained full retirement age, the first month throughout which such individual meets the insured status and age criteria specified in the first two bullets (and if in that month he meets the third bullet), benefits will begin.⁶⁶ In other words, one must make an application to receive benefits earlier than full retirement age.

- Mini-Case 2:** Joe has reached his full retirement age, and he needs one more quarter to become fully insured. If Joe makes \$1,730 in the next month, he will become fully insured and, upon application, he can have retirement benefits begin at that time.
- Mini-Case 3:** Jerry is fully insured and age 61. He will have to wait one year until he attains age 62 before he can, upon application, receive old-age benefits. The benefits will be reduced for early retirement.
- Mini-Case 4:** Jim has reached his full retirement age, and he is fully insured. He does not make application to Social Security. He will not receive retirement benefits.

4. When do benefits end?

The benefits end with the **month preceding the month in which he dies.**⁶⁷

Note:

This means that in some cases Social Security benefits for a month that have been received will have to be returned. One does not "earn" a monthly check unless one survives the month with respect of which it is paid.

⁶⁵ 42 U.S.C. §402(a)(3)(A).
⁶⁶ 42 U.S.C. §402(a)(3)(B).
⁶⁷ 42 U.S.C. §402(a)(3)(B).

Mini-Case 5: Jules receives his check by direct deposit for the month of May on June 1. He died on May 31. The amount of the May check must be remitted to Social Security.

5. What is the amount of the benefit?

In general, an individual's old-age insurance benefit for any month shall be equal to his or her **primary insurance amount**.⁶⁸ This amount is adjusted downward for early retirement⁶⁹ and upward for a delayed retirement.⁷⁰

Planning note:

The worker has to take into account that the amount of the retirement benefit and **all other benefits deriving from it** depends not only on the worker's earnings record, but also on the time at which the benefits begin and the amount of the reduction or enhancement from the baseline of retirement benefits at full retirement age. Making the decision to retire early or late has economic consequences that should be analyzed beforehand.

C. Spousal benefits

1. Who is a spouse?

A spouse (or a divorced spouse) of an eligible worker may qualify for spousal benefits.

A **spouse** means a wife or husband.⁷¹

- a. A wife is a wife of an individual, but only if she meets one of three conditions:
 - (i) She is the mother of his son or daughter;⁷²

Mini-Case 6: June married Jim; nine months later she has a child, and Jim, then fully insured, retires. Although June applied less than one year after her marriage to Jim, she may apply to Social Security as Jim's spouse.

- (ii) She was married to him for a period of not less than one year immediately preceding the day on which her application is filed,⁷³ or

Mini-Case 7: June has been married to Jim for 15 years when Jim retires fully insured. For Social Security purposes, June is Jim's spouse immediately.

Mini-Case 8: Judy, age 61, marries Jim, who has retired fully insured and receives benefits. Judy must wait one year before she can apply to Social Security as Jim's spouse.

- (iii) In the month prior to the month of her marriage to him she was entitled to, or is on application for them and upon attainment of age 62 in such prior month would have been entitled to, benefits for a wife, a widow, or a parent;

⁶⁸ 42 U.S.C. §402(a).

⁶⁹ 42 U.S.C. §402(q).

⁷⁰ 42 U.S.C. §402(w).

⁷¹ 42 U.S.C. §416(a)(1).

⁷² 42 U.S.C. §416(b)(1).

⁷³ 42 U.S.C. §416(b)(2). For these purposes, a wife shall be deemed to have been married to an individual for a period of one year throughout the month in which occurs the first anniversary of her marriage to such individual.

Mini-Case 9: June, the widow of Jerry and entitled to a widow's benefit, marries Jim who is fully insured and receiving benefits. June can immediately apply to Social Security as Jim's spouse.

Planning point:

As discussed below, one can become entitled to multiple benefits, but the rule is that only one cannot fully receive all these benefits. An individual, when he or she becomes entitled to a separate benefit, must determine whether the new benefit is larger than the current benefit and, in such case, apply for the new benefit. These calculations become important only if one is aware of the various qualifications and conditions that must be met for specific benefits.

In the preceding example, June might be entitled to a larger spousal benefit as Jim's spouse than to a widow's benefit as Jerry's widow. However, if she were not so entitled to these other benefits, June would have to wait one year before she could make a claim to Social Security as Jim's spouse.

- She had attained age 18 and was entitled to, or on application for them would have been entitled to, benefits for a divorced spouse (subject, however, to the limitations with respect to a nondisabled child age 16 and older);⁷⁴ or
- She was entitled to, or upon application for it and attainment of the required age (if any) would have been entitled to, a widow's, child's (after attainment of age 18), or parent's insurance annuity under §231a of title 45.⁷⁵

Note:

There are actually three distinct concepts involved in the material's use of the term "nondisabled child age 16 or over." However, the most important one is that of a child who is entitled to child's insurance benefits for any month, and who has attained the age of 16 but is not under a disability in such month, shall be deemed not entitled to such benefits for such month, unless he was under such a disability in the third month before such month.⁷⁶

- b. A **husband** is a husband of an individual, but only if he **meets one of three conditions:**
- (i) He is the father of her son or daughter;⁷⁷
 - (ii) He was married to her for a period of not less than one year immediately preceding the day on which his application is filed;⁷⁸ or
 - (iii) In the month prior to the month of his marriage to her:⁷⁹
 - He was entitled to, or on application for them and with attainment of age 62 in such prior month would have been entitled to, benefits for a husband, a widower, or a parent,⁸⁰
 - He had attained age 18 and was entitled to, or on application for them would have been entitled to, benefits for a divorced spouse (subject,

⁷⁴ 42 U.S.C. §416(b)(3)(B).

⁷⁵ 42 U.S.C. §416(b)(3)(C).

⁷⁶ 42 U.S.C. §402(s)(1).

⁷⁷ 42 U.S.C. §416(f)(1).

⁷⁸ 42 U.S.C. §416(f)(2). For these purposes, a husband shall be deemed to have been married to an individual for a period of one year throughout the month in which occurs the first anniversary of his marriage to such individual.

⁷⁹ 42 U.S.C. §416(f)(3).

⁸⁰ 42 U.S.C. §416(f)(3)(A).

however, to the limitations with respect to a nondisabled child age 16 and older);⁸¹ or

- He was entitled to, or upon application for it and attainment of the required age (if any) would have been entitled to, a widower's, child's (after attainment of age 18), or parent's insurance annuity under §231a of title 45.⁸²

2. Who is a divorced spouse?

The terms divorce and divorced refer to a *divorce a vinculo matrimonii*.⁸³

- a. The term divorced wife means a woman divorced from an individual, but only if she had been married to such individual for a period of 10 years immediately before the date the divorce became effective.⁸⁴ The term divorced husband means a man divorced from an individual, but only if he had been married to such individual for a period of 10 years immediately before the date the divorce became effective.⁸⁵

Mini-Case 10: June marries Jim when both are age 57. Nine years later marital difficulties arise. If June divorces Jim, then she will be unable to claim the status of Jim's divorced wife (or Jim's surviving divorced wife when Jim dies), thereby cutting off access to Jim's earnings as a basis for any entitlement to Social Security benefits. If, instead, she and Jim agree not to divorce for a period of at least one year, even though separated, June may be able to claim benefits based on whichever of these statuses applies in the future.

3. Spousal benefits in general

The wife and every divorced wife,⁸⁶ or the husband or divorced husband,⁸⁷ of an individual is entitled to old-age or disability insurance benefits, if such spouse or divorced spouse meets four requirements:

- The spouse has filed an application for spousal benefits;⁸⁸
- The spouse has attained age 62, or (in the case of a spouse) has in his or her care (individually or jointly with such individual) at the time of filing such application a child entitled to a child's insurance benefit on the basis of the wages and self-employment income of such individual;⁸⁹

Mini-Case 11: Judy, age 60, is the spouse of Jim, age 62, who is fully insured and has elected to retire early and commence Social Security benefits. She is not entitled to any retirement benefits based on her own earnings record. Judy must wait until she reaches age 62 before she can apply for and receive spousal benefits based on Jim's earnings.

Mini-Case 12: Judy, age 62, is the spouse of Jim, who has reached full retirement age and is fully insured, has elected to commence Social Security benefits. Judy is not entitled to any retirement benefits based on her own earnings record. She may apply for spousal benefits immediately as Jim's spouse.

- In the case of a divorced spouse, the ex-spouse is **not married**;⁹⁰ and

⁸¹ 42 U.S.C. §416(f)(3)(B).

⁸² 42 U.S.C. §416(f)(3)(C).

⁸³ 42 U.S.C. §416(d)(8).

⁸⁴ 42 U.S.C. §416(d)(1).

⁸⁵ 42 U.S.C. §416(d)(4).

⁸⁶ 42 U.S.C. §402(b).

⁸⁷ 42 U.S.C. §402(c).

⁸⁸ 42 U.S.C. §402(b)(1)(A); 42 U.S.C. §402(c)(1)(A).

⁸⁹ 42 U.S.C. §402(b)(1)(B); 42 U.S.C. §402(c)(1)(B).

⁹⁰ 42 U.S.C. §402(b)(1)(C); 42 U.S.C. §402(c)(1)(C).

Note:

For these purposes, a divorced wife is deemed not to be married throughout the month in which she becomes divorced. This should be contrasted with benefits of a surviving divorced spouse who may be entitled to a survivor's benefits even if remarried.

- The spouse is not entitled to old-age or disability insurance benefits or is entitled to old-age or disability insurance benefits based on a primary insurance amount that is less than one-half of the primary insurance amount of such individual.⁹¹

Note:

The spouse is entitled to only one benefit at a time, in this case the larger of the spousal benefit or her own benefit derived from her own earnings record. Note that the comparison here is between the primary insurance amounts and not the benefits. The individual worker may have elected early retirement, which, as will be discussed later, reduces the benefit that is payable from what would be payable starting at full retirement age.

Reminder:

The Primary Insurance Amount (PIA) is the amount a worker may draw at full retirement age. The calculation is discussed in detail in Chapter 2.

4. When do the spousal benefits begin?

The spousal benefit begins with the first month in which the spouse meets the four above criteria for a spouse or divorced spouse of an individual entitled to old-age benefits.⁹²

- a. Due to changes made by the Bipartisan Budget Act of 2015, a spouse may not draw a spousal benefit unless the worker (the other spouse) is actually drawing a benefit. Under old law, the one spouse could file and suspend benefits, and the other spouse could still draw a spousal benefit. Now, if a worker files and suspends benefits, family member benefits are also suspended. However, some individuals are grandfathered into the old law. This is discussed in more detail elsewhere.
- b. A divorced spouse is not dependent upon the ex-spouse's pay status. Once the ex-spouse reaches age 62, the divorced spouse may begin benefits.

Note:

Although the spouse and divorced spouse become eligible for benefits at age 62, the benefits are reduced. The amount of the reduction is discussed in detail in Chapter 2.

5. When do spousal benefits end?

Spousal benefits **end** with the month preceding the month in which any of the following occurs:

- The spouse dies;⁹³
- The individual (the eligible worker upon whose benefits the spousal benefit is based) dies;⁹⁴

⁹¹ 42 U.S.C. §402(b)(1)(D); 42 U.S.C. §402(c)(1)(D).

⁹² 42 U.S.C. §402(b)(1)(D)(i); 42 U.S.C. §402(c)(1)(D)(i).

⁹³ 42 U.S.C. §402(b)(1)(E), §402(c)(1)(E).

⁹⁴ 42 U.S.C. §402(b)(1)(F), §402(c)(1)(F).

Note:

However, if the spousal benefit ends because the individual upon whose benefits the spousal benefit is based dies, the spouse will likely qualify for survivor benefits.

- In the case of a spouse, they are divorced⁹⁵ and either:
 - (i) The spouse has not attained age 62;⁹⁶ or
 - (ii) The spouse has attained age 62 but has not been married to such individual for a period of 10 years immediately before the date the divorce became effective;⁹⁷

Mini-Case 13: Judy was the spouse of Jim, who was fully insured and receiving benefits. She was 25 and had a child in care entitled to a children's benefit based on Jim's work record. At the time of her application, they had been married for one year. Three years after her spousal benefits began, she and Jim divorce. Judy's benefits as a spouse of Jim cease for the month preceding the divorce.

- In the case of a divorced spouse, the ex-spouse marries a person other than such individual;⁹⁸

Note:

In the case of any divorced wife who marries (i) an individual entitled to benefits as a spouse, or surviving spouse, or (ii) an individual who has attained the age of 18 and is entitled to benefits as a child, such divorced spouse's entitlement to benefits shall not (but subject to the limitation of nondisabled child age 16 or over) be terminated by reason of such marriage.⁹⁹

- In the case of a spouse who has not attained age 62, no child of such individual is entitled to a child's insurance benefit;¹⁰⁰
- The spouse becomes entitled to an old-age or disability insurance benefit based on a primary insurance amount that is equal to or exceeds one-half of the primary insurance amount of such individual;¹⁰¹ or
- The individual is not entitled to disability insurance benefits and is not entitled to old-age insurance benefits.

6. What is the amount of spousal benefits?

Except in the case of an early retirement of the individual, the **spousal benefit** for each month is one-half of the primary insurance amount of the individual (or, in the case of a divorced spouse, his or her former spouse) for such month.¹⁰²

7. Divorced spouse

In general, the divorced spouse of an individual who is not entitled to old-age or disability insurance benefits, but who has attained age 62 and is a fully insured individual, if such divorced spouse¹⁰³ (i) meets the four requirements for spousal entitlement, and (ii) has been divorced from such insured individual for not less than two years, is entitled to a spouse's insurance benefit for each month, in such amount, and

⁹⁵ 42 U.S.C. §402(b)(1)(G), §402(c)(1)(G).

⁹⁶ 42 U.S.C. §402(b)(1)(G)(i), §402(c)(1)(G)(i).

⁹⁷ 42 U.S.C. §402(b)(1)(G)(ii), §402(c)(1)(G)(ii).

⁹⁸ 42 U.S.C. §402(b)(1)(H), §402(c)(1)(H).

⁹⁹ 42 U.S.C. §402(b)(3), §402(c)(3).

¹⁰⁰ 42 U.S.C. §402(b)(1)(I), §402(c)(1)(I).

¹⁰¹ 42 U.S.C. §402(b)(1)(J), §402(c)(1)(J).

¹⁰² 42 U.S.C. §402(b)(2), §402(c)(2).

¹⁰³ 42 U.S.C. §402(b)(5)(A), §402(c)(5)(A).

beginning and ending with such months, as determined in the manner otherwise provided for spousal insurance benefits, as if such insured individual had become entitled to old-age insurance benefits on the date on which the divorced spouse first meets the two above criteria for entitlement. A spouse's insurance benefit so provided that has not otherwise terminated terminates with the month preceding the first month in which the insured individual is no longer a fully insured individual.¹⁰⁴

Plain English:

A divorced spouse that meets the definition of a divorced spouse above (married to the individual for more than ten years, not remarried, and has been divorced for at least two years) can draw a spousal benefit if the individual to whom they were married is eligible for benefits and chooses not to receive benefits yet. So, an individual worker is fully insured and is eligible to receive benefits at age 62. The individual chooses to wait until full retirement age or later to begin receiving a benefit. They are not in "pay status." The divorced spouse can begin drawing a benefit although the worker is not yet receiving a benefit. Under current law, a current spouse cannot draw until the individual is actually receiving a benefit.

Discussion:

Mary is fully insured and has just turned 62. Although Mary can receive a reduced Social Security benefit, she chooses not to. Peter has been married to Mary for several years. Since Peter is Mary's current spouse, Peter cannot draw a spousal benefit based on Mary's account until Mary is actually receiving a benefit. Paul, however, was married to Mary for 15 years. They divorced several years ago. Paul never remarried. Paul is also 62 years old. Paul can draw a spousal benefit based on Mary's account as a divorced spouse even though Mary is not yet receiving a benefit.

Is this fair to Peter?

Why do you think this provision is in the law?

Does any law have to be fair?

8. Same-sex marriage

The Supreme Court previously held in *Windsor* that Section 3 of the Defense of Marriage Act (DOMA), which provided a federal definition of marriage that limited its scope for purposes of federal law to a legal union between a man and a woman, and a spouse as only a person of the opposite sex who is a husband or wife, as unconstitutional. On June 26, 2015, the Supreme Court issued its decision in *Obergefell Et Al. v Hodges, Director, Ohio Dept. of Health, Et Al*¹⁰⁵ in which the Court held that the 14th Amendment requires a state to license marriage between same-sex couples and to recognize the same-sex marriage if lawfully licensed and performed out of state. With *Obergefell*, the Department of Justice announced that the Social Security Administration would process spousal benefit claims for same-sex couples.

9. Laws that are impacted by the demise of the DOMA

- Social Security.
- Qualified plan spousal benefits and QDROs.
- Availability of spousal rollover IRAs.
- Exclusion of health insurance premium attributable to spouse.
- COBRA rights.
- Income tax provisions (selected):

¹⁰⁴ 42 U.S.C. §402(b)(5)(B), §402(c)(5)(B).

¹⁰⁵ Cited at 135 S. Ct. 2071 (2015).

- 1) Filing status, tax rate schedules and brackets.
- 2) Dependent care credit; elderly and disabled credit; adoption expense credit.
- 3) Earned income credit.
- 4) AMT exemption and brackets.
- 5) Standard deduction.
- 6) Level at which itemized deductions begin to phase out.
- 7) Alimony inclusion.
- 8) Social Security inclusion.
- 9) Amounts received from health plans and contributions made to a health plan.
- 10) Exclusion of gain from sale of principal residence.
- 11) Dependent care programs.
- 12) Statutory fringe benefits.
- 13) Exclusion from certain savings bonds used for education.
- 14) Definition of dependent.
- 15) Charitable contributions.
- 16) Medical expense deduction.
- 17) Alimony deduction.
- 18) Deduction for contributions to an IRA.
- 19) Transactions between related parties.
- 20) Entertainment expenses.
- 21) Constructive ownership of stock.
- 22) Various provisions of retirement plans, including survivor annuities.
- 23) Attribution of participation in connection with passive activities.
- 24) Various provisions of trust taxation, including income in the case of divorce and definitions of IRD.
- 25) Exclusion of foreign earned income and housing.
- 26) Basis of property acquired from a decedent or by gifts and transfers in trust.
- 27) Transfers between spouses and ex-spouses.
- 28) Rollovers of small business investment companies.
- 29) Straddles.
- 30) Exclusion of gain from disposition of small business stock.
- 31) Limitation on capital losses.
- 32) Gains and losses from short sales.
- 33) Gains on sales of depreciable property to a related taxpayer.
- 34) Losses on disposition of small business stock.
- 35) Definition of an S corporation.
- 36) Definition of self-employment income.
- 37) Imposition and rate of estate tax.
- 38) Credits for gift tax, prior transfers, foreign death taxes.
- 39) Inclusion of dower, certain gifts made within 3 years of death, transfers taking effect at death, and joint interests.
- 40) Estate expenses.
- 41) Deduction for bequests to spouse.
- 42) Qualified domestic trusts.
- 43) Split gifts.
- 44) Property settlements.
- 45) Disclaimers.

- 46) Lifetime transfers to spouse.
- 47) Various provisions related to generation-skipping.
- 48) Definitions related to FICA, FUTA, and federal income tax withholding.
- 49) Persons required to file income tax returns.
- 50) Joint returns.
- 51) Failure to pay estimated tax.
- 52) Definitions.
- 53) Treatment of long-term care insurance.
- 54) Determination of marital status.

10. Effect of the Windsor decision and Rev. Rul. 2013-17

In the *Windsor* decision, the Supreme Court held on June 26, 2013 that Section 3 of DOMA is unconstitutional because it violates Fifth Amendment principles. Subsequent to the *Windsor* decision, the Service held the following.¹⁰⁶

- a. For federal tax purposes, the terms “spouse,” “husband and wife,” “husband,” and “wife” include an individual married to a person of the same sex if the individuals are lawfully married under state law, and the term “marriage” includes such a marriage between individuals of the same sex.
- b. For federal tax purposes, the Internal Revenue Service (Service) adopts a general rule recognizing a marriage of same-sex individuals that was validly entered into in a state whose laws authorize the marriage of two individuals of the same sex even if the married couple is domiciled in a state that does not recognize the validity of same-sex marriages.
- c. For federal tax purposes, the terms “spouse,” “husband and wife,” “husband,” and “wife” do not include individuals (whether of the opposite sex or the same sex) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state, and the term “marriage” does not include such formal relationships.
- d. The holdings of Rev. Rul. 2013-17 apply for all federal tax purposes, including for purposes of the federal tax rules that apply to qualified retirement plans. The ruling provides that the holdings will be applied prospectively as of September 16, 2013. The ruling also provides that taxpayers may rely on the holdings retroactively with respect to any employee benefit plan or arrangement (or any benefit provided thereunder) for limited purposes with respect to certain employer-provided health coverage and fringe benefits that are specified in the ruling.

D. Surviving spouse benefits

1. Who is a surviving spouse?

A **surviving spouse** means a widow or a widower.¹⁰⁷

- a. A **widow** (except for purposes of the lump-sum death benefit) means the surviving wife of an individual, but only if:
 - (i) She is the mother of his son or daughter¹⁰⁸ (this qualification and the qualifications in (ii), (iii), and (iv) override the qualification in (v));

¹⁰⁶ Rev. Rul. 2013-17, 2013-38 I.R.B. 201.

¹⁰⁷ 42 U.S.C. §416(a)(2).

¹⁰⁸ 42 U.S.C. §416(c)(1).

- (ii) She legally adopted his son or daughter while she was married to him and while such son or daughter was under the age of 18;¹⁰⁹
- (iii) He legally adopted her son or daughter while she was married to him and while such son or daughter was under the age of 18;¹¹⁰
- (iv) She was married to him at the time both of them legally adopted a child under the age of 18;¹¹¹
- (v) She was married to him for a period of not less than nine months immediately prior to the day on which he died;¹¹² or

Mini-Case 14: June marries Jim when both are 67, he is retired and fully-insured, and she is not entitled to a wife's, widow's, or parent's benefit in the month preceding their marriage, but was entitled to her own retirement benefit. Six months later, Jim dies. Because June was neither a mother of Jim's child, nor married for one year, she is not entitled to any of the foregoing benefits; she was at the time of marriage ineligible to be Jim's spouse for Social Security benefits purposes. Now, because she was married to him for a period of less than nine months immediately prior to the day on which he died, June cannot claim to be Jim's surviving spouse.

As noted later, June's benefit as a surviving spouse will gain her access to Jim's work record and to a retirement benefit as surviving spouse of Jim that could exceed, in this case, her retirement benefit based solely on her own earnings.

Note:

This requirement that the surviving spouse of an individual must have been married to such individual for a period of not less than nine months immediately prior to the day on which such individual died in order to qualify as such individual's widow or widower, and the requirement that the stepchild of a deceased individual must have been such stepchild for not less than nine months immediately preceding the day on which such individual died in order to qualify as such individual's child, is deemed to be satisfied where such individual dies within the applicable nine-month period if either:

- The death was accidental¹¹³ or occurred while the individual was a member of a uniformed service serving on active duty, unless the Commissioner of Social Security determines that at the time of the marriage involved the individual could not have reasonably been expected to live for nine months;¹¹⁴ or
- The widow or widower of such individual had been previously married to such individual and subsequently divorced and such requirement would have been satisfied at the time of such divorce if such previous marriage had been terminated by the death of such individual at such time instead of by divorce;¹¹⁵ or the stepchild of such individual had been the stepchild of such individual during a previous marriage of such stepchild's parent to such individual that ended in divorce and such requirement would have been satisfied at the time of such divorce if such previous marriage had been terminated by the death of such individual at such time instead of by divorce.¹¹⁶ This second bullet does not apply if the Commissioner of Social Security determines that at the time of the marriage involved, the individual could not have reasonably been expected to live for nine months.

¹⁰⁹ 42 U.S.C. §416(c)(2).

¹¹⁰ 42 U.S.C. §416(c)(3).

¹¹¹ 42 U.S.C. §416(c)(4).

¹¹² 42 U.S.C. §416(c)(5).

¹¹³ For these purposes, the death of an individual is accidental if he receives bodily injuries solely through violent, external, and accidental means and, as a direct result of the bodily injuries and independently of all other causes, loses his life not later than three months after the day on which he receives such bodily injuries.

¹¹⁴ 42 U.S.C. §416(k)(1).

¹¹⁵ 42 U.S.C. §416(k)(2)(A).

¹¹⁶ 42 U.S.C. §416(k)(2)(B).

- (vi) In the month prior to the month of her marriage to him:¹¹⁷
 - She was entitled to, or on application for them and attainment of age 62 in such prior month would have been entitled to, benefits for a wife, widow, or parent;¹¹⁸
 - She had attained age 18 and was entitled to, or on application for them would have been entitled to, benefits for a divorced spouse (subject to the limitation for a nondisabled child age 16 or older);¹¹⁹ or
 - She was **entitled to**, or upon application for it and attainment of the required age (if any) would have been entitled to, a widow's, child's (after attainment of age 18), or parent's insurance annuity under §231a of title 45.¹²⁰
- b. A **widower** (except for purposes of the lump-sum death benefit) means the surviving husband of an individual, but only if:
- (i) He is the father of his son or daughter;¹²¹
 - (ii) He legally adopted her son or daughter while he was married to her and while such son or daughter was under the age of 18;¹²²
 - (iii) She legally adopted his son or daughter while she was married to him and while such son or daughter was under the age of 18;¹²³
 - (iv) He was married to her at the time both of them legally adopted a child under the age of 18;¹²⁴
 - (v) He was married to her for a period of not less than nine months immediately prior to the day on which she died;¹²⁵ or

Note:

Please refer to the prior note above regarding this requirement.

- (vi) In the month prior to the month of his marriage to her:¹²⁶
 - He was entitled to, or on application for them and attainment of age 62 in such prior month would have been entitled to, benefits for a husband, widower, or parent;¹²⁷
 - He had attained age 18 and was entitled to, or on application for them would have been entitled to, benefits for a divorced spouse (subject to the limitation on a nondisabled child age 16 and older);¹²⁸ or
 - He was entitled to, or upon application for it and attainment of the required age (if any) would have been entitled to, a widower's, child's (after attainment of age 18), or parent's insurance annuity under §231a of title 45.¹²⁹

¹¹⁷ 42 U.S.C. §416(c)(6).
¹¹⁸ 42 U.S.C. §416(c)(6)(A).
¹¹⁹ 42 U.S.C. §416(c)(6)(B).
¹²⁰ 42 U.S.C. §416(c)(6)(C).
¹²¹ 42 U.S.C. §416(g)(1).
¹²² 42 U.S.C. §416(g)(2).
¹²³ 42 U.S.C. §416(g)(3).
¹²⁴ 42 U.S.C. §416(g)(4).
¹²⁵ 42 U.S.C. §416(g)(5).
¹²⁶ 42 U.S.C. §416(g)(6).
¹²⁷ 42 U.S.C. §416(g)(6)(A).
¹²⁸ 42 U.S.C. §416(g)(6)(B).
¹²⁹ 42 U.S.C. §416(g)(6)(C).

- c. The term surviving divorced wife means a woman divorced from an individual who has died, but only if she had been married to the individual for a period of 10 years immediately before the date the divorce became effective.¹³⁰ The term surviving divorced husband means a man divorced from an individual who has died, but only if he had been married to the individual for a period of 10 years immediately before the divorce became effective.¹³¹
- d. The term surviving divorced parent means a surviving divorced mother or a surviving divorced father.¹³²
 - (i) The term surviving divorced mother means a woman divorced from an individual who has died, but only if:¹³³
 - She is the mother of his son or daughter;¹³⁴
 - She legally adopted his son or daughter while she was married to him and while such son or daughter was under the age of 18;¹³⁵
 - He legally adopted her son or daughter while she was married to him and while such son or daughter was under the age of 18;¹³⁶ or
 - She was married to him at the time both of them legally adopted a child under the age of 18.¹³⁷
 - (ii) The term surviving divorced father means a man divorced from an individual who has died, but only if:¹³⁸
 - He is the father of her son or daughter;¹³⁹
 - He legally adopted her son or daughter while he was married to her and while such son or daughter was under the age of 18;¹⁴⁰
 - She legally adopted his son or daughter while he was married to her and while such son or daughter was under the age of 18;¹⁴¹ or
 - He was married to her at the time both of them legally adopted a child under the age of 18.¹⁴²

2. In general

The **widow or widower** and every **surviving divorced spouse** of an individual who died a **fully insured individual** is entitled to a widow's or widower's insurance benefit for each month, if such widow, widower, or such surviving divorced spouse:

- a. Is not married;¹⁴³
- b. Meets an age requirement:
 - (i) Has attained age 60;¹⁴⁴ or
 - (ii) Has attained age 50 but has not attained age 60 and is under a disability that began before the end of the measuring period defined below;¹⁴⁵

¹³⁰ 42 U.S.C. §416(d)(2).
¹³¹ 42 U.S.C. §416(d)(5).
¹³² 42 U.S.C. §416(d)(7).
¹³³ 42 U.S.C. §416(d)(3).
¹³⁴ 42 U.S.C. §416(d)(3)(A).
¹³⁵ 42 U.S.C. §416(d)(3)(B).
¹³⁶ 42 U.S.C. §416(d)(3)(C).
¹³⁷ 42 U.S.C. §416(d)(3)(D).
¹³⁸ 42 U.S.C. §416(d)(6).
¹³⁹ 42 U.S.C. §416(d)(6)(A).
¹⁴⁰ 42 U.S.C. §416(d)(6)(B).
¹⁴¹ 42 U.S.C. §416(d)(6)(C).
¹⁴² 42 U.S.C. §416(d)(6)(D).
¹⁴³ 42 U.S.C. §402(e)(1)(A).
¹⁴⁴ 42 U.S.C. §402(e)(1)(B)(i).
¹⁴⁵ 42 U.S.C. §402(e)(1)(B)(ii).

- c. Has met one of the following qualification requirements:
 - (i) Has filed application for widow's or widower's insurance benefits;¹⁴⁶
 - (ii) Was entitled to wife's (or husband's) insurance benefits, on the basis of the wages and self-employment income of such individual, for the month preceding the month in which such individual died, and:
 - Has attained full retirement age;¹⁴⁷
 - Is not entitled to old-age or disability benefits; or
 - Has in effect a certificate filed by him or her with the Commissioner of Social Security, in accordance with regulations prescribed by the Commissioner of Social Security, in which he or she elects to receive widow's or widower's insurance benefits (subject to reduction as provided for early retirement); or
 - (iii) Was entitled, on the basis of such wages and self-employment income, to mother's (or father's) insurance benefits for the month preceding the month in which he or she attained full retirement age;¹⁴⁸ AND
- d. Is not entitled to old-age insurance benefits or is entitled to old-age insurance benefits each of which is less than the primary insurance amount of such deceased individual.¹⁴⁹

3. When do benefits begin?

The month benefits begin depends on the basis of the qualification.

- a. If the basis for the claim is the unmarried status at age 60, the first month in which he or she meets all of the qualifications.¹⁵⁰ For the widow (or divorced spouse) of the deceased person, they will meet the requirements the month after the deceased person died if they meet all of the eligibility requirements. The spouse may already be receiving spousal benefits, in which case the spousal benefits will cease and survivor benefits will begin.
- b. If the claim is based on disability at age 50 the spouse must have a disability that began during the prescribed period. The prescribed period begins with the later of:
 - The month of death of the individual upon whose account his or her benefit is based;
 - The last month for which he or she was entitled to a mother's or father's benefit (still to be covered); or
 - The month in which a previous entitlement to widow's benefits ceased because his or her disability had ceased.

The prescribed period ends with the month before he or she attains age 60 or, if earlier, the close of the eighty-fourth month following the month in which the period began.

- c. If the spouse or divorced spouse satisfies the disability requirement in "b" above, the benefits will begin with the month he or she is under a disability for the entire month and is otherwise entitled to the benefits if he or she was previously entitled to benefits based on disability and the first month occurs during the prescribed period and after the previous benefits terminated. Otherwise, he or she will receive benefits after a "waiting period." The waiting period is the earliest period of five consecutive calendar months throughout which he or she has been disabled, and begins not earlier than:

¹⁴⁶ 42 U.S.C. §402(e)(1)(C)(i).
¹⁴⁷ 42 U.S.C. §402(e)(1)(C)(ii)(I).
¹⁴⁸ 42 U.S.C. §402(e)(1)(C)(ii).
¹⁴⁹ 42 U.S.C. §402(e)(1)(D).
¹⁵⁰ 42 U.S.C. §402(e)(1)(E).

- The first day of the seventeenth month before the month in which an application is filed; or
- The first day before the month in which the prescribed period begins.

Note:

For the majority of disabled spouses or divorced spouses, the general rule is that if they were disabled when the worker upon whose account his or her benefit is based died or within seven years of death, they can begin drawing benefits at age 50.

4. When do benefits end?

Benefits end with the month preceding the first month in which any of the following occurs:

- a. He or she remarries;
- b. He or she dies;
- c. He or she becomes entitled to an old-age insurance benefit equal to or exceeding the primary insurance amount of such deceased individual; or,
- d. If he or she became entitled to such benefits before she attained age 60, subject to the rules for substantial gainful activity, the termination month (unless she attains retirement age on or before the last day of such termination month). For these purposes, the termination month for any individual is the third month following the month in which the disability ceases; except that, in the case of an individual who has a period of trial work that ends as determined by application of the nine-month rule for a 60-month period, the termination month shall be the earlier of:
 - (i) The third month following the earliest month after the end of such period of trial work with respect to which such individual is determined to no longer be suffering from a disabling physical or mental impairment; or
 - (ii) The third month following the earliest month in which such individual engages or is determined able to engage in substantial gainful activity, but in no event earlier than the first month occurring after the 36 months following such period of trial work in which he or she engages or is determined able to engage in substantial gainful activity.

5. What is the amount of the benefits?

Without regard to the early retirement reduction, the federal worker cap maximum, and the maximum cap, the widow's or widower's insurance benefit for each month is generally equal to the primary insurance amount (as determined for these purposes after application of the following provision) of such deceased individual.¹⁵¹

- a. If such deceased individual was (or upon application would have been) entitled to an old-age insurance benefit that was increased (or subject to being increased) on account of **delayed retirement**, then, for these purposes, such individual's primary insurance amount, if less than the old-age insurance benefit (increased, where applicable, on account of death or cost of living as if such individual were still alive in the case of an individual who has died) which he or she was receiving (or would upon application have received) for the month prior to the month in which he or she died, shall be deemed to be equal to such old-age insurance benefit, and (notwithstanding the general provisions regarding increment months) the number of increment months shall include any month in

¹⁵¹ 42 U.S.C. §402(e)(2)(A).

the months of the calendar year in which he or she died, prior to the month in which he or she died, which satisfy the conditions for qualifying months as increment months.¹⁵²

- b. If the deceased individual (on the basis of whose wages and self-employment income a surviving spouse, or surviving divorced spouse is entitled to surviving spouse's insurance benefits) was, at any time, entitled to an old-age insurance benefit that was reduced by reason of the application of early retirement, the surviving spouse's insurance benefit of such surviving spouse or surviving divorced spouse for any month shall be reduced to the amount referred to in clause (i) below, or (if greater) the amount referred to in clause (ii) below, if the amount of the widow's insurance benefit of such surviving spouse or surviving divorced spouse (as determined under the general rule and after application of the reduction for early retirement) is greater than:
- (i) The amount of the old-age insurance benefit to which such deceased individual would have been entitled (after application of the reduction for early retirement) for such month if such individual were still living and the adjustment on account of death were applied, where applicable;¹⁵³ and
 - (ii) 82-1/2 percent of the primary insurance amount (as determined without regard to paragraph a) of such deceased individual.¹⁵⁴

6. Deemed no marriages

No marriage is deemed to have occurred if a surviving spouse, or surviving divorced spouse marries after attaining age 60 (or after attaining age 50 if he or she was entitled before such marriage occurred to benefits based on disability).¹⁵⁵ No marriage is deemed to have occurred if a disabled surviving spouse, or disabled surviving divorced spouse (who was disabled before a measuring period) marries after attaining age 50.¹⁵⁶

Mini-Case 15: Judy was married to Jim, who was fully insured. Judy was 59 when Jim died. Judy waits one year before applying for widow's benefits. One month later, she married Joe, who is not fully insured and age 60. She may now apply for widow's benefits (at age 60) based on Jim's record. Later she may be able to apply for spousal benefits based on Joe's record if he should subsequently become fully insured and have a higher PIA than Jim.

Note:

This rule against remarriages only applies to a surviving spouse's benefits. A divorced spouse who remarries during the lifetime of the worker is not entitled to a spousal benefit. However, such spouse would become eligible for a surviving spousal benefit on the death of the worker if the remarriage took place after reaching that age.

7. Disability

An individual is deemed to be under a disability for these purposes if such individual is eligible for supplemental security income benefits, or state supplementary benefits that are paid by the Commissioner of Social Security under certain agreements, for the month for which all requirements for entitlement to benefits (other than being under a disability) are met.¹⁵⁷

¹⁵² 42 U.S.C. §402(e)(2)(C).
¹⁵³ 42 U.S.C. §402(e)(2)(D)(i).
¹⁵⁴ 42 U.S.C. §402(e)(2)(D)(ii).
¹⁵⁵ 42 U.S.C. §402(e)(3)(A).
¹⁵⁶ 42 U.S.C. §402(e)(3)(B).
¹⁵⁷ 42 U.S.C. §402(e)(9).

E. Child's insurance benefits

1. Who is a child?

A **child** means one of the following.¹⁵⁸

- a. The child or legally adopted child of an individual.¹⁵⁹ For these purposes, a person shall be deemed, as of the date of an individual's death, to be the legally adopted child of such individual if such person was either living with or receiving at least one-half of his support from such individual at the time of such individual's death and was legally adopted by such individual's surviving spouse after such individual's death but only if:
 - (i) Proceedings for the adoption of the child had been instituted by such individual before his death; or
 - (ii) Such child was adopted by such individual's surviving spouse before the end of two years after the day on which such individual died; or August 28, 1958.
- b. A stepchild who has been such stepchild for not less than one year immediately preceding the day on which application for child's insurance benefits is filed, or (if the insured individual is deceased) not less than nine months immediately preceding the day on which such individual died.¹⁶⁰
 - (i) For these purposes, a person who is not the stepchild of an individual shall be deemed the stepchild of such individual if such individual was not the mother or adopting mother or the father or adopting father of such person and such individual and the mother or adopting mother, or the father or adopting father, as the case may be, of such person went through a marriage ceremony resulting in a purported marriage between them which, but for a legal impediment not known to the applicant at the time of the ceremony, would have been a valid marriage.
 - (ii) For these purposes, a child shall be deemed to have been the stepchild of an individual for a period of one year throughout the month in which occurs the expiration of such one year.
- c. A person who is the grandchild or step-grandchild of an individual or his spouse, but only if either:¹⁶¹
 - (i) There was no natural or adoptive parent (other than such a parent who was under a disability) of such person living at the time and:
 - Such individual became entitled to old-age insurance benefits or disability insurance benefits or died; or
 - If such individual had a period of disability that continued until such individual became entitled to old-age insurance benefits or disability insurance benefits, or died, at the time such period of disability began; or
 - (ii) Such person was legally adopted after the death of such individual by such individual's surviving spouse in an adoption that was decreed by a court of competent jurisdiction within the United States and such person's natural or adopting parent or stepparent was not living in such individual's household and making regular contributions toward such person's support at the time such individual died.

¹⁵⁸ 42 U.S.C. §416(e).

¹⁵⁹ 42 U.S.C. §416(e)(1).

¹⁶⁰ 42 U.S.C. §416(e)(2).

¹⁶¹ 42 U.S.C. §416(e)(3).

Note:

For these purposes, a person is deemed to have no natural or adoptive parent living (other than a parent who was under a disability) throughout the most recent month in which a natural or adoptive parent (not under a disability) dies.

2. In general

Every child of an individual entitled to old-age or disability insurance benefits, or of an individual who dies a fully or currently insured individual is entitled to a child's insurance benefit, if such child:

- (i) Has filed application for child's insurance benefits;¹⁶²
- (ii) At the time such application was filed was unmarried¹⁶³ and:
 - Either had not attained the age of 18 or was a full-time elementary or secondary school student and had not attained the age of 19; or
 - Is under a disability that began before he or she attained the age of 22; and
- (iii) Was dependent upon such individual:¹⁶⁴
 - If such individual is living, at the time such application was filed;
 - If such individual has died, at the time of such death; or
 - If such individual had a period of disability that continued until he became entitled to old-age or disability insurance benefits, or (if he or she has died) until the month of his or her death, at the beginning of such period of disability or at the time he or she became entitled to such benefits.

Note:

A child shall be deemed dependent upon his or her **stepfather or stepmother** at the time specified above if, at such time, the child was receiving **at least one-half of his or her support** from such stepfather or stepmother.¹⁶⁵

Note:

A child shall be deemed dependent upon his father or adopting father or his mother or adopting mother at the time specified unless, at such time, such individual was not living with or contributing to the support of such child and: (i) such child is neither the legitimate nor adopted child of such individual; or (ii) such child has been adopted by some other individual.

For these purposes, a child is deemed to be a child of a fully or currently insured individual because either: (i) such insured individual and the mother or father, as the case may be, of such applicant went through a marriage ceremony resulting in a purported marriage between them which, but for a legal impediment, would have been a valid marriage; or (ii) the child is otherwise deemed to be the legitimate child of such individual.¹⁶⁶

¹⁶² 42 U.S.C. §402(d)(1)(A).
¹⁶³ 42 U.S.C. §402(d)(1)(B).
¹⁶⁴ 42 U.S.C. §402(d)(1)(C).
¹⁶⁵ 42 U.S.C. §402(d)(4).
¹⁶⁶ 42 U.S.C. §402(d)(3).

Note:

In the case of an individual entitled to old-age insurance benefits (other than an individual who was entitled to disability insurance benefits for the month preceding the first month for which he was entitled to old-age insurance benefits),¹⁶⁷ or an individual entitled to disability insurance benefits, or an individual entitled to old-age insurance benefits who was entitled to disability insurance benefits for the month preceding the first month for which he was entitled to old-age insurance benefits,¹⁶⁸ a child of such individual adopted after such individual became entitled to such old-age or disability insurance benefits is **deemed not** to meet the requirements of a **dependent unless** such child either:

- Is the natural child or stepchild of such individual (including such a child who was legally adopted by such individual);¹⁶⁹ or
- Was legally adopted by such individual in an adoption decreed by a court of competent jurisdiction within the United States,¹⁷⁰ and in the case of a child who attained the age of 18 prior to the commencement of proceedings for adoption, the child was living with or receiving at least one-half of the child's support from such individual for the year immediately preceding the month in which the adoption is decreed.¹⁷¹

3. When do child's benefits begin?

A child's insurance benefit begins with the **earlier of**:

- In the case of a child of such an individual who has died, the first month such child meets the three qualification criteria above; or
- In the case of a child of an individual entitled to an old-age insurance benefit or to a disability insurance benefit, the first month throughout which such child is a child and meets the unmarried and dependency criteria (if in such month the child files the application).

4. When do child's benefits end?

A child's insurance benefit ends with the month preceding whichever of the following first occurs:

- a. The month in which such child dies, or marries;¹⁷²
- b. The month in which such child attains the age of 18, but only if he or she:
 - (i) Is not under a disability at the time he or she attains such age; and
 - (ii) Is not a full-time elementary or secondary school student during any part of such month;¹⁷³
- c. If such child was not under a disability at the time he attained the age of 18, the earlier of:¹⁷⁴
 - (i) The first month during no part of which he or she is a full-time elementary or secondary school student; or
 - (ii) The month in which he or she attains the age of 19, but only if he or she was not under a disability in such earlier month;
- d. If such child were under a disability at the time he or she attained the age of 18 or if he or she was not under a disability at such time but was under a disability at or prior to the time he or she attained (or would attain) the age of 22;¹⁷⁵

¹⁶⁷ 42 U.S.C. §402(d)(8)(A).
¹⁶⁸ 42 U.S.C. §402(d)(8)(B).
¹⁶⁹ 42 U.S.C. §402(d)(8)(C).
¹⁷⁰ 42 U.S.C. §402(d)(8)(D)(i).
¹⁷¹ 42 U.S.C. §402(d)(8)(D)(ii).
¹⁷² 42 U.S.C. §402(d)(1)(D).
¹⁷³ 42 U.S.C. §402(d)(1)(E).
¹⁷⁴ 42 U.S.C. §402(d)(1)(F).
¹⁷⁵ 42 U.S.C. §402(d)(1)(G).

- (i) The termination month, subject to the special rules for substantial gainful activity (and for purposes of this subparagraph, the termination month for any individual) shall be the third month following the month in which his or her disability ceases; except that, in the case of an individual who has a period of trial work that ends as determined by application of the nine-month rule for a 60-month period, the termination month is the earlier of:
- The third month following the earliest month after the end of such period of trial work with respect to which such individual is determined to no longer be suffering from a disabling physical or mental impairment; or
 - The third month following the earliest month in which such individual engages or is determined able to engage in substantial gainful activity, but in no event earlier than the first month occurring after the 36 months following such period of trial work in which he or she engages or is determined able to engage in substantial gainful activity);
- (ii) Or (if later) the earlier of:
- The first month during no part of which he or she is a full-time elementary or secondary school student; or
 - The month in which he or she attains the age of 19, but only if he was not under a disability in such earlier month; or
- e. If the benefits are based on the wages and self-employment income of a stepparent who is subsequently divorced from such child's natural parent, the month after the month in which such divorce becomes final.¹⁷⁶ For these purposes each stepparent shall notify the Commissioner of Social Security of any divorce upon such divorce becoming final; and the Commissioner shall annually notify any stepparent of this rule for termination and of this notification requirement.¹⁷⁷

Note:

Entitlement of any child to these benefits on the basis of the wages and self-employment income of an individual entitled to disability insurance benefits shall also end with the month before the first month for which such individual is not entitled to such benefits unless such individual is, for such later month, entitled to old-age insurance benefits or unless he or she dies in such month. No payment may be made to a child who would not meet the definition of disability except on the basis of blindness for any month in which he or she engages in substantial gainful activity.

5. What is the amount of the child's benefits?

Such child's insurance benefit for each month shall, if the individual on the basis of whose wages and self-employment income the child is entitled to such benefit has not died prior to the end of such month, be equal to one-half of the primary insurance amount of such individual for such month. Such child's insurance benefit for each month shall, if such individual has died in or prior to such month, be equal to three-fourths of the primary insurance amount of such individual.¹⁷⁸

¹⁷⁶ 42 U.S.C. §402(d)(1)(H).

¹⁷⁷ 42 U.S.C. §402(d)(10).

¹⁷⁸ 42 U.S.C. §402(d)(2).

6. Child who marries

The rights of a child to benefits are not terminated by reason of marriage in the case of a child age 18 or older who marries an individual entitled to benefits for old age, spouse, surviving spouse, parents, or mothers and fathers,¹⁷⁹ or for disability, or another individual who has attained the age of 18 and is entitled to child's benefits.¹⁸⁰

7. Re-entitlement

- a. A child whose entitlement to child's insurance benefits on the basis of the wages and self-employment income of an insured individual terminated with the month preceding the month in which such child attained the age of 18, or with a subsequent month, may again become entitled to such benefits (provided the child neither dies nor marries), provided he or she has filed an application for re-entitlement, beginning with the first month thereafter in which either:
 - (i) He or she is **either**:
 - A full-time elementary or secondary school student and has **not** attained the age of 19;¹⁸¹ or
 - Is under a disability and has not attained the age of 22;¹⁸² or
 - (ii) He or she is under a disability that began before the close of the eighty-fourth month following the month in which his or her most recent entitlement to child's insurance benefits terminated because he or she ceased to be under such disability.¹⁸³
- b. Such re-entitlement shall end with the month preceding whichever of the following first occurs:
 - (i) The first month in which marriage or death occurs;¹⁸⁴
 - (ii) The earlier of:
 - The first month during no part of which he or she is a full-time elementary or secondary school student;¹⁸⁵ or
 - The month in which he or she attains the age of 19, but only if he or she is not under a disability in such earlier month;¹⁸⁶ or
 - (iii) If he or she was under a disability, the termination month, or (if later) the earlier of:
 - The first month during no part of which he or she is a full-time elementary or secondary school student;¹⁸⁷ or
 - The month in which he or she attains the age of 19.¹⁸⁸
- c. For these purposes, a full-time elementary or secondary school student is an individual who is in full-time attendance as a student at an elementary or secondary school, as determined by the Commissioner of Social Security in the light of the standards and practices of the schools involved. However, no individual is considered a full-time elementary or secondary school student if he or she is paid by his or her employer while

¹⁷⁹ 42 U.S.C. §402(d)(5)(A).
¹⁸⁰ 42 U.S.C. §402(d)(5)(B).
¹⁸¹ 42 U.S.C. §402(d)(6)(A)(i).
¹⁸² 42 U.S.C. §402(d)(6)(A)(ii).
¹⁸³ 42 U.S.C. §402(d)(6)(B).
¹⁸⁴ 42 U.S.C. §402(d)(6)(C).
¹⁸⁵ 42 U.S.C. §402(d)(6)(D)(i).
¹⁸⁶ 42 U.S.C. §402(d)(6)(D)(ii).
¹⁸⁷ 42 U.S.C. §402(d)(6)(E)(i).
¹⁸⁸ 42 U.S.C. §402(d)(6)(E)(ii).

attending an elementary or secondary school at the request, or pursuant to a requirement, of the employer. An individual is not considered a full-time elementary or secondary school student for these purposes while that individual is confined in a jail, prison, or other penal institution or correctional facility, pursuant to his or her conviction of an offense that constituted a felony under applicable law. An individual who is determined to be a full-time elementary or secondary school student shall be deemed such a student throughout the month with respect to which such determination is made.¹⁸⁹

- (i) In general, an individual is deemed to be a full-time elementary or secondary school student during any period of nonattendance at an elementary or secondary school at which he or she has been in full-time attendance if:
 - Such period is four calendar months or less;¹⁹⁰ and
 - The individual shows that he or she intends to continue to be in full-time attendance at an elementary or secondary school immediately following such period. An individual who does not meet this requirement with respect to such period of nonattendance shall be deemed to have met such requirement (as of the beginning of such period) if he or she is in full-time attendance at an elementary or secondary school immediately following such period.¹⁹¹
 - (ii) An elementary or secondary school is a school that provides elementary or secondary education, respectively, as determined under the law of the state or other jurisdiction in which it is located.¹⁹² For the purpose of determining whether a child is a full-time elementary or secondary school student or intends to continue to be in full-time attendance at an elementary or secondary school, there shall be disregarded any education provided, or to be provided, beyond grade 12.¹⁹³
- d. A child who attains age 19 at a time when he or she is a full-time elementary or secondary school student (and without application of the nonattendance rule) but has not (at such time) completed the requirements for, or received, a diploma or equivalent certificate from a secondary school shall be deemed (for purposes of determining whether his or her entitlement to benefits under this subsection has terminated by reason of turning 18 and for purposes of determining his or her initial entitlement to such benefits) not to have attained such age until the first day of the first month following the end of the quarter or semester in which he or she is enrolled at such time (or, if the elementary or secondary school in which he or she is enrolled is not operated on a quarter or semester system, until the first day of the first month following the completion of the course in which he or she is so enrolled or until the first day of the third month beginning after such time, whichever occurs first).¹⁹⁴

¹⁸⁹ 42 U.S.C. §402(d)(7)(A).
¹⁹⁰ 42 U.S.C. §402(d)(7)(B)(i).
¹⁹¹ 42 U.S.C. §402(d)(7)(B)(ii).
¹⁹² 42 U.S.C. §402(d)(7)(C)(i).
¹⁹³ 42 U.S.C. §402(d)(7)(D)(ii).
¹⁹⁴ 42 U.S.C. §402(d)(7)(D).

F. Mother's and father's insurance benefits (mother or father in care of a child of the individual)

1. In general

The surviving spouse and every surviving divorced parent (of an individual who died a fully or currently insured individual) is (subject to the rule for a nondisabled child reaching age 16) entitled to a mother's or father's insurance benefit for each month, if such surviving spouse or surviving divorced parent:

- Is not married;¹⁹⁵
- Is not entitled to a surviving spouse's insurance benefit;¹⁹⁶
- Is not entitled to old-age insurance benefits, or is entitled to old-age insurance benefits each of which is less than three-fourths of the primary insurance amount of such individual;¹⁹⁷
- Has filed an application for mother's or father's insurance benefits, or was entitled to a spouse's insurance benefit on the basis of the wages and self-employment income of such individual for the month preceding the month in which such individual died;¹⁹⁸
- At the time of filing such application has in his or her care a child of such individual entitled to a child's insurance benefit;¹⁹⁹ and
- In the case of a surviving divorced parent, the child in his or her care is his or her son, daughter, or legally adopted child,²⁰⁰ and the benefits are payable on the basis of such individual's wages and self-employment income.²⁰¹

2. When are benefits payable?

The benefits begin with the **first month** in which he or she becomes so entitled to such insurance benefits and ending with the month preceding the first month in which any of the following occurs: no child of such deceased individual is entitled to a child's insurance benefit; such surviving spouse or surviving divorced parent becomes entitled to an old-age insurance benefit equal to or exceeding three-fourths of the primary insurance amount of such deceased individual; he or she becomes entitled to a surviving spouse's insurance benefit; he or she remarries; or he or she dies. Entitlement to such benefits shall also end, in the case of a surviving divorced parent, with the month immediately preceding the first month in which no son, daughter, or legally adopted child of such surviving divorced parent is entitled to a child's insurance benefit on the basis of the wages and self-employment income of such deceased individual.²⁰²

3. What is the amount of the benefits?

In general, such mother's or father's insurance benefit for each month shall be equal to three-fourths of the primary insurance amount of such deceased individual.²⁰³

- a. The amount of a mother's or father's insurance benefit for each month (as determined after application of the provisions for simultaneous benefits) shall be reduced (but not below zero) by an amount equal to two-thirds of the amount of any monthly periodic benefit payable to the individual for such month, which is based upon the individual's earnings while in the service of the federal government or any state (or political

¹⁹⁵ 42 U.S.C. §402(g)(1)(A).

¹⁹⁶ 42 U.S.C. §402(g)(1)(B).

¹⁹⁷ 42 U.S.C. §402(g)(1)(C).

¹⁹⁸ 42 U.S.C. §402(g)(1)(D).

¹⁹⁹ 42 U.S.C. §402(g)(1)(E).

²⁰⁰ 42 U.S.C. §402(g)(1)(F)(i).

²⁰¹ 42 U.S.C. §402(g)(1)(F)(ii).

²⁰² 42 U.S.C. §402(g)(1).

²⁰³ 42 U.S.C. §402(g)(2).

subdivision thereof) if, on the last day the individual was employed by such entity, such service was being performed while in the service of the federal government, and constituted “employment” as so defined solely by reason of an election to become subject to the Federal Employees’ Retirement System (the “FERS election”).²⁰⁴ The amount of the reduction in any benefit, if not a multiple of \$0.10, shall be rounded to the next higher multiple of \$0.10.

- b. However, this reduction does not apply with respect to monthly periodic benefits based in whole or in part on service that constituted employment if such service was performed for at least 60 months in the aggregate during the period beginning January 1, 1988, and ending with the close of the first calendar month as of the end of which the individual is eligible for benefits and has made a valid application for such benefits.²⁰⁵

Note:

For these purposes, any periodic benefit that otherwise meets the above requirements, but which is paid on other than a monthly basis, is allocated on a basis equivalent to a monthly benefit (as determined by the Commissioner of Social Security) and such equivalent monthly benefit shall constitute a monthly periodic benefit for the above purposes. For these purposes, **periodic benefit** includes a benefit payable in a lump sum if it is a commutation of, or a substitute for, periodic payments.²⁰⁶

4. Effect of marriage

A surviving spouse or surviving divorced parent entitled to benefits is, subject to the rule concerning a disabled child reaching age 16, not terminated by reason of such marriage in the case of a surviving spouse or surviving divorced parent who marries an individual entitled to these benefits or old age, spouse, surviving spouse, parent, or disability benefits.²⁰⁷

G. Parent’s insurance benefits

1. In general

Every **parent** of an individual who died a fully insured individual is entitled to a parent’s insurance benefit, if such parent:²⁰⁸

- a. Has attained age 62;²⁰⁹
- b. Both of the following:
 - (i) Was receiving at least one-half of his or her support from such individual at the time of such individual’s death or, if such individual had a period of disability that did not end prior to the month in which he or she died, at the time such period began or at the time of such death;²¹⁰ and

²⁰⁴ 42 U.S.C. §402(g)(4)(A)(ii)(II).
²⁰⁵ 42 U.S.C. §402(g)(4)(B).
²⁰⁶ 42 U.S.C. §402(g)(4)(B).
²⁰⁷ 42 U.S.C. §402(g)(3).
²⁰⁸ 42 U.S.C. §402(h)(1).
²⁰⁹ 42 U.S.C. §402(h)(1)(A).
²¹⁰ 42 U.S.C. §402(h)(1)(B)(i).

- (ii) Filed proof of such support within two years after the date of such death, or, if such individual had such a period of disability, within two years after the month in which such individual filed application with respect to such period of disability or two years after the date of such death, as the case may be;²¹¹
- c. Has not married since such individual's death;²¹²
- d. Is not entitled to old-age insurance benefits, or is entitled to old-age insurance benefits each of which is less than 82-1/2 percent of the primary insurance amount of such deceased individual if the amount of the parent's insurance benefit for such month is determinable under the general rule below (or 75 percent of such primary insurance amount in any other case);²¹³ and
- e. Has filed an application for parent's insurance benefits.²¹⁴

2. When do benefits begin?

Benefits for each month begin with the first month in which such parent becomes so entitled to such parent's insurance benefits.

3. When do benefits end?

Benefits end with the month preceding the first month in which any of the following occurs:

- Such parent dies;
- Such parent marries; or
- Such parent becomes entitled to an old-age insurance benefit equal to or exceeding 82-1/2 percent of the primary insurance amount of such deceased individual if the amount of the parent's insurance benefit for such month is determinable under the general rule for benefits discussed below (or 75 percent of such primary insurance amount in any other case).

4. What is the amount of the benefits?

In general, such parent's insurance benefit for each month shall be equal to 82-1/2 percent of the primary insurance amount of such deceased individual.²¹⁵

- a. For any month for which more than one parent is entitled to parent's insurance benefits on the basis of such deceased individual's wages and self-employment income, such benefit for each such parent for such month shall generally be equal to 75 percent of the primary insurance amount of such deceased individual.²¹⁶
- b. The general level of benefits may nonetheless apply and the amount of the parent's insurance benefit of a parent referred to in (ii) below for such month shall be equal to 150 percent of the primary insurance amount of the deceased individual minus the amount (before the application of reductions based on maximum limitations) of the benefit for such month of the parent referred to in clause (i) in any case in which:
 - (i) Any parent is entitled to a parent's insurance benefit for a month on the basis of a deceased individual's wages and self-employment income;²¹⁷ and

²¹¹ 42 U.S.C. §402(h)(1)(B)(ii).

²¹² 42 U.S.C. §402(h)(1)(C).

²¹³ 42 U.S.C. §402(h)(1)(D).

²¹⁴ 42 U.S.C. §402(h)(1)(E).

²¹⁵ 42 U.S.C. §402(h)(2)(A).

²¹⁶ 42 U.S.C. §402(h)(2)(B).

²¹⁷ 42 U.S.C. §402(h)(2)(C)(i).

- (ii) Another parent of such deceased individual is entitled to a parent's insurance benefit for such month on the basis of such wages and self-employment income, and on the basis of an application filed after such month and after the month in which the application for the parent's benefits referred to in (i) was filed.²¹⁸

5. Who is a parent?

For these purposes, a parent means the mother or father of an individual, a stepparent of an individual by a marriage contracted before such individual attained the age of sixteen, or an adopting parent by whom an individual was adopted before he or she attained the age of sixteen.²¹⁹

In the case of a parent who marries an individual entitled to benefits as a parent, spouse, surviving spouse, or mother or father, or an individual who has attained the age of eighteen and is entitled to benefits as a child, such parent's entitlement to parent's benefits shall, subject to the rule concerning a nondisabled child age 16 or older, not be terminated by reason of such marriage.²²⁰

H. Lump-sum death payments

Upon the death of an individual who died a fully or currently insured individual, an amount equal to three times such individual's primary insurance amount, or an amount equal to \$255, whichever is smaller, shall be paid in a lump sum to the **person**, if any, determined by the Commissioner of Social Security to be the widow or widower of the deceased and to have been living in the same household with the deceased at the time of death. If there is no such person, or if such person dies before receiving payment, then such amount shall be paid:

- To a widow or widower who is entitled (or would have been so entitled had a timely application been filed), on the basis of the wages and self-employment income of such insured individual, to benefits as a surviving spouse or mother or father for the month in which occurred such individual's death;²²¹ or
- If no person qualifies for payment, or if such person dies before receiving payment, in equal shares to each person who is entitled (or would have been so entitled had a timely application been filed), on the basis of the wages and self-employment income of such insured individual, to benefits as a child for the month in which occurred such individual's death.²²²

Note:

No payment shall be made to any person unless an application is filed, by or on behalf of such person (whether or not legally competent), prior to the expiration of two years after the date of death of such insured individual, or unless such person was entitled to spousal insurance benefits, on the basis of the wages and self-employment income of such insured individual, for the month preceding the month in which such individual died.

²¹⁸ 42 U.S.C. §402(h)(2)(C)(ii).
²¹⁹ 42 U.S.C. §402(h)(4).
²²⁰ 42 U.S.C. §402(h)(4).
²²¹ 42 U.S.C. §402(i)(1).
²²² 42 U.S.C. §402(i)(2).

I. How is family status determined?

1. Family status based on state law and domicile

- a. An applicant is the wife, husband, widow, or widower of a fully or currently insured individual for purposes of benefits if the courts of the state in which such insured individual is domiciled at the time such applicant files and application, or, if such insured individual is dead, the courts of the state in which he was domiciled at the time of death, or, if such insured individual is or was not so domiciled in any state, the courts of the District of Columbia, would find that such applicant and such insured individual were validly married at the time such applicant files such application or, if such insured individual is dead, at the time he died.²²³

Note:

If such courts would not find that such applicant and such insured individual were validly married at such time, such applicant shall, nevertheless be deemed to be the wife, husband, widow, or widower, as the case may be, of such insured individual if such applicant would, under the laws applied by such courts in determining the devolution of intestate personal property, have the same status with respect to the taking of such property as a wife, husband, widow, or widower of such insured individual.²²⁴

- (i) In any case where under the preceding an applicant is not (and is not deemed to be) the wife, widow, husband, or widower of a fully or currently insured individual, or where under the definitions of such status such applicant is not the wife, divorced wife, widow, surviving divorced wife, husband, divorced husband, widower, or surviving divorced husband of such individual, but it is established to the satisfaction of the Commissioner of Social Security that such applicant in good faith went through a marriage ceremony with such individual resulting in a purported marriage between them which, but for a legal impediment not known to the applicant at the time of such ceremony, would have been a valid marriage, then, for these purposes and the definitional provisions of such statuses, such purported marriage shall be deemed to be a valid marriage. However, in the case of any person who would be deemed under the preceding sentence a wife, widow, husband, or widower of the insured individual, such marriage shall not be deemed to be a valid marriage unless the applicant and the insured individual were living in the same household at the time of the death of the insured individual or (if the insured individual is living) at the time the applicant files the application. A marriage that is deemed to be a valid marriage by reason of the preceding sentence shall continue to be deemed a valid marriage if the insured individual and the person entitled to benefits as the wife or husband of the insured individual are no longer living in the same household at the time of the death of such insured individual.²²⁵

²²³ 42 U.S.C. §416(h)(1)(A)(i).

²²⁴ 42 U.S.C. §416(h)(1)(A)(ii).

²²⁵ 42 U.S.C. §416(h)(1)(B)(i).

Note:

The above provisions do not apply if the Commissioner of Social Security determines, on the basis of information brought to the Commissioner's attention, that such applicant entered into such purported marriage with such insured individual with knowledge that it would not be a valid marriage.²²⁶

- (ii) The entitlement to a monthly spousal benefit, based on the wages and self-employment income of such insured individual, of a person who would not be deemed to be a wife or husband of such insured individual but for this provision, shall end with the month before the month in which such person enters into a marriage, valid without regard to this subparagraph, with a person other than such insured individual.²²⁷

Note:

For most purposes, a **legal impediment** to the validity of a purported marriage includes only an impediment: (i) resulting from the lack of dissolution of a previous marriage or otherwise arising out of such previous marriage or its dissolution; or (ii) resulting from a defect in the procedure followed in connection with such purported marriage.²²⁸

- b. In determining whether an applicant is the child or parent of a fully or currently insured individual for purposes of benefits, the applicable law is that which would be applied in determining the devolution of intestate personal property by the courts of the state in which such insured individual is domiciled at the time such applicant files application, or, if such insured individual is dead, by the courts of the state in which he was domiciled at the time of his death, or, if such insured individual is or was not so domiciled in any state, by the courts of the District of Columbia. Applicants who according to such law would have the same status relative to taking intestate personal property as a child or parent shall be deemed such.²²⁹ If an applicant is a son or daughter of a fully or currently insured individual but is not (and is not deemed to be) the child of such insured individual, such applicant shall nevertheless be deemed the child of such insured individual if such insured individual and the mother or father, as the case may be, of such applicant went through a marriage ceremony resulting in a purported marriage between them which, but for a legal impediment, would have been a valid marriage.²³⁰
- c. An applicant who is the son or daughter of a fully or currently insured individual, but who is not (and is not deemed to be) the child of such insured individual under paragraph b., is nevertheless deemed to be the child of such insured individual if:
- (i) In the case of an insured individual entitled to old-age insurance benefits (who was not, in the month preceding such entitlement, entitled to disability insurance benefits):²³¹
- Such insured individual: (i) has acknowledged in writing that the applicant is his or her son or daughter; (ii) has been decreed by a court to be the mother or father of the applicant; or (iii) has been ordered by a court to contribute to the support of the applicant because the applicant

²²⁶ 42 U.S.C. §416(h)(1)(B)(ii).
²²⁷ 42 U.S.C. §416(h)(1)(B)(iii).
²²⁸ 42 U.S.C. §416(h)(1)(B)(iv).
²²⁹ 42 U.S.C. §416(h)(2)(A).
²³⁰ 42 U.S.C. §416(h)(2)(B).
²³¹ 42 U.S.C. §416(h)(3)(A).

is his or her son or daughter, and such acknowledgment, court decree, or court order was made not less than one year before such insured individual became entitled to old-age insurance benefits or attained retirement age, whichever is earlier; or

Note:

For these purposes, an acknowledgement, court decree, or court order shall be deemed to have occurred on the first day of the month in which it actually occurred.

- Such insured individual is shown by evidence satisfactory to the Commissioner of Social Security to be the mother or father of the applicant and was living with or contributing to the support of the applicant at the time such applicant's application for benefits was filed;
- (ii) In the case of an insured individual entitled to disability insurance benefits, or who was entitled to such benefits in the month preceding the first month for which he or she was entitled to old-age insurance benefits:²³²
 - Such insured individual: (i) has acknowledged in writing that the applicant is his or her son or daughter; (ii) has been decreed by a court to be the mother or father of the applicant; or (iii) has been ordered by a court to contribute to the support of the applicant because the applicant is his or her son or daughter, and such acknowledgment, court decree, or court order was made before such insured individual's most recent period of disability began; or

Note:

For these purposes, an acknowledgement, court decree, or court order shall be deemed to have occurred on the first day of the month in which it actually occurred.

- Such insured individual is shown by evidence satisfactory to the Commissioner of Social Security to be the mother or father of the applicant and was living with or contributing to the support of that applicant at the time such applicant's application for benefits was filed;
- (iii) In the case of a deceased individual:²³³
 - Such insured individual: (i) had acknowledged in writing that the applicant is his or her son or daughter; (ii) had been decreed by a court to be the mother or father of the applicant; or (iii) had been ordered by a court to contribute to the support of the applicant because the applicant was his or her son or daughter, and such acknowledgment, court decree, or court order was made before the death of such insured individual; or
 - Such insured individual is shown by evidence satisfactory to the Commissioner of Social Security to have been the mother or father of the applicant, and such insured individual was living with or contributing to the support of the applicant at the time such insured individual died.

²³² 42 U.S.C. §416(h)(3)(B).
²³³ 42 U.S.C. §416(h)(3)(C).

2. Effect of Windsor case

Despite the fact that terms such as **spouse**, **surviving spouse**, **husband** and **wife** are defined in the United States Code as reported above, these gender-based definitions have been supplanted in application to same sex couples by the Supreme Court's rulings in *Windsor* and *Obergefell*.

J. Application

1. In general

Subject to the specific limitations, an individual who would have been entitled to any of the above benefits for any month had he filed application prior to the end of such month shall be entitled to such benefit for such month if he files application prior to either:

- a. The end of the twelfth month immediately succeeding such month in any case where the individual:²³⁴
 - Is filing an application for a benefit as a surviving spouse, and had attained age 50 but had not attained age 60 and is under a disability that began before the end of the measuring period;²³⁵ or
 - Is filing an application for a benefit as a spouse or child on the basis of the wages and self-employment income of a person entitled to disability insurance benefits;²³⁶ or
- b. The end of the sixth month immediately succeeding such month in any other case.²³⁷

Note:

Any benefit for a month prior to the month in which an application is filed shall be reduced, to any extent that may be necessary, so that it will not render erroneous any benefit which, before the filing of such application, the Commissioner of Social Security has certified for payment for such prior month.

2. Early application

An application for any monthly benefits filed before the first month in which the applicant satisfies the requirements for such benefits shall be deemed a valid application (and shall be deemed to have been filed in such first month) only if the applicant satisfies the requirements for such benefits before the Commissioner of Social Security makes a final decision on the application and no request for notice and opportunity for a hearing thereon is made or, if such a request is made, before a decision based upon the evidence adduced at the hearing is made (regardless of whether such decision becomes the final decision of the Commissioner of Social Security).²³⁸ Social Security recommends that you file four months before your desired start date.²³⁹

3. Waiver

However, an individual may, at his or her option, waive entitlement to any benefit for any one or more consecutive months (beginning with the earliest month for which such individual would otherwise be entitled to such benefit) that occur before the month in which such individual files an application for such benefit; and, in such case, such individual shall not be considered as entitled to such benefits for any

²³⁴ 42 U.S.C. §402(j)(1)(A).

²³⁵ 42 U.S.C. §402(j)(1)(A)(i).

²³⁶ 42 U.S.C. §402(j)(1)(A)(ii).

²³⁷ 42 U.S.C. §402(j)(1)(B).

²³⁸ 42 U.S.C. §402(j)(2).

²³⁹ <https://www.ssa.gov/benefits/retirement/apply.html>.

such month or months before such individual filed such application. An individual shall be deemed to have waived such entitlement for any such month for which such benefit would, under the previous **Note**, be reduced to zero.²⁴⁰

4. Specific limitations

In general, no individual shall be entitled to a monthly benefit for old age, spouse, or surviving spouse for any month prior to the month in which he or she files an application for benefits if the amount of the monthly benefit to which such individual would otherwise be entitled for any such month would be subject to reduction for early retirement.²⁴¹

- a. If the individual applying for **retroactive benefits** is a widow, surviving divorced wife, or widower and is under a disability, and such individual would, be entitled to retroactive benefits as a disabled widow or widower or disabled surviving divorced wife for any month before attaining the age of 60, then the nonentitlement above shall not apply with respect to such month or any subsequent month.²⁴² Retroactive benefits means benefits to which an individual becomes entitled for a month prior to the month in which application for such benefits is filed.²⁴³
- b. The nonentitlement does not apply to a benefit for a surviving spouse for the month immediately preceding the month of application if the insured individual died in that preceding month.²⁴⁴

Note:

In any case in which it is determined to the satisfaction of the Commissioner of Social Security that an individual failed as of any date to apply for monthly insurance benefits by reason of misinformation provided to such individual by any officer or employee of the Social Security Administration relating to such individual's eligibility for benefits, such individual shall be deemed to have applied for such benefits on the later of the date on which such misinformation was provided to such individual, or the date on which such individual met all requirements for entitlement to such benefits (other than application).²⁴⁵

5. Presumed filing of application

- a. If the first month for which an individual is entitled to an old-age insurance benefit is a month before the month in which such individual attains full retirement age, and if such individual is eligible for a wife's or husband's insurance benefit for such first month, such individual shall be deemed to have filed an application in such month for spousal insurance benefits.²⁴⁶
- b. If the first month for which an individual is entitled to a spousal insurance benefit reduced for early retirement is a month before the month in which such individual attains full retirement age, and if such individual is eligible (but for the rule limiting benefits to the larger of simultaneously entitled old age and disability benefits) for an old-age insurance benefit for such first month, such individual shall be deemed to have filed an application for old-age insurance benefits in such month,²⁴⁷ or if such individual is also entitled to a

²⁴⁰ 42 U.S.C. §402(j)(3).
²⁴¹ 42 U.S.C. §402(j)(4)(A).
²⁴² 42 U.S.C. §402(j)(4)(B)(i).
²⁴³ 42 U.S.C. §402(j)(4)(B)(iii).
²⁴⁴ 42 U.S.C. §402(j)(4)(B)(ii).
²⁴⁵ 42 U.S.C. §402(j)(5).
²⁴⁶ 42 U.S.C. §402(r)(1).
²⁴⁷ 42 U.S.C. §402(r)(2)(A).

disability insurance benefit for such month, in the first subsequent month for which such individual is not entitled to a disability insurance benefit.²⁴⁸

- c. For these purposes, an individual is deemed eligible for a benefit for a month if, upon filing application in such month, he or she would be entitled to such benefit for such month.²⁴⁹

IV. Disability

A. Background

1. In general

An individual is entitled to a disability insurance benefits if the individual:²⁵⁰

- Is insured for disability insurance benefits;²⁵¹
- Has not attained full retirement age;²⁵²
- Has filed application for disability insurance benefits;²⁵³ and
- Is under a disability.²⁵⁴

Note:

No payment may be made to an individual who would not meet the definition of disability except for the blindness rule for any month in which he or she engages in substantial gainful activity, and no payment may be made for such month for spousal or child benefits to any person on the basis of the wages and self-employment income of such individual.

2. When do benefits begin?

Disability insurance benefits generally begin with the first month after the individual's waiting period in which he or she becomes so entitled to such insurance benefits.²⁵⁵ However, such benefits begin with the first month during all of which he or she is under a disability and in which he or she becomes so entitled to such insurance benefits, but only if he or she was entitled to disability insurance benefits which terminated, or had a period of disability which ceased, within the 60-month period preceding the first month in which he or she is under such disability.²⁵⁶

3. When do benefits end?

Disability payments **end** with the month preceding whichever of the following months is the earliest:

- a. The month in which he or she dies;
- b. The month in which he or she attains full retirement age; or
- c. Subject to the substantial-gainful-activity rule, the termination month. For these purposes, the termination month for any individual is the third month following the month in which his or her disability ceases; except that, in the case of an individual who has a period of trial work, the termination month is the earlier of the following:

²⁴⁸ 42 U.S.C. §402(r)(2)(B).
²⁴⁹ 42 U.S.C. §402(r)(3).
²⁵⁰ 42 U.S.C. §423(a)(1).
²⁵¹ 42 U.S.C. §423(a)(1)(A).
²⁵² 42 U.S.C. §423(a)(1)(B).
²⁵³ 42 U.S.C. §423(a)(1)(C).
²⁵⁴ 42 U.S.C. §423(a)(1)(D).
²⁵⁵ 42 U.S.C. §423(a)(1)(D)(i).
²⁵⁶ 42 U.S.C. §423(a)(1)(D)(ii).

- (i) The third month following the earliest month after the end of such period of trial work with respect to which such individual is determined to no longer be suffering from a disabling physical or mental impairment;²⁵⁷ or
- (ii) The third month following the earliest month in which such individual engages or is determined able to engage in substantial gainful activity, but in no event earlier than the first month occurring after the 36 months following such period of trial work in which he or she engages or is determined able to engage in substantial gainful activity.²⁵⁸

4. What is the amount of the benefit?

Except as provided for reduction of benefits resulting from early retirement and the benefit computation years, such individual's disability insurance benefit for any month is equal to his or her primary insurance amount for such month as though he or she had attained age 62 in the first month of his or her waiting period,²⁵⁹ or in any case in which the disability benefits terminated or period of disability ceased within the prior 60 months, the first month for which he or she becomes entitled to such disability insurance benefits,²⁶⁰ AND as though he or she had become entitled to old-age insurance benefits in the month in which the application for disability insurance benefits was filed and he or she was entitled to an old-age insurance benefit for each month for which by application he or she was entitled to a disability insurance benefit. For the purposes of the preceding sentence, in the case of an individual who attained age 62 in or before the first month referred to above, the elapsed years does not include the year in which he or she attained age 62, or any year thereafter.

5. Application

An application for disability insurance benefits filed before the first month in which the applicant satisfies the requirements for such benefits is deemed a valid application (and shall be deemed to have been filed in such first month) only if the applicant satisfies the requirements for such benefits before the Commissioner of Social Security makes a final decision on the application and no request for notice and opportunity for a hearing thereon is made, or if such a request is made, before a decision based upon the evidence adduced at the hearing is made (regardless of whether such decision becomes the final decision of the Commissioner of Social Security). An individual who would have been entitled to a disability insurance benefit for any month had he filed application before the end of such month shall be entitled to such benefit for such month if such application is filed before the end of the twelfth month immediately succeeding such month.²⁶¹

Note:

In the case of a deceased individual, the requirement for the filing of an application may be satisfied by an application for benefits filed with respect to such individual within three months after the month in which he died.

²⁵⁷ 42 U.S.C. §423(a)(1)(D)(ii)(I).
²⁵⁸ 42 U.S.C. §423(a)(1)(D)(ii)(II).
²⁵⁹ 42 U.S.C. §423(a)(2)(A).
²⁶⁰ 42 U.S.C. §423(a)(2)(A).
²⁶¹ 42 U.S.C. §423(b).

B. Definitions

1. Insured for disability insurance benefits

An individual shall be insured for disability insurance benefits in any month if he would have been a fully insured individual had he attained age 62 and filed application for old-age benefits on the first day of such month,²⁶² and he meets one of the following requirements:

- He had not less than 20 quarters of coverage during the 40-quarter period that ends with the quarter in which such month occurred;²⁶³ or
- If such month ends before the quarter in which he attains (or would attain) age 31, not less than one-half (and not less than six) of the quarters during the period ending with the quarter in which such month occurred and beginning after he attained the age of 21 were quarters of coverage, or (if the number of quarters in such period is less than 12) not less than six of the quarters in the 12-quarter period ending with such quarter were quarters of coverage;²⁶⁴ or
- In the case of an individual (not otherwise insured by reason of failing to meet the 20-quarter minimum) who, by reason of failure to have sufficient quarters of coverage before age 31, had a prior period of disability that began during a period before the quarter in which he or she attained age 31, not less than one-half of the quarters beginning after such individual attained age 21 and ending with the quarter in which such month occurs are quarters of coverage, or (if the number of quarters in such period is less than 12) not less than six of the quarters in the 12-quarter period ending with such quarter are quarters of coverage.²⁶⁵

Note:

None of the three alternative bulleted requirements apply in the case of an individual who is **blind**. For these purposes, when the number of quarters in any period is an odd number, such number is reduced by one, and a quarter shall not be counted as part of any period if any part of such quarter was included in a period of disability unless such quarter was a quarter of coverage.

2. Waiting period

Waiting period means the earliest period of five consecutive calendar months throughout which the individual with respect to whom such application is filed has been under a disability,²⁶⁶ and which begins either:

- Not earlier than with the first day of the seventeenth month before the month in which such application is filed, if such individual is insured for disability insurance benefits in such seventeenth month,²⁶⁷ or
- Not earlier than with the first day of the first month after such seventeenth month in which he is so insured if he is not so insured in such month.²⁶⁸

²⁶² 42 U.S.C. §423(c)(1)(A).
²⁶³ 42 U.S.C. §423(c)(1)(A).
²⁶⁴ 42 U.S.C. §423(c)(1)(A).
²⁶⁵ 42 U.S.C. §423(c)(1)(B).
²⁶⁶ 42 U.S.C. §423(c)(2)(A).
²⁶⁷ 42 U.S.C. §423(c)(2)(B)(i).
²⁶⁸ 42 U.S.C. §423(c)(2)(B)(ii).

C. What is a disability?

1. In general

Disability means either: (i) inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months;²⁶⁹ or (ii) in the case of an individual who has attained the age of 55 and is blind, inability by reason of such blindness to engage in substantial gainful activity requiring skills or abilities comparable to those of any gainful activity in which he has previously engaged with some regularity and over a substantial period of time.²⁷⁰

- a. An individual shall be determined to be under a disability only if his physical or mental impairment or impairments are of such severity that he is not only unable to do his previous work but cannot, considering his age, education, and work experience, engage in any other kind of substantial gainful work that exists in the national economy, regardless of whether such work exists in the immediate area in which he lives, or whether a specific job vacancy exists for him, or whether he would be hired if he applied for work. For these purposes (with respect to any individual), work that exists in the national economy means work that exists in significant numbers either in the region where such individual lives or in several regions of the country.²⁷¹
- b. In determining whether an individual's physical or mental impairment or impairments are of a sufficient medical severity that such impairment or impairments could be the basis of eligibility, the Commissioner of Social Security shall consider the combined effect of all of the individual's impairments without regard to whether any such impairment, if considered separately, would be of such severity. If the Commissioner of Social Security does find a medically severe combination of impairments, the combined impact of the impairments shall be considered throughout the disability determination process.²⁷²
- c. An individual shall not be considered to be disabled for these purposes if alcoholism or drug addiction would otherwise be a contributing factor material to the Commissioner's determination that the individual is disabled.²⁷³

2. Physical or mental impairment

For purposes of this subsection, a physical or mental impairment is an impairment that results from anatomical, physiological, or psychological abnormalities that are demonstrable by medically acceptable clinical and laboratory diagnostic techniques.²⁷⁴

3. Ability to engage in substantial activity

- a. The Commissioner of Social Security shall by regulations prescribe the criteria for determining when services performed or earnings derived from services demonstrate an individual's ability to engage in substantial gainful activity. No individual who is blind shall be regarded as having demonstrated an ability to engage in substantial gainful activity on the basis of earnings that do not exceed an amount equal to the exempt amount that would be applicable, to blind individuals, if section 102 of the Senior Citizens' Right to Work Act of 1996 had not been enacted. In any event, an individual whose services or

²⁶⁹ 42 U.S.C. §423(d)(1)(A).
²⁷⁰ 42 U.S.C. §423(d)(1)(B).
²⁷¹ 42 U.S.C. §423(d)(2)(A).
²⁷² 42 U.S.C. §423(d)(2)(B).
²⁷³ 42 U.S.C. §423(d)(2)(C).
²⁷⁴ 42 U.S.C. §423(d)(3).

earnings meet such criteria shall, except for purposes of the period of trial work, be found not to be disabled. In determining whether an individual is able to engage in substantial gainful activity by reason of his earnings, where his disability is sufficiently severe to result in a functional limitation requiring assistance in order for him to work, there shall be excluded from such earnings an amount equal to the cost (to such individual) of any attendant care services, medical devices, equipment, prostheses, and similar items and services (not including routine drugs or routine medical services unless such drugs or services are necessary for the control of the disabling condition) which are necessary (as determined by the Commissioner of Social Security in regulations) for that purpose, whether or not such assistance is also needed to enable him to carry out his normal daily functions; except that the amounts to be excluded shall be subject to such reasonable limits as the Commissioner of Social Security may prescribe.²⁷⁵

- b. In determining when services performed or earnings derived from services demonstrate an individual's ability to engage in substantial gainful activity, the Commissioner of Social Security shall apply the criteria described above with respect to services performed by any individual without regard to the legality of such services.²⁷⁶

4. Proof of disability

An individual is not considered to be under a disability unless he furnishes such medical and other evidence of the existence thereof as the Commissioner of Social Security may require. An individual's statement as to pain or other symptoms shall not alone be conclusive evidence of disability; there must be medical signs and findings, established by medically acceptable clinical or laboratory diagnostic techniques, which show the existence of a medical impairment that results from anatomical, physiological, or psychological abnormalities that could reasonably be expected to produce the pain or other symptoms alleged and which, when considered with all evidence required to be furnished (including statements of the individual or his physician as to the intensity and persistence of such pain or other symptoms, which may reasonably be accepted as consistent with the medical signs and findings), would lead to a conclusion that the individual is under a disability. Objective medical evidence of pain or other symptoms established by medically acceptable clinical or laboratory techniques (for example, deteriorating nerve or muscle tissue) must be considered in reaching a conclusion as to whether the individual is under a disability. Any non-federal hospital, clinic, laboratory, or other provider of medical services, or physician not in the employ of the federal Government, that supplies medical evidence required and requested by the Commissioner of Social Security shall be entitled to payment from the Commissioner of Social Security for the reasonable cost of providing such evidence.²⁷⁷

In making any determination with respect to whether an individual is under a disability or continues to be under a disability, the Commissioner of Social Security shall consider all evidence available in such individual's case record and shall develop a complete medical history of at least the preceding 12 months for any case in which a determination is made that the individual is not under a disability. In making any determination the Commissioner of Social Security shall make every reasonable effort to obtain from the individual's treating physician (or other treating health care provider) all medical evidence, including diagnostic tests, necessary in order to properly make such determination, prior to evaluating medical evidence obtained from any other source on a consultative basis.²⁷⁸

²⁷⁵ 42 U.S.C. §423(d)(4)(A).

²⁷⁶ 42 U.S.C. §423(d)(4)(B).

²⁷⁷ 42 U.S.C. §423(d)(5)(A).

²⁷⁸ 42 U.S.C. §423(d)(5)(B).

5. Disregarded impairments

Any physical or mental impairment that arises in connection with the commission by an individual of an offense that constitutes a felony under applicable law and for which such individual is subsequently convicted, or which is aggravated in connection with such an offense (but only to the extent so aggravated), shall not be considered in determining whether an individual is under a disability.²⁷⁹ Similarly, any physical or mental impairment that arises in connection with an individual's confinement in a jail, prison, or other penal institution or correctional facility pursuant to such individual's conviction of an offense constituting a felony under applicable law, or which is aggravated in connection with such a confinement (but only to the extent so aggravated), shall not be considered in determining whether such individual is under a disability for purposes of benefits payable for any month during which such individual is so confined.²⁸⁰

6. Substantial gainful activity

No benefit shall be payable to an unmarried child under a disability that began before he attained the age of 22, to a child under a disability who has not attained the age of 22, to a child under a disability that began before the close of the eighty-fourth month following the month in which his most recent entitlement to child's insurance benefits terminated because he ceased to be under such disability, or to a surviving spouse who has attained age 50 but has not attained age 60 and is under a disability or disability insurance benefit, for any month, after the third month, in which he engages in substantial gainful activity during the 36-month period following the end of his trial work period.²⁸¹ Substantial gainful activity is measured in earnings. The earnings amount for substantial gainful activity is \$1,550 a month in 2024, \$2,590 for blind people.²⁸²

No nondisability benefit is payable on the basis of the wages and self-employment income of an individual entitled to a disability benefit for any month for which the disability benefit of such individual is not payable by reason of substantial gainful activity.²⁸³

7. Period of trial work

The term "period of trial work," with respect to an individual entitled to benefits for disability, whether child or surviving spouse, means a period of months beginning and ending as provided below.²⁸⁴

8. Services

For purposes of disability benefits, any services rendered by an individual during a period of trial work shall be deemed not to have been rendered by such individual in determining whether his disability has ceased in a month during such period. For these purposes services means activity (whether legal or illegal) that is performed for remuneration or gain or is determined by the Commissioner of Social Security to be of a type normally performed for remuneration or gain.²⁸⁵

9. When does trial work begin?

A period of trial work for any individual begins with the month in which he becomes entitled to disability insurance benefits, or, in the case of an individual entitled to child's benefits who has attained the age of

²⁷⁹ 42 U.S.C. §423(d)(6)(A).

²⁸⁰ 42 U.S.C. §423(d)(6)(B).

²⁸¹ 42 U.S.C. §423(e)(1).

²⁸² <https://www.ssa.gov/oact/cola/sga.html>.

²⁸³ 42 U.S.C. §423(e)(2).

²⁸⁴ 42 U.S.C. §422(c)(1).

²⁸⁵ 42 U.S.C. §422(c)(2).

eighteen, with the month in which he becomes entitled to such benefits or the month in which he attains the age of eighteen, whichever is later, or, in the case of an individual entitled to a surviving spouse's insurance benefits who became entitled to such benefits prior to attaining age 60, with the month in which such individual becomes so entitled. No such period may begin for an individual in a period of disability of such individual in which he had a previous period of trial work.²⁸⁶

10. When does trial work end?

A period of trial work for any individual ends with the close of whichever of the following months is earlier:

- The ninth month, in any period of 60 consecutive months, in which the individual renders services (whether or not such nine months are consecutive),²⁸⁷ or
- The month in which his disability ceases.²⁸⁸

²⁸⁶ 42 U.S.C. §422(c)(3).

²⁸⁷ 42 U.S.C. §422(c)(4)(A).

²⁸⁸ 42 U.S.C. §422(c)(4)(B).

Calculation of Benefits

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Calculation of Benefits

Learning objectives

Upon reviewing this chapter, the reader will be able to:

- Discuss the calculation of Social Security benefits;
- Define the Primary Insurance Amount;
- Summarize how the maximum family benefit limits Social Security beneficiaries;
- Identify when an individual has excess earnings and the effect of such;
- Explain how the full retirement benefit is reduced for early retirement; and
- Quantify the enhanced benefit for delayed retirement.

I. Benefit base

Note:

A person's retirement benefit in a given year is calculated in four steps. The first computation is a measure of the person's average monthly earnings over his or her work history. Each year's earnings are indexed by the average annual wages in the economy that year, and the average earnings amount computed is known as the Average Indexed Monthly Earnings (AIME). The second calculation is the person's Primary Insurance Amount (PIA), which is determined by applying a formula to the AIME. Third, the PIA is adjusted for factors including early retirement, earnings above a defined amount, and the presence of other eligible family members, to arrive at the actual benefit to be paid in the first year of retirement. Fourth, the benefit is indexed each year thereafter by increases in prices based on the Consumer Price Index.

A. Average indexed monthly earnings (AIME)

1. In general

An individual's average indexed monthly earnings is equal to the quotient obtained by dividing: (i) the total (after adjustment) of his wages paid in and self-employment income credited to his benefit computation years,¹ by (ii) the number of months in those years.² Wages and self-employment income are determined in the same way for this purpose as for determining credits.

2. Computation years

The number of an individual's benefit computation years equals the number of elapsed years reduced: (i) in the case of an individual who is entitled to old-age insurance benefits (except as provided under the disability rule, below), or who has died, by five years; and (ii) in the case of an individual who is entitled to disability insurance benefits, by the number of years equal to one-fifth of such individual's elapsed years (disregarding any resulting fractional part of a year), but not by more than five years.³

¹ 42 U.S.C. §415(b)(1)(A).

² 42 U.S.C. §415(b)(1)(B).

³ 42 U.S.C. §415(b)(2)(A).

- a. The disability rule, once applicable with respect to any individual, continues to apply for purposes of determining such individual's primary insurance amount for purposes of any subsequent eligibility for disability or old-age insurance benefits unless prior to the month in which such eligibility begins there occurs a period of at least 12 consecutive months for which he was not entitled to a disability or an old-age insurance benefit. If an individual who is entitled to disability insurance benefits is living with a child (of such individual or his or her spouse) under the age of three in any calendar year that is included in such individual's computation base years, but which is not disregarded pursuant to the disability rule or to the determination of an individual's benefit computation years by reason of the reduction in the number of such individual's elapsed years under the disability rule, the number by which such elapsed years are reduced thereby is increased by one (up to a combined total not exceeding three) for each such calendar year, except that:
- (i) No calendar year shall be disregarded by the above (in determining such individual's benefit computation years) unless the individual was living with such child substantially throughout the period in which the child was alive and under the age of three in such year and the individual had no earnings in such year; and
 - (ii) The particular calendar years to be disregarded by the above (in determining such benefit computation years) shall be those years (not otherwise disregarded) which, before the application of any recomputation, the individual was living with such child substantially throughout the period in which the child was alive and under the age of three in such year and the individual had no earnings in such year.

Note:

This applies only to the extent that its application would not result in a lower primary insurance amount. The number of an individual's benefit computation years as determined under this rule cannot be less than two.

- b. With respect to any individual:
- (i) **Benefit computation years** means those computation base years, equal in number to the number determined in the preceding paragraph, for which the total of such individual's wages and self-employment income, after adjustment, is the largest;⁴
 - (ii) **Computation base years** means the calendar years after 1950 and before⁵--
 - In the case of an individual entitled to old-age insurance benefits, the year in which occurred the first month of that entitlement; or
 - In the case of an individual who has died (without having become entitled to old-age insurance benefits), the year succeeding the year of his death;
 - Except that such term excludes any calendar year entirely included in a period of disability; and

⁴ 42 U.S.C. §415(b)(2)(B)(i).

⁵ 42 U.S.C. §415(b)(2)(B)(ii).

- (iii) **Number of elapsed years** generally means the number of calendar years after the year in which the individual attained age 21 and before the year in which the individual died, or, if it occurred earlier, the year in which the individual attained age 62; except that such term excludes any calendar year any part of which is included in a period of disability.⁶

Note:

This means that in general, the number of elapsed years for an individual surviving to age 62 is 40 years. Accordingly, the number of benefit computation years for retirement benefits will be **35**. Thus, the calculus of benefits depends on the wages and self-employment income in the 35 years in which the nominal amounts are the largest. Those wages are then indexed as described below to create the constituent “adjusted” wages, which when added together will then be divided by 420 (12 x 35) (or a lesser amount if the worker does not survive to age 62).

3. What are inflation indexed wages and self-employment income?

- a. The wages paid in and self-employment income credited to each of an individual's computation base years for purposes of the selection of benefit computation years is indexed for inflation. Wages for each year are deemed equal to the product of:
- (i) The wages and self-employment income paid in or credited to such year (as determined without regard to this subparagraph); and
 - (ii) The quotient obtained by dividing:
 - The national average wage index for the second calendar year preceding the earliest of the year of the individual's death, eligibility for an old-age insurance benefit, or eligibility for a disability insurance benefit,⁷ by
 - The national average wage index for the computation base year for which the determination is made.⁸
- b. If an individual's average indexed monthly earnings is not a multiple of \$1, it shall be reduced to the next lower multiple of \$1.⁹

Note:

Thus, indexing occurs generally for all wages earned up to age 60. Wages and earnings after that time are not indexed but they are taken into account at their nominal amount.

- c. Wages paid in or self-employment income credited to an individual's computation base year that: (i) occurs after the second calendar year specified in the first bullet above, or (ii) is a year treated as though it were the last year of the period of the computation period, are available for use in determining an individual's benefit computation years, but without applying the indexing adjustment described in paragraph a (above).¹⁰

⁶ 42 U.S.C. §415(b)(2)(B)(iii).

⁷ The use of the eligibility for disability benefit is not applicable in the year in which the individual dies, or becomes eligible. Such year is not considered as such year if the individual were entitled to disability insurance benefits for any month in the 12-month period immediately preceding such death or eligibility. Instead, but there shall be counted instead the year of the individual's eligibility for the disability insurance benefit to which he was entitled in such 12-month period).

⁸ 42 U.S.C. §415(b)(3)(A).

⁹ 42 U.S.C. §415(e)(2).

¹⁰ 42 U.S.C. §415(b)(3)(B).

The following is the complete national average wage indexing series.¹¹

| National Average Wage Indexing Series, 1951-2022 | | | | | | | |
|--|------------|------|-------------|------|-------------|------|-------------|
| Year | Index | Year | Index | Year | Index | Year | Index |
| 1951 | \$2,799.16 | 1969 | \$5,893.76 | 1987 | \$18,426.51 | 2005 | \$36,952.94 |
| 1952 | \$2,973.32 | 1970 | \$6,186.24 | 1988 | \$19,334.04 | 2006 | \$38,651.41 |
| 1953 | \$3,139.44 | 1971 | \$6,497.08 | 1989 | \$20,099.55 | 2007 | \$40,405.48 |
| 1954 | \$3,155.64 | 1972 | \$7,133.80 | 1990 | \$21,027.98 | 2008 | \$41,334.97 |
| 1955 | \$3,301.44 | 1973 | \$7,580.16 | 1991 | \$21,811.60 | 2009 | \$40,711.61 |
| 1956 | \$3,532.36 | 1974 | \$8,030.76 | 1992 | \$22,935.42 | 2010 | \$41,673.83 |
| 1957 | \$3,641.72 | 1975 | \$8,630.92 | 1993 | \$23,132.67 | 2011 | \$42,979.61 |
| 1958 | \$3,673.80 | 1976 | \$9,226.48 | 1994 | \$23,753.53 | 2012 | \$44,321.67 |
| 1959 | \$3,855.80 | 1977 | \$9,779.44 | 1995 | \$24,705.66 | 2013 | \$44,888.16 |
| 1960 | \$4,007.12 | 1978 | \$10,556.03 | 1996 | \$25,913.90 | 2014 | \$46,481.52 |
| 1961 | \$4,086.76 | 1979 | \$11,479.46 | 1997 | \$27,426.00 | 2015 | \$48,098.63 |
| 1962 | \$4,291.40 | 1980 | \$12,513.46 | 1998 | \$28,861.44 | 2016 | \$48,642.15 |
| 1963 | \$4,396.64 | 1981 | \$13,773.10 | 1999 | \$30,469.84 | 2017 | \$50,321.89 |
| 1964 | \$4,576.32 | 1982 | \$14,531.34 | 2000 | \$32,154.82 | 2018 | \$52,145.80 |
| 1965 | \$4,658.72 | 1983 | \$15,239.24 | 2001 | \$32,921.92 | 2019 | \$54,099.99 |
| 1966 | \$4,938.36 | 1984 | \$16,135.07 | 2002 | \$33,252.09 | 2020 | \$55,628.50 |
| 1967 | \$5,213.44 | 1985 | \$16,822.51 | 2003 | \$34,064.95 | 2021 | \$60,575.07 |
| 1968 | \$5,571.76 | 1986 | \$17,321.82 | 2004 | \$35,648.55 | 2022 | \$63,795.13 |

Source: <https://www.ssa.gov/oact/cola/autoAdj.html> 2023 and 2024 not yet determined.

Mini-Case 1: Assume Eric retires at his full retirement age of 66 years and eight months in November 2024. The significant year for setting the index factor is 2018, which is the second year before the year in which he reached age 62. Average wages of all wage earners in 2018 are compared to average wages of all wage earners in each year of his earnings. For example, if Eric's earnings were \$18,000.00 in 1986, the first step in determining whether the 1986 earnings amount is one of the 35 years included in the selection of the benefit computation years is to adjust Eric's 1986 earnings to the average level of wages of all wage earners in 2018. To compute this amount, multiply Eric's \$18,000.00 of wages from 1986 by the ratio of the \$52,145.80 average wages of all workers in 2018 to the 1986 average wages of all workers of \$17,321.82. This ratio is 3.0104 ($\$52,145.80 \div \$17,321.82$). Therefore, the 1986 indexed earnings amount for Eric is \$54,187.40 ($\$18,000.00 \times 3.0104$). Index factors apply for each year to be indexed, depending on the ratio of average wage levels for all wage earners in each year compared to 2018. It is equally true that a different year of attainment of age 62 would change the index factors. The index is 1.0 for the year in which the worker turns 60 and forward. In Eric's situation, earnings in years beginning with 2018 will not be indexed but will be the actual amounts reported.¹²

4. Certain exceptions to wages and self-employment income

- a. In computing an individual's average indexed monthly earnings, there shall not be counted the excess over the contribution and benefit base (before the application of any indexing of such amounts) of:
 - (i) The wages paid to him in such year, plus
 - (ii) The self-employment income credited to such year.¹³

¹¹ <https://www.ssa.gov/oact/cola/AWI.html>.

¹² Social Security Handbook, §700.4.

¹³ 42 U.S.C. §415(e)(1).

| Yearly Maximum Earnings ¹⁴ | | | |
|---------------------------------------|------------------|-----------|----------------------|
| Year | Maximum Earnings | Year | Maximum Earnings |
| | | 1994 | \$60,600 |
| 2024 | \$168,600 | 1993 | \$57,600 |
| 2023 | \$160,200 | 1992 | \$55,500 |
| 2022 | \$147,000 | 1991 | \$53,400 |
| 2021 | \$142,800 | 1990 | \$51,300 |
| 2020 | \$137,700 | 1989 | \$48,000 |
| 2019 | \$132,900 | 1988 | \$45,000 |
| 2018 | \$128,400 | 1987 | \$43,800 |
| 2017 | \$127,200 | 1986 | \$42,000 |
| 2016 | \$118,500 | 1985 | \$39,600 |
| 2015 | \$118,500 | 1984 | \$37,800 |
| 2014 | \$117,000 | 1983 | \$35,700 |
| 2013 | \$113,700 | 1982 | \$32,400 |
| 2012 | \$110,100 | 1981 | \$29,700 |
| 2011 | \$106,800 | 1980 | \$25,900 |
| 2010 | \$106,800 | 1979 | \$22,900 |
| 2009 | \$106,800 | 1978 | \$17,700 |
| 2008 | \$102,000 | 1977 | \$16,500 |
| 2007 | \$97,500 | 1976 | \$15,300 |
| 2006 | \$94,200 | 1975 | \$14,100 |
| 2005 | \$90,000 | 1974 | \$13,200 |
| 2004 | \$87,900 | 1973 | \$10,800 |
| 2003 | \$87,000 | 1972 | \$9,000 |
| 2002 | \$84,900 | 1968-1971 | \$7,800 |
| 2001 | \$80,400 | 1967 | \$6,600 |
| 2000 | \$76,200 | 1966 | \$6,600 |
| 1999 | \$72,600 | 1959-1965 | \$4,800 |
| 1998 | \$68,400 | 1955-1958 | \$4,200 |
| 1997 | \$65,400 | 1951-1954 | \$3,600 |
| 1996 | \$62,700 | 1940-1950 | \$3,000 |
| 1995 | \$61,200 | 1937-1939 | \$3,000 per employer |

The amount in 2024 is \$168,600.

B. Primary insurance amount (PIA)

1. In general

The primary insurance amount of an individual shall generally be equal to the sum of:

- (i) 90 percent of the individual's AIME to the extent that such earnings do not exceed the first bend point amount;¹⁵
- (ii) 32 percent of the individual's AIME to the extent that such earnings exceed the first bend point amount established for purposes of clause (i) but do not exceed the second bend point amount;¹⁶ and

¹⁴ <https://www.ssa.gov/news/press/factsheets/colafacts2024.pdf>.

¹⁵ 42 U.S.C. §415(a)(1)(A)(i).

¹⁶ 42 U.S.C. §415(a)(1)(A)(ii).

- (iii) 15 percent of the individual's AIME to the extent that such earnings exceed the second bend point amount,¹⁷ rounded, if not a multiple of \$0.10, to the next lower multiple of \$0.10, and thereafter increased as provided for cost-of-living increases.

2. Bend points

The bend points were established in 1979 as \$180 for the first bend point and \$1,085 for the second bend point. Bend points are established for each year by multiplying the 1979 bend points by a ratio that is determined by dividing the national wage index for the measurement year by the national wage index for 1977.¹⁸ For the determination of an individual's old age insurance amount, the bend points are used for the second calendar year preceding the year for which the determination is being made. For individuals qualifying for normal benefits (age 62 or older), the bend points for the year that they reached 60 years of age will be used. If the individual upon whose social security account a benefit will be based has not yet reached 60 years of age, the bend points will be used for the year that is two years prior to the determination year (applies when someone becomes disabled or dies prior to age 60).

Note:

Each amount so established for any calendar year shall be rounded to the nearest \$1, except that any amount so established, which is a multiple of \$0.50 but not of \$1 shall be rounded to the next higher \$1.¹⁹

Note:

No primary insurance amount computed under the general rule may be less than an amount equal to \$11.50 multiplied by the individual's years of coverage in excess of 10, or the increased amount determined for cost-of-living adjustments.²⁰

Years of coverage with respect to any individual means the number (not exceeding 35) equal to the number of years after 1950 each of which is a computation base year and in each of which the individual is credited with wages and self-employment income of not less than 25 percent (in the case of a year after 1950 and before 1991) of the maximum amount that may be counted for such year, or 15 percent (in the case of a year after 1990) of the maximum amount that could be counted for such year.²¹

Note:

In each calendar year the Commissioner of Social Security shall publish in the Federal Register, on or before November 1, the formula for computing benefits and for adjusting wages and self-employment income in the case of an individual who becomes eligible for an old-age insurance benefit, or (if earlier) becomes eligible for a disability insurance benefit or dies, in the following year, and the national average wage index on which that formula is based.²²

For an individual who first becomes eligible for old-age insurance benefits (reaches age 62) or disability insurance benefits in 2024, or who dies in 2024 before becoming eligible for benefits, his or her PIA will be the sum of:²³

- 90 percent of the first \$1,115 of his/her AIME, plus
- 32 percent of his/her AIME over \$1,115 and through \$6,721, plus

¹⁷ 42 U.S.C. §415(a)(1)(A)(iii).

¹⁸ 42 U.S.C. §415(a)(1)(B)(ii).

¹⁹ 42 U.S.C. §415(a)(1)(B)(iii).

²⁰ 42 U.S.C. §415(a)(1)(C)(i).

²¹ 42 U.S.C. §415(a)(1)(C)(ii)(II).

²² 42 U.S.C. §415(a)(1)(D).

²³ <http://www.socialsecurity.gov/OACT/COLA/autoAdj.html>.

- 15 percent of his/her AIME over \$6,721.

This amount is rounded to the next lower multiple of \$0.10 if it is not already a multiple of \$0.10.

| Benefit Formula Bend Points | | | | | |
|------------------------------------|-----------------------------------|---------------|--|---------------|--------------|
| Year^a | Dollar Amts in PIA Formula | | Dollar Amts in Max Fam Bene Formula | | |
| | First | Second | First | Second | Third |
| 1979 | \$180 | \$1,085 | \$230 | \$332 | \$433 |
| 1980 | 194 | 1,171 | 248 | 358 | 467 |
| 1981 | 211 | 1,274 | 270 | 390 | 508 |
| 1982 | 230 | 1,388 | 294 | 425 | 554 |
| 1983 | 254 | 1,528 | 324 | 468 | 610 |
| 1984 | 267 | 1,612 | 342 | 493 | 643 |
| 1985 | 280 | 1,691 | 358 | 517 | 675 |
| 1986 | 297 | 1,790 | 379 | 548 | 714 |
| 1987 | 310 | 1,866 | 396 | 571 | 745 |
| 1988 | 319 | 1,922 | 407 | 588 | 767 |
| 1989 | 339 | 2,044 | 433 | 626 | 816 |
| 1990 | 356 | 2,145 | 455 | 656 | 856 |
| 1991 | 370 | 2,230 | 473 | 682 | 890 |
| 1992 | 387 | 2,333 | 495 | 714 | 931 |
| 1993 | 401 | 2,420 | 513 | 740 | 966 |
| 1994 | 422 | 2,545 | 539 | 779 | 1,016 |
| 1995 | 426 | 2,567 | 544 | 785 | 1,024 |
| 1996 | 437 | 2,635 | 559 | 806 | 1,052 |
| 1997 | 455 | 2,741 | 581 | 839 | 1,094 |
| 1998 | 477 | 2,875 | 609 | 880 | 1,147 |
| 1999 | 505 | 3,043 | 645 | 931 | 1,214 |
| 2000 | 531 | 3,202 | 679 | 980 | 1,278 |
| 2001 | 561 | 3,381 | 717 | 1,034 | 1,349 |
| 2002 | 592 | 3,567 | 756 | 1,092 | 1,424 |
| 2003 | 606 | 3,653 | 774 | 1,118 | 1,458 |
| 2004 | 612 | 3,689 | 782 | 1,129 | 1,472 |
| 2005 | 627 | 3,779 | 801 | 1,156 | 1,508 |
| 2006 | 656 | 3,955 | 838 | 1,210 | 1,578 |
| 2007 | 680 | 4,100 | 869 | 1,255 | 1,636 |
| 2008 | 711 | 4,288 | 909 | 1,312 | 1,711 |
| 2009 | 744 | 4,483 | 950 | 1,372 | 1,789 |
| 2010 | 761 | 4,586 | 972 | 1,403 | 1,830 |
| 2011 | 749 | 4,517 | 957 | 1,382 | 1,803 |
| 2012 | 767 | 4,624 | 980 | 1,415 | 1,845 |
| 2013 | 791 | 4,768 | 1,011 | 1,459 | 1,903 |
| 2014 | 816 | 4,917 | 1,042 | 1,505 | 1,962 |
| 2015 | 826 | 4,980 | 1,056 | 1,524 | 1,987 |
| 2016 | 856 | 5,157 | 1,093 | 1,578 | 2,058 |
| 2017 | 885 | 5,336 | 1,131 | 1,633 | 2,130 |
| 2018 | 895 | 5,397 | 1,144 | 1,651 | 2,154 |
| 2019 | 926 | 5,583 | 1,184 | 1,708 | 2,228 |
| 2020 | 960 | 5,785 | 1,226 | 1,770 | 2,309 |
| 2021 | 996 | 6,002 | 1,272 | 1,837 | 2,395 |
| 2022 | 1,024 | 6,172 | 1,308 | 1,889 | 2,463 |
| 2023 | 1,115 | 6,721 | 1,425 | 2,056 | 2,682 |
| 2024 | 1,174 | 7,078 | 1,500 | 2,166 | 2,825 |

^a Year of eligibility; i.e., the year in which a worker attains age 62, becomes disabled before age 62, or dies before attaining age 62. Source: <https://www.ssa.gov/oact/cola/autoAdj.html>

Again, the national average wage indices for 1951-2022 are:

| National Average Wage Indexing Series, 1951-2022 | | | | | | | |
|--|------------|------|-------------|------|-------------|------|-------------|
| Year | Index | Year | Index | Year | Index | Year | Index |
| 1951 | \$2,799.16 | 1969 | \$5,893.76 | 1987 | \$18,426.51 | 2005 | \$36,952.94 |
| 1952 | \$2,973.32 | 1970 | \$6,186.24 | 1988 | \$19,334.04 | 2006 | \$38,651.41 |
| 1953 | \$3,139.44 | 1971 | \$6,497.08 | 1989 | \$20,099.55 | 2007 | \$40,405.48 |
| 1954 | \$3,155.64 | 1972 | \$7,133.80 | 1990 | \$21,027.98 | 2008 | \$41,334.97 |
| 1955 | \$3,301.44 | 1973 | \$7,580.16 | 1991 | \$21,811.60 | 2009 | \$40,711.61 |
| 1956 | \$3,532.36 | 1974 | \$8,030.76 | 1992 | \$22,935.42 | 2010 | \$41,673.83 |
| 1957 | \$3,641.72 | 1975 | \$8,630.92 | 1993 | \$23,132.67 | 2011 | \$42,979.61 |
| 1958 | \$3,673.80 | 1976 | \$9,226.48 | 1994 | \$23,753.53 | 2012 | \$44,321.67 |
| 1959 | \$3,855.80 | 1977 | \$9,779.44 | 1995 | \$24,705.66 | 2013 | \$44,888.16 |
| 1960 | \$4,007.12 | 1978 | \$10,556.03 | 1996 | \$25,913.90 | 2014 | \$46,481.52 |
| 1961 | \$4,086.76 | 1979 | \$11,479.46 | 1997 | \$27,426.00 | 2015 | \$48,098.63 |
| 1962 | \$4,291.40 | 1980 | \$12,513.46 | 1998 | \$28,861.44 | 2016 | \$48,642.15 |
| 1963 | \$4,396.64 | 1981 | \$13,773.10 | 1999 | \$30,469.84 | 2017 | \$50,321.89 |
| 1964 | \$4,576.32 | 1982 | \$14,531.34 | 2000 | \$32,154.82 | 2018 | \$52,145.80 |
| 1965 | \$4,658.72 | 1983 | \$15,239.24 | 2001 | \$32,921.92 | 2019 | \$54,099.99 |
| 1966 | \$4,938.36 | 1984 | \$16,135.07 | 2002 | \$33,252.09 | 2020 | \$55,628.50 |
| 1967 | \$5,213.44 | 1985 | \$16,822.51 | 2003 | \$34,064.95 | 2021 | \$60,575.07 |
| 1968 | \$5,571.76 | 1986 | \$17,321.82 | 2004 | \$35,648.55 | 2022 | \$63,795.13 |

Source: <https://www.ssa.gov/oact/cola/autoAdj.html>. 2023 and 2024 not yet determined.

The bend points change for each year of eligibility based on the changes in average total wages from the previous indexing year. The new bend points apply if the person first becomes eligible or dies in that year and they remain applicable to PIA determinations in later recomputations. Cost-of-living increases are applied to compute PIA beginning with the first year of eligibility, regardless of when a person becomes entitled to benefits.

3. Years counted

A year is not counted as the year of an individual's death or eligibility for purposes of the computation of primary insurance amount or cost-of-living increases in any case where such individual was entitled to a disability insurance benefit for any of the 12 months immediately preceding the month of such death or eligibility (but there shall be counted instead the year of the individual's eligibility for the disability insurance benefit or benefits to which he was entitled during such 12 months).²⁴

Note:

An individual is deemed to be eligible: (i) for old-age insurance benefits, for months beginning with the month in which he attains age 62; or (ii) for disability insurance benefits, for months beginning with the month in which his period of disability began, except in cases where fewer than 12 months have elapsed since the termination of a prior period of disability.²⁵

- a. In the case of an individual who was entitled to a disability insurance benefit for any of the 12 months before the month in which he became entitled to an old-age insurance benefit, became re-entitled to a disability insurance benefit, or died, the primary insurance

²⁴ 42 U.S.C. §415(a)(2)(A).
²⁵ 42 U.S.C. §415(a)(3)(B).

amount for determining any benefit attributable to that entitlement, re-entitlement, or death is the greater of:

- (i) The primary insurance amount upon which such disability insurance benefit was based, increased by the amount of each general benefit increase, and each increase provided for cost-of-living, that would have applied to such primary insurance amount had the individual remained entitled to such disability insurance benefit until the month in which he became so entitled or re-entitled or died;²⁶ or
 - (ii) The minimum amount computed above.²⁷
- b. In the case of an individual who was entitled to a disability insurance benefit for any month, and with respect to whom a primary insurance amount is required to be computed at any time after the close of the period of the individual's disability (whether because of such individual's subsequent entitlement to old-age insurance benefits or to a disability insurance benefit based upon a subsequent period of disability, or because of such individual's death), the primary insurance amount so computed may in no case be less than the primary insurance amount with respect to which such former disability insurance benefit was most recently determined.

4. The significance of bend points

The differential of the percentages associated with each segment demarcated by the bend points has economic consequences. Adding one dollar of AIME to one individual is not necessarily the same as a dollar of AIME to another: it all depends on which segment that AIME falls into. This has important consequences for spouses who have the ability to direct compensation to one or the other. One spouse could be in the 90-percent segment (low average wages) and the other in the 15-percent segment (high average wages), creating a differential of \$0.75 in combined PIA by shifting \$1 of AIME from one spouse to the other.

Another aspect of the bend points arises when no shifting is involved but where one spouse is deciding whether to return to work.

²⁶ 42 U.S.C. §415(a)(2)(B)(i).
²⁷ 42 U.S.C. §415(a)(2)(B)(ii).

Planning Question:

Should a spouse go back to work to increase Social Security benefits?

In general, the lifetime earnings are indexed over the high 35 years (420 months) to determine the AIME. Accordingly, in order to increase the AIME of a worker by \$1, the amount of \$420 must be paid (and Social Security paid). If an individual and spouse have some discretion through business structures to “split” the wages, one has to shift \$420 of wages to shift \$1 of AIME. Now here is where the bend points come back into the analysis. If Spouse A is in the 15 percent segment of the PIA calculation, the shifting of \$1 of AIME to the other spouse, B, reduces A’s PIA by 15 cents. However, if B is in the 90 percent segment, that shift will increase B’s PIA by 90 cents, a net increase of 75 cents of PIA. Now with respect to that \$420, A may be a Medicare-only payer, i.e., earnings exceed the taxable wage base/contribution base, and thus, have to pay only 2.9 percent Social Security tax on the \$420, while B may be in the full 15.3 percent Social Security rate on such earnings, with the net increase of 12.4 percent of \$420, or \$52.08 in Social Security taxes. In addition, the potential loss of the 15 cents of PIA of A also costs B 7.5 cents of spousal benefit, in which case, the net gain at maximum is 67.5 cents of PIA.

Note that if A is already at the maximum PIA (by reason of having maximum Social Security earnings over the computation period), a \$1 wage neither increases PIA nor increases any spousal benefit based on that PIA.

Also B may not have a PIA at one-half of A’s PIA level so that the increase in B’s PIA does not produce any additional benefit to B because B’s spousal benefit may still be higher.

B must also consider how much time it will take to become fully insured. A may already be fully insured, but B may have several years/quarters to accrue before reaching that status where B’s nominal PIA can be compared to the spousal benefit.

Finally, while B’s work may create a PIA in excess of one-half of A’s PIA, so that at retirement B can have a benefit on B’s record that exceeds B’s spousal benefit on A’s record, if A dies before B, B will become eligible for A’s benefit, i.e., 100 percent of A’s PIA, as adjusted. In other words, under some of the circumstances addressed here, B will have to pay \$52.08 to obtain a monthly annuity of 67.5 cents for all months up to the month A dies. If B can achieve a PIA in excess of A’s PIA, then the additional benefit will last throughout the joint lifetimes of A and B.

The discussion will return to this concept later in determining when to start claiming old-age insurance benefits.

C. Recomputation of benefits

1. In general

After an individual’s primary insurance amount has been determined, there is generally no recomputation of such individual’s primary insurance amount.²⁸

2. Post-eligibility wages and self-employment income

If an individual has wages or self-employment income for any part of a year for which he is entitled to old-age or disability insurance benefits, the Commissioner of Social Security shall recompute the individual’s primary insurance amount for that year.²⁹ For the purposes of determining the average indexed monthly earnings of an individual who receives a recomputation, there shall be used, in lieu of the bend point amounts, the amounts so established that were used in the computation of such individual’s primary insurance amount prior to this recomputation.³⁰

²⁸ 42 U.S.C. §415(f)(1).

²⁹ 42 U.S.C. §415(f)(2)(A).

³⁰ 42 U.S.C. §415(f)(2)(B).

- a. A recomputation of any individual's primary insurance amount is made as though the year with respect to which it is made is the last year of the period specified in the computation years; and the determination of creditable wages is based on the amounts in the computation of such individual's primary insurance amount prior to the application of this recomputation.³¹
- b. A recomputation with respect to any year is effective:
 - (i) In the case of an individual who did not die in that year, for monthly benefits beginning with benefits for January of the following year;³² or
 - (ii) In the case of an individual who died in that year, for monthly benefits beginning with benefits for the month in which he died.³³
- c. A recomputation is effective only if it increases the primary insurance amount by at least \$1.³⁴

3. Deceased individual

- a. In the case of an individual who became entitled to old-age insurance benefits and died before the month in which he attained full retirement age, the Commissioner of Social Security shall recompute his primary insurance amount as though he became entitled to old-age insurance benefits in the month in which he died; except that:
 - (i) His computation base years includes the year in which he died; and
 - (ii) His elapsed years does not include the year in which he died or any year thereafter. Such recomputation of such primary insurance amount shall be effective for and after the month in which he died.³⁵
- b. Upon the death of an individual entitled to old-age or disability benefits, if any person is entitled to monthly benefits or a lump-sum death payment, on the wages and self-employment income of such individual, the Commissioner of Social Security shall recompute the decedent's primary insurance amount, but only if the decedent during his lifetime was paid compensation that was treated as remuneration for employment.³⁶

D. Cost of living increases in benefits

1. General definitions

- a. The term base quarter means: (i) the calendar quarter ending on September 30 in each year after 1982; or (ii) any other calendar quarter in which occurs the effective month of a general benefit increase.³⁷
- b. The term cost-of-living computation quarter means a base quarter, as defined in (i) above, with respect to which the applicable increase percentage is greater than zero; except that there shall be no cost-of-living computation quarter in any calendar year if in the year prior to such year a law has been enacted providing a general benefit increase or if in such prior year such a general benefit increase becomes effective.³⁸
- c. The term applicable increase percentage means:

³¹ 42 U.S.C. §415(f)(2)(C).
³² 42 U.S.C. §415(f)(2)(D)(i).
³³ 42 U.S.C. §415(f)(2)(D)(ii).
³⁴ 42 U.S.C. §415(f)(4).
³⁵ 42 U.S.C. §415(f)(5).
³⁶ 42 U.S.C. §415(f)(6).
³⁷ 42 U.S.C. §415(i)(1)(A).
³⁸ 42 U.S.C. §415(i)(1)(B).

- (i) With respect to a base quarter or cost-of-living computation quarter in any calendar year for which the OASDI fund ratio is 20.0 percent or more, the CPI increase percentage; and
 - (ii) With respect to a base quarter or cost-of-living computation quarter in any calendar year for which the OASDI fund ratio is less than 20.0 percent, the CPI increase percentage or the wage increase percentage, whichever (with respect to that quarter) is the lower.³⁹
- d. The term CPI increase percentage, with respect to a base quarter or cost-of-living computation quarter in any calendar year, means the percentage (rounded to the nearest one-tenth of one percent) by which the Consumer Price Index for that quarter (as prepared by the Department of Labor) exceeds such index for the most recent prior calendar quarter that was a base quarter by reason of a general benefit increase or, if later, the most recent cost-of-living computation quarter.⁴⁰
- e. The term wage increase percentage, with respect to a base quarter or cost-of-living computation quarter in any calendar year, means the percentage (rounded to the nearest one-tenth of one percent) by which the national average wage index for the year immediately preceding such calendar year exceeds such index for the year immediately preceding the most recent prior calendar year that included a base quarter in which a general benefit increase occurs or, if later, that included a cost-of-living computation quarter.⁴¹
- f. The term OASDI fund ratio, with respect to any calendar year, means the ratio of:⁴²
- (i) The combined balance in the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund as of the beginning of such year and reduced by the outstanding amount of any loan (including interest thereon) theretofore made to either such Fund from the Federal Hospital Insurance Trust Fund, to
 - (ii) The total amount that (as estimated by the Commissioner of Social Security) will be paid from the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund during such calendar year.
- g. The Consumer Price Index for a base quarter, a cost-of-living computation quarter, or any other calendar quarter shall be the arithmetical mean of such index for the three months in such quarter.⁴³

2. Determination of cost-of-living quarters

The Commissioner of Social Security shall determine each year whether the base quarter ending September 30 of such year is a cost-of-living computation quarter.⁴⁴

- a. If the Commissioner of Social Security determines that the base quarter in any year is a cost-of-living computation quarter, the Commissioner, effective with the month of December of that year as provided below, increases the primary insurance amount of each other individual on which benefit entitlement is based, and the amount of total monthly benefits based on any primary insurance amount that is permitted under Section

³⁹ 42 U.S.C. §415(i)(1)(C).
⁴⁰ 42 U.S.C. §415(i)(1)(D).
⁴¹ 42 U.S.C. §415(i)(1)(E).
⁴² 42 U.S.C. §415(i)(1)(F).
⁴³ 42 U.S.C. §415(i)(1)(G).
⁴⁴ 42 U.S.C. §415(i)(2)(A)(i).

It below (and such total shall be increased, unless otherwise so increased under another provision, at the same time as such primary insurance amount).⁴⁵

- b. In the case of an individual who becomes eligible for an old-age or disability insurance benefit, or who dies prior to becoming so eligible, in a year in which there occurs an increase, the individual's primary insurance amount (without regard to the time of entitlement to that benefit) is increased by the amount of that increase and subsequent applicable increases, but only with respect to benefits payable for months after November of that year.⁴⁶
- c. This increase with respect to a particular cost-of-living computation quarter shall apply in the case of monthly benefits for months after November of the calendar year in which occurred such cost-of-living computation quarter, and in the case of lump-sum death payments with respect to deaths occurring after November of such calendar year.⁴⁷
- d. Whenever the Commissioner of Social Security determines that a base quarter in a calendar year is also a cost-of-living computation quarter, the Commissioner must notify the House Committee on Ways and Means and the Senate Committee on Finance of such determination within 30 days after the close of such quarter, indicating the amount of the benefit increase to be provided, the Commissioner's estimate of the extent to which the cost of such increase would be met by an increase in the contribution and benefit base and the estimated amount of the increase in such base, the actuarial estimates of the effect of such increase, and the actuarial assumptions and methodology used in preparing such estimates.⁴⁸

Note:

The Commissioner of Social Security determines and issues the OASDI fund ratio for the current calendar year on or before November 1 of the current calendar year, based upon the most recent data then available. The Commissioner includes a statement of the fund ratio and the national average wage index and a statement of the effect such ratio and the level of such index may have upon benefit increases in any notification made above and any determination published in the next paragraph.⁴⁹

If the Commissioner of Social Security determines that a base quarter in a calendar year is also a cost-of-living computation quarter, the Commissioner publishes in the Federal Register within 45 days after the close of such quarter a determination that a benefit increase is required and the percentage thereof.⁵⁰

3. What is a general benefit increase?

The term general benefit increase means an increase (other than an increase for cost of living) in all primary insurance amounts on which monthly insurance benefits are based.⁵¹

⁴⁵ 42 U.S.C. §415(i)(2)(A)(ii).
⁴⁶ 42 U.S.C. §415(i)(2)(A)(iii).
⁴⁷ 42 U.S.C. §415(i)(2)(B).
⁴⁸ 42 U.S.C. §415(i)(2)(C)(i).
⁴⁹ 42 U.S.C. §415(i)(2)(C)(ii).
⁵⁰ 42 U.S.C. §415(i)(2)(D).
⁵¹ 42 U.S.C. §415(i)(3).

E. Case Studies: Benefit calculations

1. Cases A & B: Benefit calculations for workers retiring in 2024

The following hypothetical cases of benefit calculations for workers retiring in 2024 are provided by the SSA.⁵²

Cases A & B: **Case A**, born in 1962, retires at age 62. **Case B**, born in 1958, retires at his normal (or full) retirement age of 66 years and eight months. Each worker retires in 2024. In each case, the analysis assumes the worker has covered earnings from 1981 through 2023, as shown at right in columns labeled “nominal earnings.”

Indexing brings nominal earnings up to near-current wage levels. For each case, the table shows columns of earnings before and after indexing. Between these columns is a column showing the indexing factors. A factor will always equal one for the year in which the person attains age 60 and all later years. The indexing factor for a prior year Y is the result of dividing the average wage index for the year in which the person attains age 60 by the average wage index for year Y. For example, the **Case-A** indexing factor for 1981 is the average wage for 2022 (\$63,795.13) divided by the average wage for 1981 (\$13,773.10). For Case-B, the indexing factor for 1981 is the average wage of 2018 (\$52,145.80) divided by the average wage for 1981 (\$13,773.10).

The benefit computation uses the highest 35 years of indexed earnings. Below the indexed earnings are the sums for the highest 35 years of indexed earnings and the corresponding average monthly amounts of such earnings. (The average is the result of dividing the sum of the 35 highest amounts by the number of months in 35 years.) Such an average is called “average indexed monthly earnings” (AIME). The next step is to calculate benefits based on AIME amounts.

⁵² <http://www.ssa.gov/OACT/ProgData/retirebenefit1.html> and <http://www.ssa.gov/OACT/ProgData/retirebenefit2.html>.

| Earnings Before and After Indexing | | | | | | |
|------------------------------------|----------------------|-----------------|-------------------|--------------------------|-----------------|-------------------|
| | Case A: Born in 1962 | | | Case B: Born in 1958 | | |
| | Nominal Earnings | Indexing Factor | Indexed* Earnings | Nominal Earnings | Indexing Factor | Indexed* Earnings |
| 1981 | 11,774 | 4.6319 | 54,536 | 29,700 | 3.7861 | 112,447 |
| 1982 | 13,000 | 4.3902 | 57,073 | 32,400 | 3.5885 | 116,267 |
| 1983 | 13,758 | 4.1862 | 57,594 | 35,700 | 3.4218 | 122,158 |
| 1984 | 14,473 | 3.9538 | 57,223 | 37,800 | 3.2318 | 122,162 |
| 1985 | 15,372 | 3.7922 | 58,294 | 39,600 | 3.0998 | 122,752 |
| 1986 | 16,076 | 3.6829 | 58,871 | 42,000 | 3.0104 | 126,437 |
| 1987 | 16,605 | 3.4621 | 57,488 | 43,800 | 2.8299 | 123,950 |
| 1988 | 17,718 | 3.2996 | 58,462 | 45,000 | 2.6971 | 121,370 |
| 1989 | 18,647 | 3.1740 | 59,186 | 48,000 | 2.5944 | 124,531 |
| 1990 | 19,445 | 3.0338 | 58,992 | 51,300 | 2.4798 | 127,214 |
| 1991 | 20,405 | 2.9248 | 59,681 | 53,400 | 2.3907 | 127,663 |
| 1992 | 21,230 | 2.7815 | 59,051 | 55,500 | 2.2736 | 126,185 |
| 1993 | 22,391 | 2.7578 | 61,750 | 57,600 | 2.2542 | 129,842 |
| 1994 | 22,652 | 2.6857 | 60,836 | 60,600 | 2.1953 | 133,035 |
| 1995 | 23,330 | 2.5822 | 60,243 | 61,200 | 2.1107 | 129,175 |
| 1996 | 24,338 | 2.4618 | 59,915 | 62,700 | 2.0123 | 126,171 |
| 1997 | 25,605 | 2.3261 | 59,560 | 65,400 | 1.9013 | 124,345 |
| 1998 | 27,180 | 2.2104 | 60,079 | 68,400 | 1.8068 | 123,585 |
| 1999 | 28,688 | 2.0937 | 60,064 | 72,600 | 1.7114 | 124,248 |
| 2000 | 30,376 | 1.9840 | 60,266 | 76,200 | 1.6217 | 123,574 |
| 2001 | 32,151 | 1.9378 | 62,302 | 80,400 | 1.5839 | 127,346 |
| 2002 | 33,015 | 1.9185 | 63,339 | 84,900 | 1.5682 | 133,140 |
| 2003 | 33,444 | 1.8727 | 62,631 | 87,000 | 1.5308 | 133,180 |
| 2004 | 34,362 | 1.7896 | 61,494 | 87,900 | 1.4628 | 128,580 |
| 2005 | 36,064 | 1.7264 | 62,261 | 90,000 | 1.4111 | 126,999 |
| 2006 | 37,493 | 1.6505 | 61,882 | 94,200 | 1.3491 | 127,085 |
| 2007 | 39,330 | 1.5789 | 62,098 | 97,500 | 1.2906 | 125,834 |
| 2008 | 41,234 | 1.5434 | 63,641 | 102,000 | 1.2615 | 128,673 |
| 2009 | 42,305 | 1.5670 | 66,292 | 106,800 | 1.2809 | 136,800 |
| 2010 | 41,787 | 1.5308 | 63,968 | 106,800 | 1.2513 | 133,639 |
| 2011 | 42,897 | 1.4843 | 63,672 | 106,800 | 1.2133 | 129,580 |
| 2012 | 44,368 | 1.4394 | 63,863 | 110,100 | 1.1765 | 129,533 |
| 2013 | 45,884 | 1.4212 | 65,210 | 113,700 | 1.1617 | 132,085 |
| 2014 | 46,603 | 1.3725 | 63,963 | 117,000 | 1.1219 | 131,262 |
| 2015 | 48,394 | 1.3263 | 64,185 | 118,500 | 1.0841 | 128,466 |
| 2016 | 50,220 | 1.3115 | 65,864 | 118,500 | 1.0720 | 127,032 |
| 2017 | 50,931 | 1.2677 | 64,565 | 127,200 | 1.0362 | 131,805 |
| 2018 | 53,880 | 1.2234 | 65,917 | 128,400 | 1 | 128,400 |
| 2019 | 56,775 | 1.1792 | 66,949 | 132,900 | 1 | 132,900 |
| 2020 | 57,156 | 1.1468 | 65,547 | 137,700 | 1 | 137,700 |
| 2021 | 58,152 | 1.0532 | 61,243 | 142,800 | 1 | 142,800 |
| 2022 | 63,152 | 1 | 63,152 | 147,000 | 1 | 147,000 |
| 2023 | 64,112 | 1 | 64,112 | 160,200 | 1 | 160,200 |
| Highest-35 Total: | | | 2,187,773 | Highest-35 Total: | | 4,582,835 |
| AIME: | | | 5,208 | AIME: | | 10,911 |

| Formula bend points | | | | |
|---------------------|----------|---------|---------|--|
| Case | AIME | First | Second | Formula applied to AIME |
| A | \$5,208 | \$1,174 | \$7,078 | $0.9(1,174) + 0.32(5,208 - 1,174) = \$2,347.48$ |
| B | \$10,911 | \$960 | \$5,785 | $0.9(960) + 0.32(5,785 - 960) + 0.15(10,911 - 5,785) = \$3,176.90$ |

Because the worker in **Case A** retires in 2024, and 2024 is the year in which the worker is first eligible for benefits, there are no applicable cost-of-living adjustments, or COLAs, to the amount computed above. Therefore, the **Case-A** PIA is the **Case-A** amount computed above truncated to the next lower dime, or **\$2,347.40**.

The worker in **Case B** is first eligible in 2020 (the year **Case B** reached age 62). The **Case-B** PIA is the **Case-B** amount computed above truncated to the next lower dime and increased by cost-of-living adjustments, or COLAs, for 2021 through 2024. These COLAs are 1.3 percent, 5.9 percent, 8.7 percent, and 3.2 percent respectively.⁵³ The resulting PIA is \$3,823.12. rounded down to **\$3,823.10**.

Assuming the worker in **Case A** begins receiving benefits at the earliest possible age, which is age 62, and because **Case A's** normal retirement age is 67 years, the benefit amount for **Case A** is reduced for 60 months of early retirement. The \$2,347.40 PIA is thus reduced to a monthly benefit of **\$1,643**.⁵⁴

The benefit amount for **Case B**, assuming that benefits begin exactly at normal retirement age of 66 years and 8 months, is not reduced except for rounding down to the next lower dollar. The \$3,823.10 PIA is thus reduced to a monthly benefit of **\$3,823**.⁵⁵

II. Reductions of benefits

A. Overview of family benefits

As discussed in Chapter 1, various individuals may receive a benefit based on an eligible worker's account based on their relationships or former relationships to the worker. The benefits that such individuals may draw are based on the PIA of the eligible worker and subjected to limitations and reductions based on the individual's relationship to the worker and/or limitations on the worker, such as the earnings limitation or reduction for early retirement. The starting points for each relationship, as discussed in Chapter 1, are:

⁵³ <https://www.ssa.gov/oact/cola/colaseries.html>.

⁵⁴ The reduction is 5/9 of one percent for 36 months and 5/12 of one percent for 24 months. The result is rounded down to the nearest dollar. Reductions in benefits are discussed in the next part of this chapter.

⁵⁵ The benefit is actually rounded down to the nearest dollar after Medicare is deducted. Medicare is disregarded in the example for ease of calculation.

| | |
|--|---|
| Spouse or divorced spouse: | 50% of the insured's PIA. |
| Surviving spouse or surviving divorced spouse: | 100% of the deceased worker's benefit. If the deceased worker is receiving an increased benefit based on delayed retirement, the survivor will receive the increased amount. If the worker was receiving a reduced amount because of early retirement, the surviving spouse will receive a reduced amount, but not below 82.5% of the deceased worker's PIA |
| Child | 50% of the PIA of a living parent, 75% of a deceased parent. |
| Mother or father (child in care) | 75% of the deceased worker's PIA. |
| Parent | Generally, 82.5% of the worker's PIA, 75% if two parents qualify |

The amounts may then be reduced or increased based on additional rules discussed below.

B. Family maximum benefits

1. In general

In the case of an individual whose primary insurance amount has been computed or recomputed, the total monthly benefits to which beneficiaries may be entitled for a month on the basis of the wages and self-employment income of such individual shall, except as provided by the limitations for certain benefits and on total benefits discussed below (but prior to any increases resulting from the application of cost-of-living increases), be reduced as necessary so as not to exceed:

- **150 percent** of such individual's primary insurance amount to the extent that it does not exceed the first bend point amount established;⁵⁶
- **272 percent** of such individual's primary insurance amount to the extent that it exceeds the first bend point amount established but does not exceed the second bend point amount established;⁵⁷
- **134 percent** of such individual's primary insurance amount to the extent that it exceeds the second bend point amount established but does not exceed the third bend point amount established;⁵⁸ and
- **175 percent** of such individual's primary insurance amount to the extent that it exceeds the third bend point amount established.⁵⁹

Any such amount that is not a multiple of \$0.10 shall be decreased to the next lower multiple of \$0.10.

2. Bend points

The maximum family bend point amounts established for the calendar year 1979 are first \$230, second \$332, and third \$433, respectively.⁶⁰ For individuals who initially become eligible for old-age or disability insurance benefits, or who die (before becoming so eligible for such benefits), in any calendar year after 1979, each of the amounts so established is equal the product of the corresponding amount established for the calendar year 1979 and the average wage index ratio, with such product being rounded to the nearest \$1, except that any amount so established that is a multiple of \$0.50 but not of \$1 shall be rounded to the next higher \$1.⁶¹

⁵⁶ 42 U.S.C. §403(a)(1)(A).

⁵⁷ 42 U.S.C. §403(a)(1)(B).

⁵⁸ 42 U.S.C. §403(a)(1)(C).

⁵⁹ 42 U.S.C. §403(a)(1)(D).

⁶⁰ 42 U.S.C. §403(a)(2)(A).

⁶¹ 42 U.S.C. §403(a)(2)(B).

Note:

The Commissioner of Social Security publishes in the Federal Register, on or before November 1, the formula that (except as provided for cost-of-living) is to be applicable to individuals who become eligible for old-age or disability insurance benefits, or who die (before becoming eligible for such benefits), in the following calendar year.⁶²

Note:

A year shall not be counted as the year of an individual's death or eligibility for these purposes in any case where such individual was entitled to a disability insurance benefit for any of the 12 months immediately preceding the month of such death or eligibility (but there shall be counted instead the year of the individual's eligibility for the disability insurance benefits to which he was entitled during such 12 months).⁶³

Note:

If a person turns 62 or becomes disabled or dies, the formula used to compute the family maximum is similar to that used to compute the PIA. It involves computing the sum of four separate percentages of portions of the worker's PIA. For 2022 these portions were the first \$1,308, the amount over \$1,308 to and including \$1,889, the amount over \$1,889 to and including \$2,463, and the amount over \$2,463. These dollar amounts are the "bend points" of the family-maximum formula. The following tables from the SSA website⁶⁴ show family maximum benefit (and PIA) bend points for years beginning with 1979.

| Year ^a | Dollar Amounts in PIA Formula | | Dollar Amounts in Maximum Family Benefit Formula | | |
|-------------------|-------------------------------|---------|--|--------|-------|
| | First | Second | First | Second | Third |
| 1979 | \$180 | \$1,085 | \$230 | \$332 | \$433 |
| 1980 | 194 | 1,171 | 248 | 358 | 467 |
| 1981 | 211 | 1,274 | 270 | 390 | 508 |
| 1982 | 230 | 1,388 | 294 | 425 | 554 |
| 1983 | 254 | 1,528 | 324 | 468 | 610 |
| 1984 | 267 | 1,612 | 342 | 493 | 643 |
| 1985 | 280 | 1,691 | 358 | 517 | 675 |
| 1986 | 297 | 1,790 | 379 | 548 | 714 |
| 1987 | 310 | 1,866 | 396 | 571 | 745 |
| 1988 | 319 | 1,922 | 407 | 588 | 767 |
| 1989 | 339 | 2,044 | 433 | 626 | 816 |
| 1990 | 356 | 2,145 | 455 | 656 | 856 |
| 1991 | 370 | 2,230 | 473 | 682 | 890 |
| 1992 | 387 | 2,333 | 495 | 714 | 931 |
| 1993 | 401 | 2,420 | 513 | 740 | 966 |
| 1994 | 422 | 2,545 | 539 | 779 | 1,016 |
| 1995 | 426 | 2,567 | 544 | 785 | 1,024 |
| 1996 | 437 | 2,635 | 559 | 806 | 1,052 |
| 1997 | 455 | 2,741 | 581 | 839 | 1,094 |
| 1998 | 477 | 2,875 | 609 | 880 | 1,147 |

⁶² 42 U.S.C. §403(a)(2)(C).

⁶³ 42 U.S.C. §403(a)(2)(D).

⁶⁴ Website: <http://www.ssa.gov/OACT/COLA/familymax.html>.

⁶⁵ Source: <https://www.ssa.gov/oact/cola/familymax.html> or <http://www.ssa.gov/OACT/COLA/bendpoints.html>.

| Dollar Amounts in Primary Insurance Amount and Maximum Family Benefit Formulas ⁶⁵ | | | | | |
|--|-------------------------------|--------|--|--------|-------|
| Year ^a | Dollar Amounts in PIA Formula | | Dollar Amounts in Maximum Family Benefit Formula | | |
| | First | Second | First | Second | Third |
| 1999 | 505 | 3,043 | 645 | 931 | 1,214 |
| 2000 | 531 | 3,202 | 679 | 980 | 1,278 |
| 2001 | 561 | 3,381 | 717 | 1,034 | 1,349 |
| 2002 | 592 | 3,567 | 756 | 1,092 | 1,424 |
| 2003 | 606 | 3,653 | 774 | 1,118 | 1,458 |
| 2004 | 612 | 3,689 | 782 | 1,129 | 1,472 |
| 2005 | 627 | 3,779 | 801 | 1,156 | 1,508 |
| 2006 | 656 | 3,955 | 838 | 1,210 | 1,578 |
| 2007 | 680 | 4,100 | 869 | 1,255 | 1,636 |
| 2008 | 711 | 4,288 | 909 | 1,312 | 1,711 |
| 2009 | 744 | 4,483 | 950 | 1,372 | 1,789 |
| 2010 | 761 | 4,586 | 972 | 1,403 | 1,830 |
| 2011 | 749 | 4,517 | 957 | 1,382 | 1,803 |
| 2012 | 767 | 4,624 | 980 | 1,415 | 1,845 |
| 2013 | 791 | 4,768 | 1,011 | 1,459 | 1,903 |
| 2014 | 816 | 4,917 | 1,042 | 1,505 | 1,962 |
| 2015 | 826 | 4,980 | 1,056 | 1,524 | 1,987 |
| 2016 | 856 | 5,157 | 1,093 | 1,578 | 2,058 |
| 2017 | 885 | 5,336 | 1,131 | 1,633 | 2,130 |
| 2018 | 895 | 5,397 | 1,144 | 1,651 | 2,154 |
| 2019 | 926 | 5,583 | 1,184 | 1,708 | 2,228 |
| 2020 | 960 | 5,785 | 1,226 | 1,770 | 2,309 |
| 2021 | 996 | 6,002 | 1,272 | 1,837 | 2,395 |
| 2022 | 1,024 | 6,172 | 1,308 | 1,889 | 2,463 |
| 2023 | 1,115 | 6,721 | 1,425 | 2,056 | 2,682 |
| 2024 | 1,174 | 7,078 | 1,500 | 2,166 | 2,825 |

^a Year of eligibility; that is, the year in which a worker attains age 62, becomes disabled before age 62, or dies before attaining age 62.

Mini-Case 2: Jack retired this year with a PIA of \$3,000. He has a wife eligible for benefits and two dependent children. His family maximum is calculated as follows.

| | |
|---|-----------------|
| 150.00 percent of \$1,500 | \$2,250.00 |
| 272.00 percent of \$666 (\$2,166 - \$1,500) | \$1,811.52 |
| 134.00 percent of \$659 (\$2,825 - \$2,166) | \$883.06 |
| 175.00 percent of \$175 (\$3,000 - \$2,825) | <u>\$306.25</u> |

Total \$5,250.83

Jack's potential maximum family benefit is rounded down to the nearest dollar. The maximum family benefit is \$5,250 per month.

Note:

Comparing this to the simple case of a retiree and a spousal benefit, the combined 150 percent of PIA (retiree and spouse) is always less than the family maximum. However, where additional beneficiaries are involved, the effective percentage the spouse may receive may be less than 50 percent of the (potential) retiree's benefit.

3. Additional limitation for disability benefits

The total monthly benefits to which beneficiaries may be entitled for old-age, survivors, or disability of this title for any month on the basis of the wages and self-employment income of an individual entitled to disability insurance benefits shall be reduced to the smaller of: (i) the larger of (a) 85 percent of such individual's average indexed monthly earnings, or (b) 100 percent of his primary insurance amount; or (ii) 150 percent of such individual's primary insurance amount (the "total benefits limit").⁶⁶ This is subject to cost-of-living increases for a base quarter, but before the limitations specified in paragraphs 4, 5, and 6 below.

Mini-Case 3: Jim became disabled in September. His average indexed monthly earnings (AIME) was \$400 and his PIA was \$360. 85% of Jim's AIME is \$340. His maximum family benefit is the smaller of:

- The larger of 85 percent of AIME (\$340) or 100 percent of the PIA (\$360); or
- 150 percent of the PIA (\$540).

Therefore, Jim's family maximum is \$360.

4. Limitations for various benefits

- a. When an individual who is (1) entitled to benefits on the basis of the wages and self-employment income of any insured individual and (2) to whom the maximum benefits provisions apply (but for the provisions that limit a child to benefits derived from one parent) would be entitled to child's insurance benefits for a month on the basis of the wages and self-employment income of one or more other insured individuals, then, the total monthly benefits to which all beneficiaries are entitled on the basis of such wages and self-employment income may not be so reduced to less than the smaller of:⁶⁷
- (i) The sum of the maximum amounts of benefits payable on the basis of the wages and self-employment income of all such insured individuals the "sum rule"); or
 - (ii) An amount (a) initially equal to the product of 1.75 and the primary insurance amount that would be computed for January of the year determined in the *Note* box following, with respect to average indexed monthly earnings equal to one-twelfth of the contribution and benefit base determined for that year, and (b) thereafter increased in accordance with the cost-of-living provisions (the "product rule").

⁶⁶ 42 U.S.C. §403(a)(6).

⁶⁷ 42 U.S.C. §403(a)(3)(A).

Note:

The year for these purposes is the year in which occurred the month that the application of these reduction provisions began with respect to benefits payable on the basis of the wages and self-employment income of the insured individual. If for any month subsequent to the first month for which the product rule applies (with respect to benefits payable on the basis of the wages and self-employment income of the insured individual) this reduction ceases to apply, then the year determined under the preceding sentence is redetermined (for purposes of any subsequent application with respect to benefits payable on the basis of such wages and self-employment income) as though this reduction had not been previously applicable.

- b. When any of such individuals is entitled to monthly benefits as a divorced spouse or as a surviving divorced spouse for any month, the benefit to which he or she is entitled on the basis of the wages and self-employment income of such insured individual for such month shall be determined without regard to this provision, and the benefits of all other individuals who are entitled for such month to monthly old age or survivors' benefits based on the wages and self-employment income of such insured individual is determined as if no such divorced spouse or surviving divorced spouse were entitled to benefits for such month.⁶⁸
- c. The benefit of the entitled individual whose entitlement is based on a valid marriage (that does not depend on the deeming provisions) to such insured individual is, for such month and all months thereafter, determined without regard to this provision, and the benefits of all other individuals who are entitled, for such month or any month thereafter, to monthly old-age or survivors' benefits based on the wages and self-employment income of such insured individual are determined as if such entitled individuals were not entitled to benefits for such month in any case in which:⁶⁹
 - (i) Two or more individuals are entitled to monthly benefits for the same month as a spouse or as a surviving spouse,
 - (ii) At least one of such individuals is entitled by reason of a deemed valid marriage, and
 - (iii) Such entitlements are based on the wages and self-employment income of the same insured individual.

5. Reduction after deductions

In any case in which benefits are reduced, the reduction is made after any deductions provided here and after any deductions for disability benefits. However, any reduction based on maximum limitations in the case of an individual who is entitled to a benefit as a spouse, surviving spouse, child, widow, widower, mother or father, or parent for any month on the basis of the same wages and self-employment income as another person: (i) who also is entitled to a benefit as a spouse, widow, widower, child, mother or father, or parent for such month; (ii) who does not live in the same household as such individual; and (iii) whose benefit for such month is suspended (in whole or in part) by reason of excess deductions is made before such suspension. Whenever a reduction is made in the total of monthly benefits to which individuals are entitled for any month on the basis of the wages and self-employment income of an insured individual, each such benefit other than the old-age or disability insurance benefit is proportionately decreased.⁷⁰

⁶⁸ 42 U.S.C. §403(a)(3)(C).

⁶⁹ 42 U.S.C. §403(a)(3)(D).

⁷⁰ 42 U.S.C. §403(a)(4).

Note:

The adjustment for the maximum benefits is made by proportionately reducing all the monthly benefits subject to the family maximum on the Social Security earnings record (except for retired worker's or disabled worker's benefits). All benefits subject to the family maximum are reduced in order to bring the total monthly benefits payable within the limit for the particular case.

Mini-Case 4: Refer to **mini-case 3**. If Jack's PIA is \$3,000, his wife is entitled to a wife's benefit of \$1,500, and each of his two children is also entitled to \$1,500. The total of the four benefits is \$7,500, which exceeds the family maximum of \$5,250 by \$2,250. Jack's old-age benefit of \$3,000 is not reduced, but his wife's and the children's benefits are reduced equally. \$2,250 divided by three is \$750. The spouse and children get \$750 each ($\$1,500 - 750 = \750), with no rounding necessary.

Note:

Rounding down to the next dollar is actually done after any deduction for Medicare premiums. Also, the family maximum reduction is applied before any reduction for early retirement.

6. Smallest increase

When an individual's primary insurance amount is increased for the following month under any provision, and two or more persons are entitled to monthly benefits for a particular month on the basis of the wages and self-employment income of such insured individual and (for such particular month), then the total of monthly benefits for all persons on the basis of such wages and self-employment income for such particular month shall for purposes of determining the total monthly benefits for all persons on the basis of such wages and self-employment income for months subsequent to such particular month is considered to have been increased by the smallest amount that would have been required in order to assure that the total of monthly benefits payable on the basis of such wages and self-employment income for any such subsequent month is not less (after the application of the other reduction provisions and the reduction for early retirement) than the total of monthly benefits (after the application of such other provisions and the reduction for early retirement) payable on the basis of such wages and self-employment income for such particular month.⁷¹

7. Special computations of PIA

- a. The total monthly benefits to which beneficiaries may be entitled under for old age, survivors, and disability for a month on the basis of the wages and self-employment income of an individual whose primary insurance amount is computed by reason of a disability amount enhanced by a general benefit increase is equal to the total monthly benefits as determined above with respect to such individual's primary insurance amount for the last month of his prior entitlement to disability insurance benefits, increased for this purpose by the general benefit increases and other cost-of-living increases that would have applied to such total monthly benefits had the individual remained entitled to disability insurance benefits until the month in which he became entitled to old-age insurance benefits or re-entitled to disability insurance benefits or died.⁷²
- b. The total monthly benefits to which beneficiaries may be entitled for old age, survivors, and disability for a month on the basis of the wages and self-employment income of an individual whose primary insurance amount is computed by reason of a termination of a

⁷¹ 42 U.S.C. §403(a)(5).

⁷² 42 U.S.C. §403(a)(10)(A)(i).

disability period preceding old age and survivors is equal to the total monthly benefits that were authorized with respect to such individual's primary insurance amount for the last month of his prior entitlement to disability insurance benefits.⁷³

- c. The total monthly benefits shall equal the total monthly benefits that would have been authorized with respect to the primary insurance amount for the last month of his prior entitlement to disability insurance benefits if such total monthly benefits had been computed without regard to the total benefits limitations in any case in which:⁷⁴
- (i) The total monthly benefits with respect to such individual's primary insurance amount for the last month of his prior entitlement to disability insurance benefits was computed under the total benefits limit;⁷⁵ and
 - (ii) The individual's primary insurance amount is computed by reason of a disability amount enhanced by a general benefit increase or by reason of a termination of a disability period preceding old age and survivors by reason of the individual's entitlement to old-age insurance benefits or death.⁷⁶

Note:

This paragraph applies before the application of the reduction for child's benefits based on multiple parents.⁷⁷

Mini-Case 5: A wage earner, his wife, and child are entitled to benefits. The wage earner's primary insurance amount is \$600.00. His maximum is \$900.00. Due to the maximum limit, the monthly benefits for the wife and child must be reduced to \$150.00 each. Their original benefit rates are \$300.00 each.

- Maximum—\$900.00.
- Subtract primary insurance amount—\$600.00.
- Amount available for wife and child—\$300.00.
- Divide by 2—\$150.00 each for wife and child.

The wife is also entitled to benefits on her own record of \$120.00 monthly. This reduces her wife's benefit to \$30.00. The following table illustrates this calculation.

- Wife's benefit, reduced for maximum—\$150.00.
- Subtract reduction due to dual entitlement—\$120.00.
- Wife's benefit—\$30.00.

In computing the total benefits payable on the record, we disregard the \$120.00 we cannot pay the wife. This allows us to increase the amount payable to the child to \$270.00. Below shows the steps in our calculation.

- Amount available under maximum—\$300.00.
- Subtract amount due wife after reduction due to entitlement to her own benefit—\$30.00.
- Child's benefit—\$270.00.

⁷³ 42 U.S.C. §403(a)(10)(A)(ii).

⁷⁴ 42 U.S.C. §403(a)(10)(B).

⁷⁵ 42 U.S.C. §403(a)(10)(B)(i).

⁷⁶ 42 U.S.C. §403(a)(10)(B)(ii).

⁷⁷ 42 U.S.C. §403(a)(10)(C).

- Mini-Case 6:** A wage earner, his wife, and two children are entitled to benefits. The wage earner's primary insurance amount is \$1,347. His maximum is \$2,020. Due to the maximum limit, the monthly benefits for the wife and children must be reduced to \$224 each. Their original rates (50 percent of the worker's benefit) are \$673.00 each. The following shows the calculation.
- Maximum—\$2,020
 - Subtract primary insurance amount—\$1,347
 - Amount available for wife and children—\$673
 - Divide by 3—\$224 each for wife and children

The children are also entitled to benefits on their own records. Child one is entitled to \$390 monthly and child two is entitled to \$150 monthly. This causes a reduction in the benefit to child one to \$0 and the benefit to child two to \$74. Again, the following illustrates the calculation.

- Benefit payable to child 1 reduced for maximum—\$224.
- Subtract reduction due to dual entitlement—\$390.00.
- Benefit payable to child 1—\$0.00.
- Benefit payable to child 2, reduced for maximum—\$224.
- Subtract reduction for dual entitlement—\$150.
- Benefit payable to child 2—\$74.

In computing the total benefits payable on the record, we consider only the benefits actually paid to the children, or \$74. This allows payment of an additional amount to the wife, increasing her benefit to \$599. This is how the calculation works.

- Amount available under maximum for wife and children—\$673.
- Subtract amount due children after reduction due to entitlement to their own benefits—\$74.
- Amount available for wife—\$599.
- Amount payable to wife (lesser of remaining family benefit or original benefit)—\$599.00.

- Mini-Case 7:** A wage earner, his wife, and four children are entitled to benefits. The wage earner's primary insurance amount is \$1,347. His maximum is \$2,020. Due to the maximum limit, the monthly benefits for the wife and children must be reduced to \$224 each. Their original rates are \$673.00 each. This is how the calculation works.
- Maximum—\$2,020.
 - Subtract primary insurance amount—\$1,347.
 - Amount available for wife and children—\$673.
 - Divide by 5—\$134.60 each for wife and four children.

Two children are also entitled to benefits on their own records. Child one is entitled to \$390 monthly and child two is entitled to \$120 monthly. This causes a reduction in the benefit to child one to \$0.00 and the benefit to child two to \$14. This calculation is as follows.

- Benefit to child 1, reduced for maximum—\$134.
- Subtract reduction due to dual entitlement—\$390.00.
- Benefit payable to child 1—\$0.00.
- Benefit to child 2, reduced for maximum—\$134.
- Subtract reduction for dual entitlement—\$120.00.
- Benefit payable to child two—\$14.

In computing the total benefits payable on the record, we disregard the \$254 we cannot pay the children. This allows payment of an additional amount to the wife, and the two remaining children as follows.

- Amount available under maximum for wife and children—\$673.
- Subtract amount due child one and child two after reduction due to entitlement to their own benefits—\$14.

- Amount available for wife and the other two children—\$659.
- Amount payable to the wife and each of the remaining two children \$219.

C. Reduction of benefits for early retirement

1. In general

- a. If the first month for which an individual is entitled to an old-age, spouse, or surviving spouse's insurance benefit is a month before the month in which such individual attains full retirement age, the amount of such benefit for such month and for any subsequent month shall generally be reduced by:
- (i) Five-ninths of one percent of such amount if such benefit is an old-age insurance benefit, 25/36 of one percent of such amount if such benefit is a spousal insurance benefit, or 19/40 of one percent of such amount if such benefit is a widow's or widower's insurance benefit,⁷⁸ multiplied by either --
- The number of months in the reduction period for such benefit, if such benefit is for a month before the month in which such individual attains retirement age,⁷⁹ or
 - If less, the number of such months in the adjusted reduction period for such benefit, if such benefit is for the month in which such individual attains age 62, or for the month in which such individual attains full retirement age.⁸⁰

Note:

The reduction can apply to a spousal benefit even though it is not applicable to the retired worker. For example if husband retires at full retirement age, and spouse is 62, spouse would be entitled to a full one-half of the worker's PIA at her attaining full retirement age, but because she elects to take spousal benefits early, she must reduce that amount in accordance with the percentages applicable to her reduction period. In contrast, if she waits until full retirement age she will be entitled to the full one-half. According to the SSA, if one receives only reduced spousal insurance benefits for every month, one will usually be ahead for 12 years. However, if one outlives the worker, the widow(er)'s insurance benefit will be computed based on one's age at the time of the worker's death. There is no reduction for the prior entitlement as a spouse. Thus, the spouse may be entitled to a full widow(er)'s benefit notwithstanding the receipt of early spousal benefits. We will return to this point in a later chapter.

- b. The amount of the reduction for early retirement:
- (i) For old-age insurance benefits and spousal insurance benefits the amount is specified above for the first 36 months of the reduction period or adjusted reduction period, and five-twelfths of one percent for any additional months included in such periods;⁸¹ and
- (ii) For surviving spouse's insurance benefits is periodically revised by the Commissioner of Social Security such that --
- The amount of the reduction at early retirement age as shall be 28.5 percent of the full benefit;⁸² and

⁷⁸ 42 U.S.C. §402(s)(1)(A).
⁷⁹ 42 U.S.C. §402(s)(1)(B)(i).
⁸⁰ 42 U.S.C. §402(s)(1)(B)(ii).
⁸¹ 42 U.S.C. §402(s)(9)(A).
⁸² 42 U.S.C. §402(s)(9)(B)(i).

- The amount of the reduction for each month in the reduction period (or the adjusted reduction period shall be established by linear interpolation between 28.5 percent at the month of attainment of early retirement age and zero percent at the month of attainment of retirement age.⁸³

Note:

According to the SSA, if one receives a reduced widow(er)'s insurance benefit beginning between ages 60 and full retirement age, one will generally be ahead as to cumulative benefits one receives during approximately the 17-1/2 years after the month of entitlement. One will be behind after that. If one has already decided to take one's own benefits at age 62 (perhaps monthly payment rates are much higher), one will generally be ahead in total benefits for longer than 17-1/2 years -- often much longer -- by taking reduced widow(er)'s insurance benefits at age 60.

The following chart contains the full retirement age for **workers and spouses born after 1937**:

Full Retirement Age

| If your birth date is... | Then your full retirement age is... |
|---------------------------------|--|
| 1/2/38-1/1/39 | 65 years and 2 months |
| 1/2/39-1/1/40 | 65 years and 4 months |
| 1/2/40-1/1/41 | 65 years and 6 months |
| 1/2/41-1/1/42 | 65 years and 8 months |
| 1/2/42-1/1/43 | 65 years and 10 months |
| 1/2/43-1/1/55 | 66 years |
| 1/2/55-1/1/56 | 66 years and 2 months |
| 1/2/56-1/1/57 | 66 years and 4 months |
| 1/2/57-1/1/58 | 66 years and 6 months |
| 1/2/58-1/1/59 | 66 years and 8 months |
| 1/2/59-1/1/60 | 66 years and 10 months |
| 1/2/60 and later | 67 years |

The following chart contains the full retirement age for **widow(er)s born after 1939**:

Full Retirement Age

| If your birth date is... | Then your full retirement age is... |
|---------------------------------|--|
| 1/2/40-1/1/41 | 65 years and 2 months |
| 1/2/41-1/1/42 | 65 years and 4 months |
| 1/2/42-1/1/43 | 65 years and 6 months |
| 1/2/43-1/1/44 | 65 years and 8 months |
| 1/2/44-1/1/45 | 65 years and 10 months |
| 1/2/45-1/1/57 | 66 years |
| 1/2/57-1/1/58 | 66 years and 2 months |
| 1/2/58-1/1/59 | 66 years and 4 months |
| 1/2/59-1/1/60 | 66 years and 6 months |
| 1/2/60-1/1/61 | 66 years and 8 months |
| 1/2/61-1/1/62 | 66 years and 10 months |
| 1/2/62 and later | 67 years |

⁸³ 42 U.S.C. §402(s)(9)(B)(ii).

Note:

The increase in the full retirement age affects the amount of the reduction for persons who begin receiving reduced benefits.

2. Disability benefits

If an individual is entitled to a disability insurance benefit for a month after a month for which such individual was entitled to an old-age insurance benefit, such disability insurance benefit for each month shall be reduced by the amount such old-age insurance benefit would be reduced under the general rule or after any adjustment in the primary insurance amount for such month had such individual attained full retirement age in the first month for which he most recently became entitled to a disability insurance benefit.⁸⁴

3. Spousal and surviving spousal adjustments

- a. In lieu of the general reduction (but subject to the following adjustments) such spouse's or surviving spouse's insurance benefit for each month is reduced as provided below if the first month for which an individual both is entitled to a spouse's or surviving spouse's insurance benefit and has attained age 62 (in the case of a spouse's insurance benefit) or age 50 (in the case of a surviving spouse's insurance benefit) is a month for which such individual is also entitled to:
 - (i) An old-age insurance benefit (to which such individual was first entitled for a month before he attains full retirement age);⁸⁵ or
 - (ii) A disability insurance benefit.⁸⁶
- b. For any month for which such individual is entitled to an old-age insurance benefit and is not entitled to a disability insurance benefit, such individual's spouse's insurance benefit is reduced by the sum of:
 - (i) The amount by which such old-age insurance benefit is reduced under the general rule for such month;⁸⁷ and
 - (ii) The amount by which such spousal insurance benefit would be reduced under the general rule for such month if it were equal to the excess of such spousal insurance benefit (before reduction for early retirement) over such old-age insurance benefit (before reduction for early retirement).⁸⁸
- c. For any month for which such individual is entitled to a disability insurance benefit, such individual's spouse's, or surviving spouse's insurance benefit shall be reduced by the sum of:
 - (i) The amount by which such disability insurance benefit is reduced under the preceding paragraph for such month (if such paragraph 2. applied to such benefit);⁸⁹ and

⁸⁴ 42 U.S.C. §402(s)(2).
⁸⁵ 42 U.S.C. §402(s)(3)(A)(i).
⁸⁶ 42 U.S.C. §402(s)(3)(A)(ii).
⁸⁷ 42 U.S.C. §402(s)(3)(B)(i).
⁸⁸ 42 U.S.C. §402(s)(3)(B)(ii).
⁸⁹ 42 U.S.C. §402(s)(3)(C)(i).

- (ii) The amount by which such wife's, husband's, widow's, or widower's insurance benefit would be reduced under the general rule for such month if it were equal to the excess of such spouse's or surviving spouse's insurance benefit (before reduction for early retirement) over such disability insurance benefit (before reduction for early retirement).⁹⁰
- d. For any month for which such individual is entitled neither to an old-age insurance benefit nor to a disability insurance benefit, such individual's spouse's, or surviving spouse's insurance benefit shall be reduced by the amount by which it would be reduced under the general rule.⁹¹
- e. Notwithstanding paragraph a., if the first month for which an individual is entitled to a widow's or widower's insurance benefit is a month for which such individual is also entitled to an old-age insurance benefit to which such individual was first entitled for that month or for a month before she or he became entitled to a widow's or widower's benefit, the reduction in such surviving spouse's insurance benefit shall be determined under the general rule.⁹²

4. Increase in primary insurance amount

If an individual is or was entitled to a benefit subject to reduction that is increased by reason of an increase in the primary insurance amount of the individual on whose wages and self-employment income such benefit is based, then the amount of the reduction of such benefit (after the application of any adjustment for the adjusted reduction period) for each month beginning with the month of such increase in the primary insurance amount shall be computed under the general rule or spousal or surviving spousal adjustment rule, whichever applies, as though the increased primary insurance amount had been in effect for and after the month for which the individual first became entitled to such monthly benefit reduced under the general rule or spousal or surviving spousal adjustment rule.⁹³

5. Spousal benefits

- a. No spouse's insurance benefit shall be reduced for early retirement:
 - (i) For any month before the first month for which there is in effect a certificate filed by him or her with the Commissioner of Social Security, in which he or she elects to receive spouse's insurance benefits reduced as provided for early retirement;⁹⁴ or
 - (ii) For any month in which he or she has in his or her care (individually or jointly with the person on whose wages and self-employment income the spouse's insurance benefit is based) a child of such person entitled to child's insurance benefits.⁹⁵

Note:

The importance of a.(ii) above is that a parent receiving benefits under the "child in care" rule is not required to reduce the benefits that he or she will eventually draw on his or her own record or as a spouse.

⁹⁰ 42 U.S.C. §402(s)(3)(C)(ii).
⁹¹ 42 U.S.C. §402(s)(3)(D).
⁹² 42 U.S.C. §402(s)(3)(E).
⁹³ 42 U.S.C. §402(s)(4).
⁹⁴ 42 U.S.C. §402(s)(5)(A)(i).
⁹⁵ 42 U.S.C. §402(s)(5)(A)(ii).

- b. Any certificate shall be effective for purposes of preventing deductions for the month in which it is filed and for any month thereafter, and for months, in the period designated by the individual filing such certificate, of one or more consecutive months (not exceeding 12) immediately preceding the month in which such certificate is filed but not for any month before the month in which he or she attains age 62, nor shall it be effective for any month in which he or she has in his or her care (individually or jointly with the person on whose wages and self-employment income the wife's or husband's insurance benefit is based) a child of such person.⁹⁶
- c. If an individual does not have in his or her care such a child in the first month for which he or she is entitled to a wife's or husband's insurance benefit, and if such first month is a month before the month in which he or she attains full retirement age, he or she shall be deemed to have filed in such first month the certificate.⁹⁷
- d. No widow's or widower's insurance benefit for a month in which he or she has in his or her care a child of his or her deceased spouse (or deceased former spouse) entitled to child's insurance benefits shall be reduced below the amount to which he or she would have been entitled had he or she been entitled for such month to mother's or father's insurance benefits on the basis of his or her deceased spouse's (or deceased former spouse's) wages and self-employment income.⁹⁸

6. Reduction period

For purposes of an individual's old-age, wife's, husband's, widow's, or widower's insurance benefit the reduction period is as follows.

- a. The period beginning:
 - (i) In the case of an old-age insurance benefit, with the first day of the first month for which such individual is entitled to such benefit;⁹⁹
 - (ii) In the case of a wife's or husband's insurance benefit, with the first day of the first month for which a certificate is effective;¹⁰⁰ or
 - (iii) In the case of a widow's or widower's insurance benefit, with the first day of the first month for which such individual is entitled to such benefit or the first day of the month in which such individual attains age 60, whichever is the later.¹⁰¹
- b. The period ending with the last day of the month before the month in which such individual attains retirement age.¹⁰²

7. Adjusted reduction period

For purposes of an individual's old-age, spouse's, or surviving spouse's insurance benefit the adjusted reduction period is the reduction period excluding:

- Any month in which such benefit was subject to deductions for excess earnings and certain noncovered work;¹⁰³
- In the case of a spouse's insurance benefits, any month in which such individual had in his or her care (individually or jointly with the person on whose wages and self-

⁹⁶ 42 U.S.C. §402(s)(5)(B).

⁹⁷ 42 U.S.C. §402(s)(5)(C).

⁹⁸ 42 U.S.C. §402(s)(5)(D).

⁹⁹ 42 U.S.C. §402(s)(6)(A)(i).

¹⁰⁰ 42 U.S.C. §402(s)(6)(A)(ii).

¹⁰¹ 42 U.S.C. §402(s)(6)(A)(iii).

¹⁰² 42 U.S.C. §402(s)(6)(B).

¹⁰³ 42 U.S.C. §402(s)(7)(A).

employment income such benefit is based) a child of such person entitled to child's insurance benefits;¹⁰⁴

- In the case of a spouse's insurance benefits, any month for which such individual was not entitled to such benefits because of the occurrence of an event that terminated her or his entitlement to such benefits;¹⁰⁵
- In the case of a surviving spouse's insurance benefits, any month in which the reduction in the amount of such benefit was determined by reason of the minimum mother or father benefits when a child is in care;¹⁰⁶
- In the case of a surviving spouse's insurance benefits, any month before the month in which she or he attained age 62, and also for any later month before the month in which she or he attained retirement age, for which she or he was not entitled to such benefit because of the occurrence of an event that terminated her or his entitlement to such benefits;¹⁰⁷ and
- In the case of old-age insurance benefits, any month for which such individual was entitled to a disability insurance benefit.¹⁰⁸

8. Rounding

The early retirement reduction is applied after reduction for maximum benefits and before application of rounding conventions. If the amount of any reduction computed under the general rule, disability benefits, or spousal or surviving spousal adjustments is not a multiple of \$0.10, it is increased to the next higher multiple of \$0.10.¹⁰⁹

Mini-Case 8: Mary's full retirement age for unreduced benefits is 67 years. She elects to begin receiving benefits at age 62. Her primary insurance amount of \$980.50 must be reduced because of her entitlement to benefits 60 months prior to full retirement age. The reduction is 36 months at five-ninths of one percent and 24 months at five-twelfths of one percent.

$$\$980.50 \times 36 \times 5/9 \times 0.01 = \$196.10$$

$$\$980.50 \times 24 \times 5/12 \times 0.01 = \$98.05$$

The two added together equal a total reduction of \$294.15. This amount is rounded to \$294.20 (the next higher multiple of 10 cents) and deducted from the primary insurance amount. The resulting \$686.30 is rounded down to the nearest dollar. Mary's monthly benefit payable will be \$686.

Mini-Case 9: Ashley is entitled to old-age benefits and is in pay status. Her spouse, Sam, elects to begin receiving spousal benefits at age 64. His full retirement age for unreduced benefits is 67 years. His benefit will be reduced for 36 months of entitlement prior to full retirement age. If his unreduced benefit (one-half of Sam's PIA) is \$412.40 the reduction will be $\$412.40 \times 36 \times 25/36 \times 0.01$. The resulting \$103.10 is rounded to \$103.10 (the next higher multiple of 10 cents) and subtracted from \$412.40 to determine the monthly benefit amount of \$309.30 rounded down to \$309.

Mini-Case 10: Ms. Lindy is entitled to an unreduced widow benefit of \$785.70 beginning at age 64 and 4 months. Her full retirement age for unreduced old-age benefits is 67

¹⁰⁴ 42 U.S.C. §402(s)(7)(B).
¹⁰⁵ 42 U.S.C. §402(s)(7)(C).
¹⁰⁶ 42 U.S.C. §402(s)(7)(D).
¹⁰⁷ 42 U.S.C. §402(s)(7)(E).
¹⁰⁸ 42 U.S.C. §402(s)(7)(F).
¹⁰⁹ 42 U.S.C. §402(s)(8).

years. She will receive benefits for 32 months prior to attainment of full retirement age. The number of months in the period from age 60 through full retirement age of 67 years 84. The reduction in her benefit is $\$785.70 \times 32 \times 0.285$ divided by 84 or $\$85.31$. $\$85.31$ is rounded to the next higher multiple of 10 cents ($\$85.40$) and subtracted from $\$785.70$. The result is a monthly benefit of $\$700$.

D. Delayed retirement

1. In general

The amount of an old-age insurance benefit that is payable without regard to this provision for delayed benefits (the "full retirement age benefit") to an individual is increased by:

- The applicable percentage of such amount,¹¹⁰ multiplied by
- The number (if any) of the increment months for such individual.¹¹¹

2. Increment months

The number of increment months for any individual shall be a number equal to the total number of the following months:

- a. Months that have elapsed after the month before the month in which such individual attained retirement age and prior to the month in which such individual attained age 70;¹¹² and
- b. Months with respect to which --
 - (i) Such individual was a fully insured individual,¹¹³ and
 - (ii) Such individual either was not entitled to an old-age insurance benefit or, if so entitled, did not receive benefits pursuant to a request by such individual that benefits not be paid.¹¹⁴

Note:

A determination is made for each year, beginning with 1972, of the total number of an individual's increment months through the year for which the determination is made and the total so determined is applicable to such individual's old-age insurance benefits beginning with benefits for January of the year following the year for which such determination is made; except that the total number applicable in the case of an individual who attains age 70 is determined through the month before the month in which the individual attains such age and is applicable to the old-age insurance benefit beginning with the month in which the individual attains such age.¹¹⁵

3. Order

This enhancement is applied after reduction for maximum benefit limitations.¹¹⁶

4. Applicable percentage

The applicable percentage is two-thirds of one percent in the case of an individual who first becomes eligible for an old-age insurance benefit (age 62) in a calendar year after 2004.¹¹⁷

¹¹⁰ 42 U.S.C. §402(w)(1)(A).

¹¹¹ 42 U.S.C. §402(w)(1)(B).

¹¹² 42 U.S.C. §402(w)(2)(A).

¹¹³ 42 U.S.C. §402(w)(2)(B)(i).

¹¹⁴ 42 U.S.C. §402(w)(2)(B)(ii).

¹¹⁵ 42 U.S.C. §402(w)(3).

¹¹⁶ 42 U.S.C. §402(w)(4).

¹¹⁷ 42 U.S.C. §402(w)(6)(D).

| Delayed Retirement Credit Rates | | |
|---------------------------------|--|--|
| If a person turned 65: | Then the person's monthly percentage is: | and the person's yearly percentage is: |
| Prior to 1982 | 1/12 of 1% | 1.0% |
| 1982-1989 | 1/4 of 1% | 3.0% |
| 1990-1991 | 7/24 of 1% | 3.5% |
| 1992-1993 | 1/3 of 1% | 4.0% |
| 1994-1995 | 3/8 of 1% | 4.5% |
| 1996-1997 | 5/12 of 1% | 5.0% |
| 1998-1999 | 11/24 of 1% | 5.5% |
| 2000-2001 | 1/2 of 1% | 6.0% |
| 2002-2003 | 13/24 of 1% | 6.5% |
| 2004-2005 | 7/12 of 1% | 7.0% |
| 2006-2007 | 5/8 of 1% | 7.5% |
| 2008 or later | 2/3 of 1% | 8.0% |

Note:

A widow(er) of a worker who had received or was eligible for delayed retirement credits is entitled to the same increase that had been applied to the benefit of the deceased spouse or for which the deceased was eligible as of the time of death. A surviving (including divorced) spouse receiving widow(er)'s benefits is also entitled to this increase.

E. Deductions on account of work

1. In general

- a. Deductions are made from any payment or payments to which an individual is entitled, and from any payment or payments to which any other persons are entitled on the basis of such individual's wages and self-employment income, until the total of such deductions equals the sum of: (i) such individual's benefit or benefits for old age or survivors for any month; and (ii) the benefit or benefits (other than disability benefits) of all other persons for such month based on such individual's wages and self-employment income, if for the month he is charged with excess earnings equal to the total of the benefits.¹¹⁸
- b. If the excess earnings so charged are less than the total benefits of the worker and all other persons receiving benefits based on the worker's account, the deductions with respect to such month are equal only to the amount of such excess earnings.
- c. If a child who has attained the age of 18 and is entitled to child's insurance benefits, or a person who is entitled to mother's or father's insurance benefits, is married to an individual entitled to old-age insurance benefits, the child or such person, as the case may be, is, for these purposes and the determination of excess earnings, deemed to be entitled to such benefits on the basis of the wages and self-employment income of the individual entitled to old-age insurance benefits. If a deduction has already been made for excess earnings with respect to a person's benefit or benefits for old age or survivors for a month, he is deemed entitled to those payments for such month for purposes of further deductions under these provisions, and for purposes of charging of each person's excess earnings, only to the extent of the total of his benefits remaining after such earlier deductions have been made. For these purposes and the determination of excess earnings:

¹¹⁸ 42 U.S.C. §403(b)(1).

- (i) An individual is deemed to be entitled to payments for old-age or survivors' benefits equal to the amount of the benefit or benefits to which he is entitled after the application of the maximum limitations; and
- (ii) If a deduction is made with respect to an individual's benefit or benefits other than disability because of the occurrence in any month of an event of noncovered work outside the United States, such individual is not considered to be entitled to any benefits for old age and survivors for such month.

2. Divorced spouse

If a divorced spouse has been divorced for not less than two years, the benefit to which he or she is entitled on the basis of the wages and self-employment income of the ex-husband or wife is not reduced for the excess earnings of the ex-husband or wife.¹¹⁹

Note:

The two-year limitation does not apply with respect to any divorced spouse in any case in which the individual whose wages and self-employment income the benefit is based became entitled to old-age insurance benefits before the date of the divorce.¹²⁰

3. Noncovered work outside the United States or failure to have a child in care

Deductions, in such amounts and at such time or times as the Commissioner of Social Security shall determine, is made from any payment or payments to which an individual is entitled, until the **total** of such deductions equals such individual's old age or survivors' benefits or benefit for any month:¹²¹

- In which such individual is under full retirement age and for more than forty-five hours of which such individual engaged in noncovered remunerative activity outside the United States;¹²²
- In which such individual, if a spouse under full retirement age entitled to a spouse's insurance benefit, did not have in his or her care (individually or jointly with his or her spouse) a child of such spouse entitled to a child's insurance benefit and such spouse's insurance benefit for such month was not reduced for early retirement;¹²³
- In which such individual, if a widow or widower entitled to a mother's or father's insurance benefit, did not have in his or her care a child of his or her deceased spouse entitled to a child's insurance benefit;¹²⁴ or
- In which such individual, if a surviving divorced mother or father entitled to a mother's or father's insurance benefit, did not have in his or her care a child of his or her deceased former spouse who –
 - (i) Is his or her son, daughter, or legally adopted child,¹²⁵ and
 - (ii) Is entitled to a child's insurance benefit on the basis of the wages and self-employment income of such deceased former spouse.¹²⁶

¹¹⁹ 42 U.S.C. §403(b)(2)(A).
¹²⁰ 42 U.S.C. §403(b)(2)(B).
¹²¹ 42 U.S.C. §403(c).
¹²² 42 U.S.C. §403(c)(1).
¹²³ 42 U.S.C. §403(c)(2).
¹²⁴ 42 U.S.C. §403(c)(3).
¹²⁵ 42 U.S.C. §403(c)(4)(A).
¹²⁶ 42 U.S.C. §403(c)(4)(B).

Note:

For these purposes, a child is not considered entitled to a child's insurance benefit for any month in which the child is over 16 and is not disabled. In general, **no deduction** is made under this provision from any child's insurance benefit for the month in which the child entitled to such benefit attained the age of **18** or any subsequent month; nor is any deduction so made from any widow's or widower's insurance benefit if the widow, surviving divorced wife, widower, or surviving divorced husband involved became entitled to such benefit **prior to** attaining age **60**.

4. Noncovered work outside the United States by old-age insurance beneficiary

Deductions are made from any wife's, husband's, or child's insurance benefit, based on the wages and self-employment income of an individual entitled to old-age insurance benefits, to which a wife, divorced wife, husband, divorced husband, or child is entitled, until the total of such deductions equals such wife's, husband's, or child's insurance benefit or benefits for any month in which such individual is under full retirement age and for more than forty-five hours of which such individual engaged in noncovered remunerative activity outside the United States.¹²⁷

- a. In general, the benefit to which he or she is entitled for such month (on the basis of the wages and self-employment income of the individual entitled to old-age insurance benefits referred to in the preceding paragraph) are determined without regard to deductions as a result of excess earnings of such individual. Also, the benefits of all other individuals, who are entitled for such month-to-month benefits (other than disability benefits) on the basis of the wages and self-employment income of such individual, are determined as if no such divorced spouse were entitled to benefits for such month. If, a divorced spouse is entitled to monthly benefits as a spouse for any month, and the divorced spouse has been divorced for not less than two years.¹²⁸
- b. The two-year requirement does not apply with respect to any divorced spouse in any case in which the individual entitled to old-age insurance benefits became entitled to such benefits before the date of the divorce.¹²⁹
- c. Deductions are made from any child's insurance benefit to which a child who has attained the age of eighteen is entitled, or from any mother's or father's insurance benefit to which a person is entitled, until the total of such deductions equals such child's insurance benefit or benefits or mother's or father's insurance benefit or benefits for any month in which such child or person entitled to mother's or father's insurance benefits is married to an individual under retirement age who is entitled to old-age insurance benefits and for more than forty-five hours of which such individual engaged in noncovered remunerative activity outside the United States.¹³⁰

Note:

If more than one of the events specified in paragraphs 3 and 4 above occurs in any one month, which would occasion deductions equal to a benefit for such month, only an amount equal to such benefit is deducted.¹³¹

¹²⁷ 42 U.S.C. §403(d)(1)(A).
¹²⁸ 42 U.S.C. §403(d)(1)(B)(i).
¹²⁹ 42 U.S.C. §403(d)(1)(B)(ii).
¹³⁰ 42 U.S.C. §403(d)(2).
¹³¹ 42 U.S.C. §403(e).

F. Charging earnings to months

1. Excess earnings

An individual's excess earnings for a taxable year is 33-1/3 percent of his earnings for such year in excess of the product of the applicable exempt amount in the case of an individual who has attained (or, but for the individual's death, would have attained) full retirement age before the close of such taxable year, or 50 percent of his earnings for such year in excess of such product in the case of any other individual, multiplied by the number of months in such year, except that, in determining an individual's excess earnings for the taxable year in which he attains full retirement age, any earnings of such individual for the month in which he attains such age and any subsequent month (with any net earnings or net loss from self-employment in such year being prorated in an equitable manner under regulations of the Commissioner of Social Security) are excluded. For purposes of the preceding sentence, the number of months in the taxable year in which an individual dies is 12. The excess earnings as derived under the first sentence, if not a multiple of \$1, are reduced to the next lower multiple of \$1.¹³²

2. Applicable exempt amount

Whenever the Commissioner of Social Security increases benefits effective with the month of December following a cost-of-living computation quarter the Commissioner also determines and publishes in the Federal Register on or before November 1 of the calendar year in which such quarter occurs the new exempt amounts (separately stated for individuals for the individual attaining full retirement age in that calendar year and for other individuals) that are to be applicable (unless precluded by reason of the legislative resetting of the exempt amount) with respect to taxable years ending in (or with the close of) the calendar year after the calendar year in which such benefit increase is effective (or, in the case of an individual who dies during the calendar year after the calendar year in which the benefit increase is effective, with respect to such individual's taxable year that ends, upon his death, during such year).¹³³

Note:

Persons who retire early will have to account for any earnings that exceed the annual exempt amount; if they are between age 62 and the age they are on December 31 of the calendar year immediately preceding the calendar year in which they attain (or would attain) the full retirement age.

Note:

Full retirement age with respect to any individual entitled to monthly insurance benefits, means the retirement age that is applicable in the case of old-age insurance benefits, regardless of whether or not the particular benefits to which the individual is entitled (or the only such benefits) are old-age insurance benefits.¹³⁴

- a. In general, the exempt amount for each month of a particular taxable year is whichever of the following is the larger:
 - The corresponding exempt amount that is in effect with respect to months in the taxable year in which the determination for increased benefits is made;¹³⁵ or
 - The indexed exempt amount.¹³⁶

¹³² 42 U.S.C. §403(f)(3).
¹³³ 42 U.S.C. §403(f)(8)(A).
¹³⁴ 42 U.S.C. §403(f)(9).
¹³⁵ 42 U.S.C. §403(f)(8)(B)(i).
¹³⁶ 42 U.S.C. §403(f)(8)(B)(ii).

Note:

Notwithstanding the determination of a new exempt amount by the Commissioner of Social Security, such new exempt amount does not take effect if during the calendar year in which such determination is made a law increasing the exempt amount is enacted.¹³⁷

| Annual Exempt Amounts ¹³⁸ | | |
|--------------------------------------|-----------------------------|--------------------------------------|
| Year | Age 65-69 | Under Age 65 |
| 1985 | \$7,320 | \$5,400 |
| 1986 | \$7,800 | \$5,760 |
| 1987 | \$8,160 | \$6,000 |
| 1988 | \$8,400 | \$6,120 |
| 1989 | \$8,880 | \$6,480 |
| 1990 | \$9,360 | \$6,840 |
| 1991 | \$9,720 | \$7,080 |
| 1992 | \$10,200 | \$7,440 |
| 1993 | \$10,560 | \$7,680 |
| 1994 | \$11,160 | \$8,040 |
| 1995 | \$11,280 | \$8,160 |
| 1996 | \$12,500 | \$8,280 |
| 1997 | \$13,500 | \$8,640 |
| 1998 | \$14,500 | \$9,120 |
| 1999 | \$15,500 | \$9,600 |
| | Year of Full Retirement Age | Prior to Year of Full Retirement Age |
| 2000 | \$17,000 | \$10,080 |
| 2001 | \$25,000 | \$10,680 |
| 2002 | \$30,000 | \$11,280 |
| 2003 | \$30,720 | \$11,520 |
| 2004 | \$31,080 | \$11,640 |
| 2005 | \$31,800 | \$12,000 |
| 2006 | \$33,240 | \$12,480 |
| 2007 | \$34,440 | \$12,960 |
| 2008 | \$36,120 | \$13,560 |
| 2009 | \$37,680 | \$14,160 |
| 2010 | \$37,680 | \$14,160 |
| 2011 | \$37,680 | \$14,160 |
| 2012 | \$38,880 | \$14,640 |
| 2013 | \$40,080 | \$15,120 |
| 2014 | \$41,400 | \$15,480 |
| 2015 | \$41,880 | \$15,720 |
| 2016 | \$41,880 | \$15,720 |
| 2017 | \$44,880 | \$16,920 |
| 2018 | \$45,360 | \$17,040 |
| 2019 | \$46,920 | \$17,640 |
| 2020 | \$48,600 | \$18,240 |
| 2021 | \$50,520 | \$18,960 |
| 2022 | \$51,960 | \$19,560 |
| 2023 | \$56,520 | \$21,240 |
| 2024 | \$59,520 | \$22,320 |

¹³⁷

42 U.S.C. §403(f)(8)(C).

¹³⁸

<https://www.ssa.gov/COLA>

- b. The indexed exempt amount is the product of the corresponding exempt amount that was in effect with respect to months in the taxable year ending in 2002 (with respect to individuals attaining full retirement age) or the taxable year ending in 1994 (with respect to other individuals), and the ratio of:
- The national average wage index for the calendar year before the calendar year in which the determination of increased benefits is made,¹³⁹ to
 - The national average wage index for 2000 (with respect to individuals attaining full retirement age) or 1992 (with respect to other individuals),¹⁴⁰ with such product, if not a multiple of \$10, being rounded to the next higher multiple of \$10 where such product is a multiple of \$5 but not of \$10 and to the nearest multiple of \$10 in any other case.
- c. Whenever the Commissioner of Social Security determines that an exempt amount is to be increased in any year, the Commissioner must notify the House Committee on Ways and Means and the Senate Committee on Finance within 30 days after the close of the base quarter in such year of the estimated amount of such increase, indicating the new exempt amount, the actuarial estimates of the effect of the increase, and the actuarial assumptions and methodology used in preparing such estimates.
- d. The exempt amount that is applicable to an individual who has attained full retirement age before the close of the taxable year involved is, for each month of any taxable year ending in 2024, \$4,960.¹⁴¹ The exempt amount that is applicable to an individual who has not attained full retirement age before the close of the taxable year involved is, for each month of any taxable year ending in 2024, \$1,860.

Note:

However, no deduction in benefits is made for excess earnings with respect to the earnings of any individual in any month beginning with the month in which the individual attains full retirement age.¹⁴²

3. How excess earnings are charged

The amounts of an individual's excess earnings are charged to months as follows.

- There is charged to the first month of such taxable year an amount of his excess earnings equal to the sum of the payments (other than disability benefits) to which he and all other persons (excluding divorced spouses referred to above) are entitled for such month on the basis of his wages and self-employment income (or the total of his excess earnings if such excess earnings are less than such sum), and the balance, if any, of such excess earnings shall be charged to each succeeding month in such year to the extent, in the case of each such month, of the sum of the payments to which such individual and all such other persons are entitled for such month on the basis of his wages and self-employment income, until the total of such excess has been so charged.

Note:

The deductions begin with the first chargeable month of the taxable year and continue each month until all excess earnings have been charged.

¹³⁹ 42 U.S.C. §403(f)(8)(B)(ii)(I).

¹⁴⁰ 42 U.S.C. §403(f)(8)(B)(ii)(II).

¹⁴¹ 42 U.S.C. §403(f)(8)(D)(vii).

¹⁴² 42 U.S.C. §403(f)(8)(E).

- Where an individual is entitled to benefits (other than disability) and other persons (excluding divorced spouses referred to above) are entitled to spousal or child benefits on the basis of the wages and self-employment income of such individual, the excess earnings of such individual for any taxable year are charged in accordance with these provisions before the excess earnings of such persons for a taxable year are charged to months in such individual's taxable year.

Subject to the disentanglement of a nondisabled child over age 16, no part of the excess earnings of an individual are charged to any month ("nonchargeable month"):

- For which such individual was not entitled to a benefit;¹⁴³
- In which such individual was at or above full retirement age;¹⁴⁴
- In which such individual, if a child entitled to child's insurance benefits, has attained the age of 18;¹⁴⁵
- For which such individual is entitled to widow's or widower's insurance benefits if such individual became so entitled prior to attaining age 60;¹⁴⁶
- In which such individual did not engage in self-employment and did not render services for wages of more than the applicable exempt amount if such month is in the taxable year in which occurs the first month that is both --
 - A month for which the individual is entitled to benefits (other than survivors or disability) (without having been entitled for the preceding month to any benefit);¹⁴⁷ and
 - A month in which the individual did not engage in self-employment and did not render services for wages of more than the applicable exempt amount;¹⁴⁸ or

Note:

An individual is presumed, with respect to any month, to have been engaged in self-employment in such month until it is shown to the satisfaction of the Commissioner of Social Security that such individual rendered no substantial services in such month with respect to any trade or business the net income or loss of which is includible in computing his net earnings or net loss from self-employment for any taxable year. The Commissioner of Social Security shall by regulations prescribe the methods and criteria for determining whether or not an individual has rendered substantial services with respect to any trade or business.¹⁴⁹ These are discussed later in these materials.

An individual will be presumed, with respect to any month, to have rendered services for wages of more than the applicable exempt amount until it is shown to the satisfaction of the Commissioner of Social Security that such individual did not render such services in such month for more than such amount.¹⁵⁰

- In which such individual did not engage in self-employment and did not render services for wages of more than the applicable exempt amount, in the case of an individual entitled to spousal benefits (but only by reason of having a child in his or her care) or child or mother's or father's benefits, if such month is in a year in which such entitlement

¹⁴³ 42 U.S.C. §403(f)(1)(A).
¹⁴⁴ 42 U.S.C. §403(f)(1)(B).
¹⁴⁵ 42 U.S.C. §403(f)(1)(C).
¹⁴⁶ 42 U.S.C. §403(f)(1)(D).
¹⁴⁷ 42 U.S.C. §403(f)(1)(E)(i).
¹⁴⁸ 42 U.S.C. §403(f)(1)(E)(ii).
¹⁴⁹ 42 U.S.C. §403(f)(4)(A).
¹⁵⁰ 42 U.S.C. §403(f)(4)(B).

ends for a reason other than the death of such individual, and such individual is not entitled to any benefits for the month following the month during which such entitlement ended.¹⁵¹

Note:

The term first month of such taxable year means the earliest month in such year to which the charging of excess earnings described in such paragraph is not prohibited by the application of the above paragraphs a, b, c, d, e, or f.¹⁵²

4. Earnings for the taxable year

An individual's earnings for a taxable year is: (i) the sum of his wages for services rendered in such year and his net earnings from self-employment for such year, minus (ii) any net loss from self-employment for such year.¹⁵³

- a. Excluded from the gross income for these purposes are royalties received attributable to a copyright or patent obtained before the taxable year in which he or she attained such age and that the property to which the copyright or patent relates was created by his or her own personal efforts if the individual has attained full retirement age on or before the last day of the taxable year.¹⁵⁴ Also excluded from gross income for these purposes is other income not attributable to services performed after the month in which he or she initially became entitled to insurance benefits, other than disability benefits or child's benefits payable by reason of being under a disability.¹⁵⁵
- b. For these purposes an individual's net earnings from self-employment for any taxable year shall be determined as described earlier in these materials, except that ministry and public officials will be treated as engaging in a trade or business and the gross income shall be computed by excluding the amounts in paragraph a.¹⁵⁶ An individual's net loss from self-employment for any taxable year is the excess of the deductions (plus his distributive share of bottom-line loss) taken into account under the preceding sentence over the gross income (plus his distributive share of income so described) taken into account under the preceding sentence.¹⁵⁷
- c. For these purposes, an individual's wages are computed without regard to the limitations as to amounts of remuneration in excess of the contribution base, or for domestic workers, employees performing services not in the course of a trade or business, certain agricultural workers, and home workers; and in making such computation services, which do not constitute employment, performed within the United States by the individual as an employee or performed outside the United States in the active military or naval service of the United States, are deemed to be employment as so defined if the remuneration for such services is not includible in computing his net earnings or net loss from self-employment. Wages do not include:
 - (i) The amount of any payment made to, or on behalf of, an employee or any of his dependents (including any amount paid by an employer for insurance or

¹⁵¹ 42 U.S.C. §403(f)(1)(F).

¹⁵² 42 U.S.C. §403(f)(2).

¹⁵³ 42 U.S.C. §403(f)(5)(A).

¹⁵⁴ 42 U.S.C. §403(f)(5)(D)(i).

¹⁵⁵ 42 U.S.C. §403(f)(5)(D)(ii).

¹⁵⁶ 42 U.S.C. §403(f)(5)(B)(i).

¹⁵⁷ 42 U.S.C. §403(f)(5)(B)(ii).

annuities, or into a fund, to provide for any such payment) on account of retirement;¹⁵⁸ or

- (ii) Any payment or series of payments by an employer to an employee or any of his dependents upon or after the termination of the employee's employment relationship because of retirement after attaining an age specified in a severance or salary continuation plan or in a pension plan of the employer.¹⁵⁹

Note:

For these purposes, any individual's net earnings from self-employment that result from or are attributable to the performance of services by such individual as a director of a corporation during any taxable year are deemed to have been derived (and received) by such individual in that year, at the time the services were performed, regardless of when the income, on which the computation of such net earnings from self-employment is based, is actually paid to or received by such individual (unless such income was actually paid and received prior to that year).¹⁶⁰

Note:

Nonqualified deferred compensation generally is neither wages nor self-employment income in the year it is received, but rather, in the earlier year when it was earned.

5. Wages

Wages (determined as provided above) which, according to reports received by the Commissioner of Social Security (W-2), are paid to an individual during a taxable year are presumed to have been paid to him for services performed in such year until it is shown to the satisfaction of the Commissioner of Social Security that they were paid for services performed in another taxable year. If such reports with respect to an individual show his wages for a calendar year, such individual's taxable year shall be presumed to be a calendar year for these purposes until it is shown to the satisfaction of the Commissioner of Social Security that his taxable year is not a calendar year.¹⁶¹

6. Interaction with multiple beneficiaries

Where an individual's excess earnings are charged to a month and the excess earnings so charged are less than the total of the payments (without regard to such charging) to which all persons (excluding divorced spouses of an individual (for more than two years) whose wages and self-employment income the benefit is based became entitled to old-age insurance benefits before the date of the divorce) are entitled for such month on the basis of his wages and self-employment income, an allocation is necessary. The difference between such total and the excess so charged to such month shall be paid (if it is otherwise payable) to such individual and other persons in the proportion that the benefit to which each of them is entitled (without regard to such charging, without the application of the reduction by reason of the simultaneous entitlement to old age or widow(er)'s benefits, and prior to the application of the maximum benefits rule) bears to the total of the benefits to which all of them are entitled.¹⁶²

Mini-Case 11: Mr. Bond is entitled to a retirement benefit of \$800. His wife and child are each entitled to an auxiliary benefit of \$200. Mr. Bond worked and had excess earnings of \$2,094. These earnings are charged against the total monthly family benefit of \$1,200 (\$800 plus (2 x \$200)). Therefore, no benefits are payable to the family for January and February's benefits are reduced by \$894.

¹⁵⁸ 42 U.S.C. §403(f)(5)(C)(i).
¹⁵⁹ 42 U.S.C. §403(f)(5)(C)(ii).
¹⁶⁰ 42 U.S.C. §403(f)(5)(E).
¹⁶¹ 42 U.S.C. §403(f)(6).
¹⁶² 42 U.S.C. §403(f)(7).

Note:

If a survivor or other person entitled to benefits on the worker's Social Security record has excess earnings, only his or her monthly benefit amount is charged and deducted.

Mini-Case 12: The facts are the same as in *Mini-Case 11* above, except it was the wife who worked. Her excess earnings were \$800, which are charged only against her own monthly benefit of \$200. She therefore receives no payments for January through April (4 x \$200 = \$800).

7. Nonservice month

Benefits on account of excess earnings are not reduced for any month in which the beneficiary had a nonservice month in a grace year.¹⁶³ A nonservice month is any month in which the individual, while entitled to retirement or survivors benefits:

- Did not work in self-employment;
 - Did not perform services for wages greater than the monthly exempt amount set for that month; and
 - Did not work in noncovered remunerative activity on seven or more days in a month while outside the United States. A nonservice month occurs even if there are no excess earnings in the year.
- a. A beneficiary's initial grace year is the first taxable year in which the beneficiary has a nonservice month in or after the month in which the beneficiary is entitled to a retirement, auxiliary, or survivor's benefit.¹⁶⁴
- (i) A beneficiary may have another grace year each time his or her entitlement to one type of benefit ends and, after a break in entitlement of at least one month, the beneficiary becomes entitled to a different type of retirement or survivors benefit. The new grace year would then be the taxable year in which the first nonservice month occurs after the break in entitlement.¹⁶⁵
 - (ii) For purposes of determining whether a given year is a beneficiary's grace year, a month that occurred while the beneficiary was entitled to disability benefits or as a disabled widow, widower, or child is not counted as a nonservice month.¹⁶⁶
 - (iii) A beneficiary entitled to child's benefits, to spouse's benefits before age 62 (entitled only by reason of having a child in his or her care), or to mother's or father's benefits is entitled to a termination grace year in any year the beneficiary's entitlement to these types of benefits terminates. This provision does not apply if the termination is because of death or if the beneficiary is entitled to a Social Security benefit for the month following the month in which the entitlement ended. The beneficiary is entitled to a termination grace year in addition to any other grace year(s) available to him or her.¹⁶⁷

Mini-Case 13: Don, age 62, will retire from his regular job in April of next year. Although he will have earned \$20,000 for January-April of that year and plans to work part time, he will not earn over the monthly exempt amount after April. Don's taxable year is the calendar year. Because next year will be the first year in which he has a non-

¹⁶³ Regs. 404.435(a)(7).

¹⁶⁴ Regs. 404.435(b)(1).

¹⁶⁵ Regs. 404.435(b)(2).

¹⁶⁶ Regs. 404.435(b)(3).

¹⁶⁷ Regs. 404.435(b)(4).

service month while entitled to benefits, it will be his grace year and he will be entitled to the monthly earnings test for that year only. He will receive benefits for all months in which he does not earn over the monthly exempt amount (May-December) even though his earnings have substantially exceeded the annual exempt amount. However, in the years that follow, up to the year of full retirement age, only the annual earnings test will be applied if he has earnings that exceed the annual exempt amount, regardless of his monthly earnings amounts.

Mini-Case 14: Marion was entitled to mother's insurance benefits from 2020 because she had a child in her care. Because she had a nonservice month in 2020, 2020 was her initial grace year. Marion's child turned 16 in May 2022, and the child's benefits terminated in April 2022. Marion's entitlement to mother's benefits also terminated in April 2022. Because Marion's entitlement did not terminate by reason of her death and she was not entitled to another type of Social Security benefit in the month after her entitlement to a mother's benefit ended, she is entitled to a termination grace year for 2022, the year in which her entitlement to mother's insurance benefits terminated. She applied for and became entitled to widow's insurance benefits effective February 2024. Because there was a break in entitlement to benefits of at least one month before entitlement to another type of benefit, 2024 will be a subsequent grace year if Marion has a nonservice month in 2024.

- b. One considered to have worked in self-employment in any month in which the individual performed substantial services in the operation of a trade or business (or in a combination of trades and businesses if there are more than one), as an owner or partner even though the individual had no earnings or net earnings resulting from his or her services during the month.¹⁶⁸ The individual is presumed to have worked in self-employment in each month of the taxable year until it is shown to the satisfaction of the SSA that in a particular month the individual did not perform substantial services in any trades and businesses from which the individual derived annual net income or loss.¹⁶⁹
- c. One is presumed to have performed services in any month for wages of more than the applicable monthly exempt amount in each month of the year, until it is shown to the satisfaction of the SSA that the individual did not perform services for wages in that month that exceeded the monthly exempt amount.¹⁷⁰

8. Annual reports

One may receive a partial monthly benefit when his or her excess earnings remaining to be charged for the year are less than the amount of his or her total benefit for the next month, subject to charging.

- a. However, the partial payment is paid only at the close of the taxable year when one files his or her annual report of earnings, unless otherwise requested. Where the partial monthly benefit is not a multiple of \$1, the monthly benefit amount is rounded to the next lower multiple of \$1. If there is only one beneficiary involved, the partial benefit paid is the difference between the monthly benefit amount and the excess earnings charged to the month.

¹⁶⁸ Regs. 404.435(c).

¹⁶⁹ Regs. 404.435(d).

¹⁷⁰ Regs. 404.435(e).

Mini-Case 15: Ms. Ridgely has a monthly benefit amount of \$288.20. She had excess earnings of \$700 that are charged against her benefits beginning with January. This results in the loss of her entire benefit for January and February plus \$123.60 of the March payment ((2 x \$288.20) plus \$123.60 = \$700). She receives a partial monthly benefit of \$164.00 for March (\$288.20 minus \$123.60 = \$164.60 rounded to the next lower multiple of \$1).

- b. Where excess earnings are charged against the family benefits of a retirement insurance beneficiary and one or more persons entitled to benefits on the worker's earnings record, the partial benefit is allocated to each person entitled to benefits. The partial benefit is allocated in the proportion to the original entitlement rate of beneficiary on the worker's earnings record. However, a beneficiary's prorated share of the partial benefit may not be more than the benefit amount that would have been paid if there were no work deductions.

Note:

One is generally required to file an annual report of earnings if one is:

- (i) A Social Security beneficiary (unless entitled to benefits because of disability); or
- (ii) Receiving benefits on a beneficiary's behalf if the beneficiary:
 - Was entitled to Social Security benefits for the taxable year;
 - Had not reached full retirement age in or before the first month of entitlement in that year;
 - Had total earnings (wages and net earnings from self-employment) more than the yearly exempt amount; and
 - Did not have all benefits withheld in the year for all entitlement months in which he or she was under full retirement age.

- c. No annual report for a taxable year need be filed if the individual (or the beneficiary on whose behalf the individual is receiving benefits) was not paid any benefits because of work and high earnings.

Caution:

If one fails to file an annual report or other information showing that benefits are payable for that year, benefits that might otherwise have been payable may not be paid after three years, three months, and 15 days after the close of the taxable year.

- (i) The SSA will accept as a filing of an annual report of earnings the W-2 information reported by an employer, or, if the individual is self-employed, the self-employment tax data filed with the IRS. The SSA uses the information in them along with other information to adjust benefits under the earnings test.
- (ii) The annual report of earnings must be filed on or before the fifteenth day of the fourth month following the end of the taxable year; on the calendar year, the annual report of earnings is due April 15. If the due date falls on a Saturday, Sunday, legal holiday, or other non-work day for federal employees set by statute or Executive Order, it is extended to the first full work day after the original deadline.

Note:

The Social Security Administration may grant an extension of time for filing the annual report of earnings if there is a valid reason, but only upon a written request for an extension before the annual report is due. If it grants a request for an extension, it will set a new due date for the annual report. The individual will receive a written notice of the approved extended reporting date. If one needs another extension, the individual must make the request before the due date of the new approved reporting date. More than one extension may be granted in a taxable year. However, the total amount of time of all extensions granted for any one taxable year cannot be more than four months. There is a penalty for late reporting that may be avoided if the worker knows the annual report will be unavoidably late.

- (iii) One may file the annual report regarding earnings for the taxable year by written statement or telephone. The information needed for the annual report:
 - The total amount of wages (before payroll deductions) earned during the taxable year for which the report is being made;
 - The total net earnings or net loss from self-employment for the taxable year;
 - Months during a grace year in which the individual did not earn over the monthly exempt amount as an employee and did not perform substantial services in self-employment; and
 - An estimate of the expected total earnings (wages and net earnings from self-employment) for the next taxable year.
- (iv) A penalty deduction in benefits may apply if the annual report of earnings is not filed in a timely manner, if all of the following factors exist:
 - The annual report of earnings was not made within three months and 15 days after the close of the taxable year;
 - There is no good cause for not reporting on time;
 - A work deduction (part or all of one month's benefit) is required because of earnings; and
 - The individual received and accepted a benefit check for one or more months during that taxable year.
- (v) If one fails to file the annual report on time, one will not receive:
 - Any benefit payments withheld due to the failure to file an annual report on time; and
 - Any monthly benefit payments that must be withheld because of excess earnings in the year the annual report was due.

Note:

The SSA accepts the information on the W-2 forms and the SE tax return to be the annual report of earnings required by law and assumes that all adjustments to benefits were based on a report filed on time. No penalty is imposed unless one knowingly and intentionally attempted to hide earnings from the SSA in an effort to avoid the payment of taxes and/or to avoid deductions under the earnings test.

- (vi) The penalty deduction that may be imposed due to a failure to file the annual report of earnings on time is as follows:
 - For the first time one fails to file the report, the amount of the penalty is equal to the monthly benefit rate for the last month one is entitled to in the taxable year. However, if the work deduction is less than the full

benefit for the month, the amount of the penalty equals the amount of the work deduction, but not less than \$10;

- For the second time one fails to file the report, the amount of the penalty is two times the monthly benefit rate; and
- For the third and any subsequent time one fails to file the report, the amount of the penalty is three times the monthly benefit rate.

The number of months imposed for the penalty cannot be more than the number of months that work deductions are imposed for the year. The amount of the penalty is the same no matter how long one delays filing each report, whether for one month or one year after the due date.

Mini-Case 16: A beneficiary with a monthly benefit rate of \$136 has excess earnings of \$190 for that year. This requires a loss of benefits in two months. Therefore, the maximum amount of the penalty is \$272 (two times the monthly benefit rate) even if that year may have been the third year that the beneficiary failed to file the annual report on time.

Note:

Benefits of a spouse or child are not affected if a penalty is imposed for failing to submit the annual report of earnings on time. However, their benefits are affected for any month the worker loses part or all of the benefit because of excess earnings.

- d. If one goes to work and expects that total earnings will be more than the yearly exempt amount, one should file a report of expected earnings. This report prevents payment of monthly benefits to an individual that may have to be returned at the end of the year if, under the earnings test, one was not due all the payments received.
- (i) When one files the expected earnings report, the worker is encouraged to make a high estimate of earnings for the year. Based on that report, SSA suspends benefits for the number of months required by the estimate.
 - (ii) At the end of the taxable year, SSA will figure the amount of benefit payments due for that taxable year. If all payments that were due have not been made, the individual is paid whatever amount that is due. If, on the other hand, the individual has been paid too much, SSA either withholds the amounts from future benefits payable, or demands refund of the amount.

G. Simultaneous entitlement

1. Child benefits

A child, entitled to child's insurance benefits on the basis of the wages and self-employment income of an insured individual, who would be entitled, on filing application, to child's insurance benefits on the basis of the wages and self-employment income of some other insured individual, is generally deemed entitled to child's insurance benefits on the basis of the wages and self-employment income of such other individual if an application for child's insurance benefits on the basis of the wages and self-employment income of such other individual has been filed by any other child who would, on filing application, be entitled to child's insurance benefits on the basis of the wages and self-employment income of both such insured individuals.¹⁷¹

¹⁷¹ 42 U.S.C. §402(k)(1).

Note:

However, any child who under the preceding provisions is entitled for any month to child's insurance benefits on the wages and self-employment income of more than one insured individual is entitled to only one of such child's insurance benefits for such month. Such child's insurance benefits for such month shall be the benefit based on the wages and self-employment income of the insured individual who has the greatest primary insurance amount, except that such child's insurance benefits for such month shall be the largest benefit to which such child could be entitled (without the application of the reduction of benefits on account of maximum limitations) if entitlement to such benefit would not, with respect to any person, result in a benefit lower (after the application of the reduction of benefits on account of maximum limitations) than the benefit that would be applicable if such child were entitled on the wages and self-employment income of the individual with the greatest primary insurance amount. If more than one child is entitled to child's insurance benefits pursuant to the preceding provisions, each such child who is entitled on the wages and self-employment income of the same insured individuals is entitled on the wages and self-employment income of the same such insured individual.¹⁷²

2. Old age and disability not involved

Any individual (other than an individual who is a surviving spouse or surviving divorced spouse) who married after attaining age 60 (or after attaining age 50 if he was entitled before such marriage occurred to benefits based on disability), or a disabled surviving spouse or surviving divorced spouse who married after attaining age 50) who, under any of the preceding provisions and under the disability provisions is entitled for any month to more than one monthly insurance benefit (other than an old-age or disability insurance benefit) is entitled to only one such monthly benefit for such month, such benefit to be the largest of the monthly benefits to which he or she would otherwise be entitled for such month. Any individual who is entitled for any month to more than one surviving spouse's insurance benefit described in the parenthetical shall be entitled to only one such benefit for such month, such benefit to be the largest of such benefits.¹⁷³

3. Either old age or disability involved

If an individual is entitled to an old-age or disability insurance benefit for any month and to any other monthly insurance benefit for such month, such other insurance benefit for such month, after any reduction for early retirement, and any reduction by reason of maximum benefit limitations, are reduced, but not below zero, by an amount equal to such old-age or disability insurance benefit (after reduction for early retirement).¹⁷⁴

Note:

If an individual is entitled for any month to a surviving spouse's insurance benefit of an individual who is a surviving spouse or surviving divorced spouse who married after attaining age 60 (or after attaining age 50 if he was entitled before such marriage occurred to benefits based on disability), or a disabled surviving spouse or surviving divorced spouse who married after attaining age 50, and to any other monthly insurance benefit (other than an old-age insurance benefit or a disability benefit), such other insurance benefit for such month, after any reduction under the preceding paragraph, any reduction for early retirement, and any reduction by reason of maximum benefits limitations, shall be reduced, but not below zero, by an amount equal to such surviving spouse's insurance benefit after any reduction or reductions under the preceding paragraph and the maximum benefits limitations.¹⁷⁵

¹⁷² 42 U.S.C. §402(k)(2)(A).

¹⁷³ 42 U.S.C. §402(k)(2)(B).

¹⁷⁴ 42 U.S.C. §402(k)(3)(A).

¹⁷⁵ 42 U.S.C. §402(k)(3)(B).

4. Both old age and disability involved

Any individual who is entitled for any month to both an old-age insurance benefit and a disability insurance benefit shall be entitled to only the larger of such benefits for such month, except that, if such individual so elects, he shall instead be entitled to only the smaller of such benefits for such month.¹⁷⁶

Mini-Case 17: Alicia is entitled to a spouse's insurance benefit of \$102.10 and a parent's insurance benefit of \$94.40. Her spouse's insurance benefit is suspended for several months because of her husband's work. Alicia cannot be paid a parent's insurance benefit for these months. However, if she and her husband get divorced and she cannot meet the requirements for receiving benefits as a divorced spouse, her entitlement to spouse's insurance benefits is terminated. If she is still entitled to parent's insurance benefits, these will be paid to her, effective the month her spouse's insurance benefits terminate.

Mini-Case 18: Martha is entitled to retirement insurance benefits of \$128.10 and to spouse's insurance benefits of \$159.10. The total benefit payable to her is \$159.10, made up of a retirement insurance benefit of \$128.10 and a spouse's insurance benefit of \$31.00. If the spouse's insurance benefit is not payable for some months because of her husband's earnings, she will receive her own retirement insurance benefit of \$128.10.

¹⁷⁶

42 U.S.C. §402(k)(4).

Planning point:

Perhaps the most often asked question concerns the interrelationship of one spouse's benefits with another as a function of when benefit payments begin to either spouse and the capacity in which the benefits are received. The Social Security Website includes as one of its FAQs the following:

Question: Can I receive reduced retirement benefits at age 62 under my record, then at full retirement age receive full spouse's benefits?

Answer: The following information explains two provisions when an individual is entitled to his or her own retirement benefit and is entitled to additional benefits as a spouse.

1. An individual is filing for both his or her own retirement benefit and benefits on his or her spouse's record concurrently. One of the provisions of the Social Security Act provides that whenever an individual files for reduced retirement or spouse's benefits, that individual is "deemed" to have filed for the other benefit as well. Essentially, this means that if an individual is eligible for both retirement and spouse's benefits in the initial month of entitlement, then he/she must be awarded both benefits. An individual cannot restrict the application to only one benefit when the deemed filing provision of the law applies.

2. An individual is filing for his or her own retirement benefit but is not eligible to file for spouse's benefits on his or her husband/wife's record until the spouse becomes entitled. An individual can elect to receive his or her own retirement benefit as early as age 62, but his or her benefit will be permanently reduced for each month before full retirement age. If the individual is due additional benefits as a spouse, as soon as the husband/wife on whose record he or she is eligible starts receiving Social Security benefits, then the spouse's benefits are payable. If payment of spouse benefits occurs before full retirement age, the benefit is reduced each month between the entitlement date to spouse's benefits and full retirement age.

A second question of great importance to planning is the following.

Question: Can my spouse collect benefits at age 62 from her work and earnings and then receive a combined total up to 50 percent from my account when I start receiving benefits at age 65?

Answer: The answer depends on the situation. The following information explains two provisions when an individual is entitled to his or her own retirement benefit and is entitled to additional benefits as a spouse.

1. One of the provisions of the Social Security Act provides that whenever an individual files for reduced retirement or spouse's benefits, that individual is "deemed" to have filed for the other benefit as well. Essentially, this means that if an individual is eligible for both retirement and spouse's benefits in the initial month of entitlement, then he/she must be awarded both benefits. An individual **cannot** restrict the application to only one benefit when the deemed filing provision of the law applies.

2. An individual who files for his or her own retirement benefit is not eligible to file for spouse's benefits on his or her husband/wife's record until the husband/wife becomes entitled. An individual can elect to receive his or her own retirement benefit as early as age 62, but his or her benefit will be permanently reduced for each month before full retirement age. If the individual is due additional benefits as a spouse, as soon as the husband/wife on whose record he or she is eligible starts receiving Social Security benefits, then the spouse's benefit is payable (and determined under those rules). If payment of spouse benefits occurs before full retirement age, the benefit is reduced each month between the entitlement date to spouse's benefits and full retirement age.

This will be applied in the following module.

H. Government Pension Offset (GPO)¹⁷⁷

1. GPO in general

The GPO applies when an individual who receives a pension from a government job in which the worker did not pay Social Security taxes receives a spousal, widow's, or widower's benefit. The reduction is made for both regular and disability retirement benefits received from non-covered government employment.

2. Why are benefits reduced?

Benefits paid to spouses, widows, and widowers are dependent benefits. These benefits were intended to compensate stay-at-home (non-working) spouses. The benefits were set up in the 1930s, when many spouses did not work. Spousal benefits recognized the non-working spouse's contribution to the working spouse's ability to work and earn a living for the family. Widow's and widower's benefits also recognized the non-working spouse's contribution and kept the non-working spouse from being without income when the working spouse died.

The law requires the spousal, widow's, or widower's benefit to be offset by the dollar amount of their own Social Security benefit. If a spouse would draw \$900 on their own record, but qualifies for \$1,000 spousal benefit, they would draw the higher amount, \$1,000. The \$1,000 is offset by the \$900 for which they qualify on their own account, so that they are actually drawing \$900 on their own account and a \$100 spousal benefit.

For example, if an individual qualifies for a Social Security benefit on the individual's own record of \$1,000, and qualifies for a spousal benefit of \$900, the individual will receive no spousal benefit. It is completely offset by the individual's own benefit. If the individual, however, is drawing a government pension instead of Social Security, he or she would qualify for a full spousal benefit if not for this provision. For the recipient, life would be good, but it would be contrary to the intent of the spousal, widow's, or widower's benefits.

3. How much is the GPO?

Social Security benefits subject to the GPO are reduced by two thirds of the government pension. If an individual receives a monthly civil service pension (or other government pension from work for which they did not pay Social Security taxes) of \$600, and also qualifies for a spousal, widow's, or widower's Social Security benefit, the Social Security benefit will be reduced by \$400. If they are eligible for a Social Security benefit of \$900, they would only receive \$500 (\$900 - \$400).

Taking a government pension as a lump-sum distribution does not eliminate the reduction. The Social Security benefit will be reduced as though the retiree received the benefit as a monthly annuity.

4. When does the GPO provision not apply?

The GPO does not apply in the following circumstances:

- a. The recipient spouse, widow, or widower is receiving a government pension that is not based on his or her own earnings, such as survivor benefits from a government pension.

¹⁷⁷ The information in this section is taken from 20 U.S.C. §404.408a and <https://www.ssa.gov/pubs/EN-05-10007.pdf>.

- b. The recipient spouse, widow, or widower receives a government pension from a federal, state, or local government job from employment that was subject to Social Security taxes, and:
 - (i) His or her last day of employment on which the pension is based was before July 1, 2004; or
 - (ii) The recipient was entitled to and filed for spousal, widow's, or widower's benefits prior to April 1, 2004; or
 - (iii) The recipient paid Social Security taxes on earnings during the last 60 months of government service (under certain conditions, less than 60 months for people whose last day of employment falls after June 30, 2004, and before March 2, 2009).
- c. The recipient is a federal employee who switched from the Civil Service Retirement System (CSRS) to the Federal Employees' Retirement System (FERS) after December 31, 1987; and:
 - (i) His or her last day of service (that their pension is based on) is before July 1, 2004; or
 - (ii) The recipient paid Social Security taxes on his earnings for 60 months or more during the period beginning January 1988 and ending with the first month of entitlement to benefits; or
 - (iii) The recipient filed for and was entitled to spousal, widow's, or widower's benefits before April 1, 2004.
- d. The recipient received, or was eligible to receive, a government pension before December 1982 and met all the requirements for Social Security spouse's benefits in effect in January 1977; or
- e. The recipient received, or was eligible to receive, a federal, state, or local government pension before July 1, 1983, and was receiving one-half support from his or her spouse.

There is no reduction to Social Security benefits that an individual receives based on the individual's own work record.

I. Windfall Elimination Provision¹⁷⁸

Workers who draw certain public retirement from earnings on which they were not required to pay Social Security tax must draw their Social Security benefits under the special rules of the Windfall Elimination Provision (WEP). The calculation of the PIA is done using 40 percent instead of 90 percent for the first bend point.

The WEP does not apply under the following circumstances:

- a. The recipient is a federal worker first hired after December 31, 1983.
- b. The recipient was an employee of a non-profit organization who was exempt from Social Security coverage on December 31, 1983, unless the non-profit organization waived exemption and did pay Social Security taxes, but then the waiver was terminated prior to December 31, 1983.
- c. The recipient's only pension is for railroad employment.
- d. The only work the recipient performed for which he or she didn't pay Social Security taxes was before 1957.

¹⁷⁸ <https://www.ssa.gov/pubs/EN-05-10045.pdf>.

- e. The recipient has 30 or more years of substantial earnings under Social Security.

Note:

There is a strong push in Washington to eliminate or modify the Windfall Elimination Provision. A bill introduced in the House of Representatives by Richard Neal, a Democrat from Massachusetts, would give current retirees turning 62 before 2023 an additional \$150 per month. The bill was introduced on April 2, 2021.

J. Second chance?

A little-known provision of the law can give some baby boomers a second chance with respect to the issue of when to take Social Security. Those who have begun to receive Social Security retirement benefits and decide to stop the benefits may submit **Form SSA-521, Request for Withdrawal of Application**, available at the following Internet address: <http://www.socialsecurity.gov/online/ssa-521.pdf>.

- a. This enables the individual to retire again and now be entitled to the benefit one would have received had he or she waited in the first place. The condition for this dispensation is repayment of any benefits received under Social Security at the earlier retirement age. Perhaps one of the most interesting aspects of this procedure is that there is apparently no interest due, so an early retirement can provide one with an interest-free loan of sorts from the government if conditions warrant a change in benefit collection strategy.
- b. Even if the individual does not rescind the original election to receive benefits, the reduced benefit level may still be increased by reason of additional earnings in the interim. Social Security operates an Automatic Earnings Reappraisal Operation that examines each beneficiary's record periodically to see if additional earnings may increase the monthly benefit amount. This has the effect of a recalculation of the basic ("full retirement age") benefit and the same percentage reduction then applied to this amount. Of course, if one's benefit is already maxed out by having the maximum amount of Social Security earnings in the worker's record, additional earnings cannot increase any benefit.
- c. ***Effective December 8, 2010, an individual can only withdraw an application for retirement benefits within 12 months of the first month of entitlement.***

REQUEST FOR WITHDRAWAL OF APPLICATION

Do not write in this space

IMPORTANT NOTICE - This is a request to cancel your application. If we approve it, the decision we made on your application will have no legal effect. You will forfeit all rights attached to an application, including the rights of appeal. You will have to return any payment we made to you or anyone else on the basis of that application. You must then reapply if you want a determination of your Social Security rights at any time in the future. Any subsequent application may not involve the same retroactive period. We intend for you to use this procedure only when your decision to file has resulted, or will result, in a disadvantage to you. Your local Social Security office will be glad to explain whether, and how, this procedure will help you.

NAME OF WAGE EARNER, SELF-EMPLOYED INDIVIDUAL, OR ELIGIBLE INDIVIDUAL SOCIAL SECURITY NUMBER

IF DIFFERENT, PRINT YOUR NAME (First name, middle initial, last name) YOUR SOCIAL SECURITY NUMBER

TYPE OF BENEFIT YOU WANT TO WITHDRAW DATE OF APPLICATION IF APPLICABLE, DO YOU WANT TO KEEP MEDICARE BENEFITS? Yes No

I hereby request the withdrawal of my application, dated as above, for the reasons stated below. I understand that (1) this request may not be cancelled after 60 days from the mailing of notice of approval; and (2) if a determination of my entitlement has been made, there must be repayment of all benefits paid on the application I want withdrawn, and all other persons whose benefits would be affected must consent to this withdrawal. I further understand that the application withdrawn and all related material will remain a part of the records of the Social Security Administration and that this withdrawal will not affect the proper crediting of wages or self-employment income to my Social Security earnings record.

Give reason for withdrawal. (If you need more space, use the reverse of this form.)

1. I intend to continue working. (I have been advised of the alternatives to withdrawal for applicants under full retirement age and still wish to withdraw my application.)
2. Other (Please explain fully): _____

Continued on reverse

SIGNATURE OF PERSON MAKING REQUEST

Signature (First name, middle initial, last name) (Write in ink) Date (Month, day, year)

SIGN HERE Telephone Number (include area code)

Mailing Address (Number and Street, Apt. No., P.O. Box, or Rural Route)

City and State ZIP Code Enter Name of County (if any) in which you now live

Witnesses are required ONLY if this request has been signed by mark (X) above. If signed by mark (X), two witnesses to the signing who know the person making the request must sign below, giving their full addresses.

1. Signature of Witness 2. Signature of Witness

Address (Number and Street, City, State and ZIP Code) Address (Number and Street, City, State and ZIP Code)

FOR USE OF SOCIAL SECURITY ADMINISTRATION

APPROVED NOT APPROVED BECAUSE BENEFITS NOT REPAYED CONSENT(S) NOT OBTAINED OTHER (Attach special determination)

SIGNATURE OF SSA EMPLOYEE TITLE OTHER (Specify) DATE
 CLAIMS AUTHORIZER

Miscellaneous Planning Issues

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Miscellaneous Planning Issues

Learning objectives

Upon reviewing this chapter, the reader will be able to:

- Describe the treatment of employees and the self-employed under the Social Security program;
- Identify the exclusions from Social Security coverage and the kinds of structuring present in various forms of business entities that may be used either to avoid the earnings test or limit the amount of Social Security benefits subject to the income tax in particular years; and
- Summarize the factors that should be considered in determining when Social Security benefits should begin.

I. Self-employed worker

A. Social Security coverage

Social Security has been an evolving process.

In 1951, most self-employed people became covered by Social Security. Farmers, ministers, and some other individuals (including certain professionals) were not covered until 1955. Additional groups of professionals were covered for taxable years ending after 1955. Self-employed medical doctors were covered for taxable years ending on or after December 31, 1965.

“Self-employment income” that is creditable for Social Security is based on “net earnings from self-employment” derived from a “trade or business” covered by the law. Payment from self-employment that is not covered under Social Security is included when figuring income for earnings-test purposes.

B. “Trade or business”

1. Definition

The term “trade or business” has the same meaning for Social Security purposes as it has when used in §162 relating to income taxes. However, certain occupations and the self-employed activities of members of certain religious groups who have been granted exemptions from the self-employment tax are not included in the term “trade or business” for Social Security purposes unless certain conditions are met.

2. Guidelines

“Trade or business” is not specifically defined in Internal Revenue Code §162. The following are guidelines for deciding whether a trade or business exists under §162:

- a. The activity is started and carried on in good faith with the intention of making a profit or producing income;
- b. The activity is carried on regularly, with a continuity of operation, a continual repetition of transactions, or a regularity of activities;
- c. The activity is a person’s regular occupation or calling that he or she carries on to make a living or a profit; and
- d. The person presents himself or herself to the public as being engaged in the selling of goods and/or services.

3. Personal services

A person may carry on a business through employees. Absentee owners or silent partners can derive income from a trade or business. For taxable years beginning after 1977, **limited partners** are excluded from Social Security coverage. An ongoing issue today involves members of a limited liability company, which arose as a business form after the 1977 Social Security legislation. See the discussion later regarding limited liability companies.

4. Other factors

- a. The length of time a person is engaged in an activity usually is a factor in determining if it is a trade or business. For seasonal activities or those of short duration, the period of time is not important.
- b. The illegality of an activity does not prevent it from being a trade or business. Professional gamblers, bookies, etc. may be engaged in a trade or business, are considered self-employed, and are required to report income and pay self-employment taxes.
- c. A hobby is not generally a trade or business. However, if a person conducts such activities, e.g., buying and selling coins and stamps, to provide part or all of his or her livelihood, they may be a trade or business.

5. Partnerships

- a. Business partners are self-employed. A partnership is generally the same for Social Security purposes as for income-tax purposes. However, Social Security excludes coverage of a limited partner in a limited partnership.
- b. Two or more persons, including husbands and wives, may be self-employed as partners for income-tax and Social Security purposes. This may apply even if they do not operate under a formal partnership agreement, and even if they are not considered partners under state law because they have not complied with local statutory requirements.
- c. For both federal income-tax purposes and for Social Security purposes, a partnership, which involves a continuing enterprise, and a joint venture, which is usually for the accomplishment of a single project or transaction, are essentially the same.
- d. Valid partnerships may be formed with family members. The determination regarding partnerships with family members in a business depends on how the business is operated. Merely "helping out" in the business or doing chores does not establish a partnership. In cases involving closely related parties, the factors that usually indicate a partnership, such as the use of property, must be carefully evaluated to determine whether they indicate the existence of a partnership or a sole proprietorship. The following factors help establish whether a business is conducted as a partnership:
 - (i) Copies of any written agreements entered into by the parties or statements of the parties as to the terms of the arrangement;
 - (ii) Copies of partnership income tax returns on which the business income was reported;
 - (iii) Corroboration from the other partner(s); and
 - (iv) Statements from disinterested third parties, such as suppliers, wholesalers, customers, local business people, etc., who are familiar with the manner in which the business was conducted.

- e. Transfer of capital interest to a family member in a family partnership to a member of the same family (including only his or her spouse, ancestors, and lineal descendants) generally makes the member a partner if:
 - (i) A bona fide transfer by gift or purchase of a capital interest in the partnership has occurred;
 - (ii) The member actually owns the partnership interest and is vested with dominion and control over it;
 - (iii) The partnership is one in which capital is a material income-producing factor; and
 - (iv) A valid partnership was in existence before the transfer or was created at the time of the transfer.

6. Writers

Whether writers who receive royalties are engaged in a trade or business is a decision of fact. A one-time venture of short duration is usually not a trade or business, but a repetition of such ventures would constitute a trade or business.

Mini-Case 1: Eric wrote only one book as a sideline on the joys of coaching lacrosse. It was never revised or updated. Eric's writing activity would probably not be a trade or business.

Mini-Case 2: Angela wrote a book on Social Security benefits for the elderly. She prepared new editions annually to reflect changes in the Social Security law. Angela's writing and editing activities would probably be a trade or business.

Mini-Case 3: Jen, a college professor who writes a book on office administration and gives lectures and advice to business groups on the same subject, would probably be in a trade or business.

Note:

The issue of whether an individual is engaged in a trade or business as a self-employed person may also have relevance in determining excess earnings. An individual who works more than 45 hours in a month may be engaged in self-employment if the work constitutes a trade or business, with negative consequences to the individual of the amount of Social Security benefits payable. An individual apparently can write a one-shot book after retiring from other work and spend more than 45 hours in any month in doing so and escape excess earnings on amounts received in connection with the book.

7. Nonprofessional fiduciaries

- a. Nonprofessional fiduciaries who serve as executors or administrators in isolated instances only for the estate of deceased friends or relatives are generally not engaged in a trade or business, unless:
 - (i) There is a trade or business among the assets of the estate;
 - (ii) The fiduciary actively participates in the operation of this trade or business; and
 - (iii) The fees of the fiduciary are related to the operation of the trade or business.
- b. However, the activities of a nonprofessional fiduciary of a single estate may be a trade or business if they are of sufficient scope and duration, such as when the executor manages an unusually large estate that requires extensive management activities over a long period.

8. Beneficiary of a trust

A beneficiary of a trust that operates a trade or business is not engaged in the trade or business, because the trust, rather than the beneficiary, is engaged in the activity. However, a trade or business that is carried on by a conservator, committee, or guardian on behalf of an incompetent person is considered to be carried on by the incompetent, if the person has been legally adjudged as incompetent.

9. Owner of land treated as a landlord

- a. An owner of land is generally treated as a landlord if the owner's right of entry on the land is limited to the right to protect and maintain the property and the person occupying the land has the following rights and obligations:
 - (i) Right to possession of the land;
 - (ii) Right to use of the land for his or her own purposes;
 - (iii) Right to use and possession for a definite period of time;
 - (iv) Obligation to pay rent;
 - (v) Right to sublease; and
 - (vi) Control over the running of the business.
- b. An owner of land can enter it to make repairs, prevent waste, etc. In the case of a farm, an owner may take part in formulating the farm plan and may require the practice of good husbandry. An owner may also furnish supplies and equipment and share in the cost of seed, fertilizer, and other expenses for maintaining the fertility of the land or increasing its yield.
- c. Neither the exercise of these rights nor the furnishing of these goods is inconsistent with a landlord-tenant relationship. In this case, the tenant is a self-employed farm operator and the farm owner is a landlord. The landlord's rental income counts for Social Security only if he or she materially participates in the crop production.

C. Exclusions for Social Security purposes

1. Exclusions

- a. A "trade or business" does not include the following for Social Security purposes:
 - Work as an employee, except newspaper vendors, who are age 18 or older;
 - Work by U.S. citizens performing services in the United States as employees of a foreign government and, in some circumstances, as employees of an instrumentality wholly owned by a foreign government, or an international organization;
 - Employees of a state or political subdivision thereof who are paid solely on a fee basis and whose services are not otherwise covered as employment under a federal-state coverage agreement (see Chapter 10 of the *Social Security Handbook* for a description of the federal-state coverage agreement);
 - Work as an employee or employee representative covered by the Railroad Retirement system;
 - Work as a public official (except public officials of a state or political subdivision thereof who are paid solely on a fee basis and whose services are not covered under a federal-state coverage agreement);
 - Self-employment by members of certain religious sects exempt from self-employment taxes;

- Services performed by ordained, commissioned, or licensed ministers if they elected to be exempted from coverage under the Code, and by members of religious orders who have not taken a vow of poverty;
 - Services performed by Christian Science practitioners, if they have elected to be exempted from coverage under the Code; or
 - Deemed self-employment income of employees of church or church-controlled organizations that have elected to be exempt from payment of Social Security taxes for its employees.
- b. The term “trade or business” does not include services by a member of a religious order who has taken a vow of poverty when these services are performed in the exercise of the duties required by the order. However, these services may be covered as employment for the order if the order irrevocably elects coverage for its entire active membership and its lay employees. (For rules that apply, see §932 of the *Social Security Handbook*.)

D. Net earnings from self-employment

Note:

The 2018 Tax Act provides a new code §199A, Deduction for Qualified Business Income (QBI). Section 199A’s qualified business income deduction begins in 2018 and phases out on 1/1/2026.

However, this deduction only reduces income subject to federal income taxes. This deduction does NOT apply with respect to self-employment taxes or AMT.

1. Calculation

- a. Net earnings from self-employment are a person’s gross income from any trade or business that he or she operates, less allowable deductions for that trade or business. Net earnings also include the person’s share of profit or loss in any partnership to which he or she belongs. These are the same net earnings that are counted under the Social Security retirement insurance program and that are reported on the federal income tax return. If a person has more than one business, calculate net earnings by adding up the net profits or losses from all the businesses. If any part of income is not included in gross earnings from self-employment, expenses connected with this income cannot be deducted.
- b. Under certain circumstances, optional methods of computing net earnings from self-employment are available. (These methods are discussed below.)
- c. Definitions of terms used in calculating income for income-tax purposes also apply to calculating net earnings from self-employment.

2. Self-employment income

Self-employment income is the net earnings from self-employment for a taxable year. The following qualifications must be met:

- Net earnings for the taxable year must be at least \$400. (Certain church employees who are treated as self-employed must report earnings of \$100 or more);
- The trade or business must be covered by Social Security; and
- For a nonresident alien, earnings are not considered self-employment income except as provided by an international agreement.

3. Limits on self-employment income

Corresponding to the taxable wage base applicable to employees, self-employment income cannot exceed the amounts listed in the table below. Any wages covered by Social Security earned during the taxable year must be subtracted from the limits shown below.

| Self-Employment Income Limits ¹ | |
|--|--|
| If the taxable year is... | Then your self-employment income limit is... |
| 2013 | \$113,700 |
| 2014 | \$117,000 |
| 2015 | \$118,500 |
| 2016 | \$118,500 |
| 2017 | \$127,200 |
| 2018 | \$128,400 |
| 2019 | \$132,900 |
| 2020 | \$137,700 |
| 2021 | \$142,800 |
| 2022 | \$147,000 |
| 2023 | \$160,200 |
| 2024 | \$168,600 |

4. Net earnings from self-employment and self-employment income

Only that part of net earnings that is included in the term “self-employment income” is subject to Social Security self-employment taxes and counted for Social Security benefit purposes. (However, even if net earnings do not count for these purposes, they are included in figuring the amount of benefits that must be withheld under the excess earnings test).

5. Gross business receipts

- a. Gross business receipts for Social Security purposes include:
 - Professional fees received;
 - Compensation for services (other than as an employee);
 - Pay for work done on contract; and
 - Income from the sale, exchange, or conversion of goods held for sale in the ordinary course of business.
- b. Gross business receipts do **not** include:
 - Income from the sale, exchange, or conversion of business assets that are not part of business inventory, such as delivery trucks and office equipment;
 - Dividends, interest, and rental income from real property; or
 - Gains and losses from the sale or exchange of capital assets, except those realized in the course of business by an options or commodities dealer.

¹ <http://ssa.gov/OACT/COLA/autoAdj.html>.

6. Retirement payments received from partnerships

If a person is a retired partner receiving retirement payments from a partnership of which he or she is a member or a former member, the payments are excluded from net earnings from self-employment under all of the following conditions:

- a. The payments are made under a written plan of the partnership that meets the requirements prescribed by the Secretary of the Treasury.² The written plan must also provide for periodic payments because of retirement, to partners generally or to a class or classes of partners, to continue at least until such partner's death.

Note:

To qualify as payments on account of retirement, the payments must constitute bona fide retirement income. Thus, payments of benefits not customarily included in a pension or retirement plan, such as layoff benefits, are not payments on account of retirement. Eligibility for retirement generally is established on the basis of age, physical condition, or a combination of age or physical condition and years of service. Generally, retirement benefits are measured by, and based on, such factors as years of service and compensation received. In determining whether the plan of the partnership provides for payments on account of retirement, issues such as factors, formulas, etc., reflected in public and broad-based private pension or retirement plans may be taken into account in prescribing eligibility requirements and in computing benefits.³

The plan of the partnership must provide for payments on account of retirement, to partners generally or to a class or classes of partners, on a periodic basis, which continue at least until the partner's death. For these purposes, a class of partners may, in an appropriate case, contain only one member. Payments are made on a periodic basis if made at regularly recurring intervals (usually monthly) exceeding one year.⁴

- b. The person provided **no services** in any business conducted by the partnership (or its successors) **during the taxable year** of the partnership ending within or with the taxable year in which he or she received payments.
- c. At the end of the partnership's taxable year referred to in (b) above, the other partners have no obligation to the person other than for the retirement payments under the plan.
- d. The person's share in the capital of the partnership has been paid in full by the end of the partnership's taxable year referred to in (b) above.

Planning point:

Many retirement-of-interest provisions provide a payout over a period of years. In general, such payments must be allocated between §736(a) payments and §736(b) payments; the latter are for partnership capital. In general, any agreed allocation will be respected as long as the amount allocated to §736(b) does not exceed the fair market value of the partner's share of the property as determined as of the date of death or retirement.⁵ If no allocation is made, then only a ratable portion of fixed payments received will be allocated to the payment for capital (contingent payments require a recovery of §736(b) payments). Thus, partners will take fullest advantage of the exclusion for retirement payments from Social Security the sooner the §736(b) payments are completed. Review of the partnership agreement and possible redrafting may be necessary. And note that if the partnership does not provide for the retirement of the partner's interest in the partnership, the retirement payments themselves are included in self-employment income.

² I.R.C. §1402(a)(10).

³ Treas. Regs. §1.1402-17(b)(1).

⁴ Treas. Regs. §1.1402-17(b)(2).

⁵ Treas. Regs. §1.736-1(b)(5)(iii).

7. Limited partner

The Code and regulations provide that, except for guaranteed payments, the limited partner's distributive share is not self-employment income. While this is generally clear in a limited partnership, it has proved uncertain in the context of a limited liability company.

8. Deduction of business expenses

- a. All allowable business expenses (except those incurred by certain church employees who are treated as self-employed) must be deducted in computing net earnings from self-employment.
- b. An operator of a business who becomes liable for a business expense must take the deduction even if the expense is paid by someone else. If a person rents the property where he or she conducts his or her business and the person's son pays the rent, the person must deduct the rent because he or she became liable for it. If the son owns the property where the business is conducted, the person cannot deduct expenses such as taxes, insurance, and repairs, paid by the son in connection with the property because the person did not become liable for them.

9. Dividends on stock and interest on bonds

- a. Dividends on stock and interest on bonds (including debentures, notes, certificates, other evidence of indebtedness issued with interest coupons or in registered form by a corporation, and government bonds) do not count for Social Security purposes unless they are received in the course of business as a dealer in stocks or securities.
- b. Other interest received in the course of business does count for Social Security purposes. For example, if a person is a merchant and receives interest on accounts or notes receivable, the person must include this interest in computing net earnings from self-employment.

10. Interest received by dealers

- a. Dividends and interest received by a dealer in stocks and securities from stocks and bonds while they are in the dealer's inventory are earnings from self-employment. Securities bought by a dealer but not held for resale are considered a personal investment and are not part of the trade or business, and the interest and dividends received do not count as earnings from self-employment.
- b. A person is a dealer in stocks and securities if he or she:
 - (i) Is a merchant with an established place of business;
 - (ii) Regularly engages in buying stocks and bonds in his or her own name; and
 - (iii) Sells stocks and bonds to customers for a profit.

11. Interest received by traders

Interest and dividends received by a trader in stocks or securities are not counted as earnings for Social Security purposes. A trader is one who buys and sells stocks and bonds for his or her own account only.

12. Interest received by a dealer/stockbroker

Often a dealer in securities is also a stockbroker. Profits earned as a broker and those earned as a dealer in securities are both included in net earnings. Dividends and interest paid on securities while they are part of stock in trade are also counted. A person is a stockbroker if he or she buys and sell stocks and

bonds as an agent of the actual owner. A stockbroker does not buy or sell in his or her own name. Earnings come from commissions rather than from selling the stock or bond at a profit.

13. Calculation of dividend and interest income for partnerships

Partnerships are treated as individuals when it comes to the dividend and interest exclusion. Dividends and interest on securities held for investment are excluded from net earnings of the partners. However, if a partnership is in business as a securities dealer, income on the securities held for resale by the partnership is included as net earnings of the partners.

14. Gains and losses

When calculating earnings for Social Security purposes, gains or losses from the disposition of certain properties may be excluded if a person:

- a. Sells or exchanges a capital asset, except in the course of business of an options or commodities dealer;
- b. Cuts timber or disposes of timber, coal, or iron ore, even though it is held primarily for sale to customers, if §631 applies; or
- c. Sells, exchanges, involuntarily converts, or makes other disposition of property that is not: (i) stock in trade or other property of a kind that would be included in inventory if it were on hand at the close of the taxable year; or (ii) property held primarily for sale to customers in the ordinary course of business.

15. Rental allowances for ministers

A minister must include the following (which are excluded from gross income for income-tax purposes) in net earnings from self-employment (unless granted an exemption from coverage under Social Security):

- a. The rental value of a home furnished as part of compensation;
- b. A rental allowance paid as part of compensation; and
- c. The value of any meals or lodging furnished in connection with services performed in the exercise of the ministry.

16. Rental income

- a. Income received from renting rooms or apartments does not count for Social Security purposes unless the person provides personal services for the convenience of the occupant. Income received from renting property for business or commercial use is usually excluded from earnings from self-employment. However, if the person provides services primarily for the convenience of the tenant beyond those usually provided with rental of apartments or other space for occupancy only, rental income may be counted as earnings.
- b. Payments for the use or occupancy of space in parking lots, warehouses, or storage garages are included in determining net earnings from self-employment.

Note:

Rental income from two or more property operations is treated separately in figuring net earnings from self-employment. Rental income does not count for Social Security purposes even if the person has income from another property, such as a boardinghouse, which is included in earnings from self-employment. If a person rents part of the property and provides significant services and the other part without such services, income from the property rented with services is counted while the income from the other property is not counted.

17. Rent received by real-estate dealers

- a. Rentals from real estate being held for sale in the ordinary course of a trade or business are earnings from self-employment. The profit a dealer gets from selling the real estate is also earnings from self-employment.
- b. Property held by real-estate dealers for personal use or as investment is not held for sale. Rentals received from such property are not considered earnings from self-employment because they are not received in the regular course of a trade or business. Such property is not “stock in trade.”

18. Earnings for real-estate brokers

The following items are counted as earnings for a real-estate broker (i.e., one who buys, sells, or rents properties owned by someone else):

- a. Fees received for buying, selling, and renting properties owned by someone else; and
- b. Income received from the sale or rental of properties for which the person has taken title in his or her own name until he or she can find a buyer.

19. Farm rental income

Farm rental income counts as net earnings from self-employment for Social Security purposes if the landlord materially participates, as part of the rental arrangement, in the production or management of the production of the crop or livestock.

20. Material participation

The farm rental arrangement, either oral or written, must state that the person will materially participate in the production of the farm commodities. Actual participation may establish an oral agreement. Four tests are used to determine material participation.

- a. The conditions for **Test I: Financial Contribution, Periodic Inspection, and Consultation**, are met if the person has an arrangement for participation and does any three of the following:
 - (i) Advance, pay, or stand good for a significant part (usually one-third, but it depends on individual circumstances) of the cost of production, which includes expenses that relate directly to the production of the commodity, such as feed, seed, plants, fertilizer, fuel, machinery repair, pesticides, and other supplies;
 - (ii) Furnish a significant part of the tools, equipment, and livestock used in producing the commodities;
 - (iii) Make periodic inspections of the production activities for the purpose of seeing whether the farm work is being done properly, whether anything else needs to be done, or when the work should be done; or
 - (iv) Advise and consult with the tenant periodically in connection with what, where, when, or how things are to be done in producing the commodities.

- b. Under **Test II: Decisions Affecting Success of Enterprise**, a person is deemed to be materially participating if he or she is regularly and frequently making decisions that significantly affect the success of the enterprise. Making final decisions contributing to or affecting the success of the enterprise count toward material participation, including:
 - (i) What, when, and where to plant, cultivate, dust, or spray;
 - (ii) When to harvest the crop;
 - (iii) What goods to buy, sell, or rent;
 - (iv) What standards to follow; and
 - (v) What records to keep, reports to make, and bills to pay, etc., counts toward material participation.
- c. The criteria for **Test III: 100 Hours of Work Over Five-Week Period**, are as follows:
 - (i) If the person works at least 100 hours spread over five or more weeks (not necessarily consecutive) on activities connected with the production of the crop, the person is materially participating;
 - (ii) If the person works less than 100 hours or conducts the 100 hours of work in fewer than five different weeks, the person may still be materially participating if the work done adds up to a significant contribution to the production of the crop; or
 - (iii) If the work alone is not enough to establish material participation, it is considered along with the other things that are done that help establish material participation.
- d. The **total activities** may count as material participation even if Tests I-III are not met. There are different types of situations or combinations of factors that, based on the total picture, result in material participation.

E. Self-employed persons (sole proprietors and partners)

1. In general

The Code imposes a tax on the **self-employment income** of each individual according to the rates set forth in §1401(a), relating to old-age, survivor, and disability insurance (OASDI), and §1401(b), relating to hospital insurance (HI). The Social Security Act of 1983 adjusted the self-employment tax rates to equal the combined employer and employee rates under §§3111 and 3101, respectively. The presently scheduled self-employment tax rates and the credits against tax are as follows.

| Self-Employment Tax Rates (percent)⁶ | | | |
|--|-------|------|----------|
| Taxable years beginning in: | OASDI | HI | Combined |
| 1990 and later | 12.40 | 2.90 | 15.30 |

In 2024, the taxable wage base increased under the Social Security Act provisions to \$168,600.

2. Deduction

The self-employed are entitled to a deduction equal to one-half of the individual's self-employment tax liability in recognition of the fact that employees do not pay tax on the value of the employer's FICA contribution. The deduction may be treated as a trade or business expense in determining the individual's taxable income under §164(f) or, in the alternative, as a reduction in computing the individual's net self-employment earnings subject to self-employment tax. If the individual chooses to apply the deduction in computing net self-employment earnings subject to tax, the deduction is equal to one-half of the product

⁶ I.R.C. §§1401(a), (b), and (c).

of the individual's net earnings from self-employment (as determined prior to the deduction for the self-employment tax) and the combined OASDI and HI in effect for the particular taxable year.⁷

Mini-Case: In 2024, Joe makes \$40,000 from his proprietorship. He may deduct \$2,826 ($0.5 \times 0.153 \times 0.9235 \times \$40,000$) and be subject to income tax on \$37,175, while paying self-employment tax of \$5,652 ($0.153 \times 0.9235 \times \$40,000$). Or he may pay income taxes on the \$40,000 but reduce his self-employment income subject to self-employment tax by \$2,826, so that the tax is \$5,253 ($0.153 \times 0.9235 \times \$37,175$).

3. Self-employment income

Self-employment income subject to tax is determined by the individual's **net earnings** from self-employment. However, no amount of an individual's net earnings from self-employment is taxable to the extent that net earnings exceed the **taxable wage base**, which is effective for the calendar year in which the individual's taxable year begins, **minus** the amount of **wages paid** to the individual during the taxable year.⁸ For these purposes, the taxable wage base is equal to the wage base for Social Security purposes. In 2024, the taxable wage base for Social Security purposes is \$168,600. Wages that reduce the taxable wage base in determining the maximum amount of self-employment income subject to tax are wages that are normally subject to FICA⁹ or the Railroad Retirement tax.

4. Liability

Every self-employed U.S. citizen and resident alien with net earnings from self-employment of \$400 or more is liable for self-employment taxes, even if there is otherwise no liability to file an income tax return.¹⁰

- a. The trade or business must, however, be carried on by an individual, either personally or through agents or employees.¹¹ Thus, income derived from a trade or business carried on by an estate, corporation (including an S corporation), or trust is exempt from self-employment taxes.
- b. The taxable year for purposes of computing the tax on self-employment income is the same as the taxable year for income-tax purposes.¹² In the case of partnership income, if the taxable year of a partner does not correspond to that of the partnership, the partner is required to compute the self-employment tax on the partner's distributive share of the ordinary income or loss of the partnership for the partnership taxable year ending within the partner's taxable year.¹³

5. Net earnings from self-employment

As previously discussed, self-employment income subject to tax is determined by an individual's net earnings from a trade or business carried on as a sole proprietor or by a partnership of which the individual is a member.

- a. **Aggregation of earnings** -- If an individual is engaged in more than one trade or business, net earnings from self-employment consist of the aggregate of the net earnings from all such trades or businesses. Losses from one trade or business will operate to offset any income earned in another trade or business.

⁷ I.R.C. §1402(a)(12) is effective for taxable years that began after 1989.

⁸ I.R.C. §1402(b)(1).

⁹ I.R.C. §1402(d).

¹⁰ I.R.C. §6017; *Briant v. Commissioner*, 44 T.C.M. 472 (1982). If a joint income tax return is filed, the tax is computed separately on the separate self-employment income of the husband and/or wife. However, each spouse is fully liable for the total self-employment tax due on the return.

¹¹ *Briant v. Commissioner*, 44 T.C.M. 472 (1982).

¹² Treas. Regs. §1.1402(a)(2)-(a).

¹³ Treas. Regs. §1.1402(a)-2(e).

- b. **Net earnings** -- Section 1402(a) defines the term **net earnings from self-employment**:
- Gross income derived from a trade or business, less allowable deductions attributable to such trade or business; plus
 - An individual's distributive share (whether or not distributed) of the net income or loss from any trade or business carried on by a partnership of which he is a member.¹⁴
- c. **Excluded income** -- For these purposes, the rules applicable in determining net income for income-tax purposes are used in computing net earnings from self-employment. Consequently, income that is excludable from gross income is not taken into account in determining net earnings from self-employment except as otherwise provided.
- (i) If an individual uses the accrual method of accounting in computing taxable income from a trade or business, the same method must be used for determining net earnings from self-employment.¹⁵
 - (ii) Similarly, if the taxpayer uses the installment method of accounting for sales, the same method must be used in computing net earnings from self-employment.
- d. **Self-employment income** -- A member of a partnership includes as self-employment income the member's distributive share of the net income or loss from **all** partnerships of which he is a member.¹⁶ However, payments made to a retiring partner on a periodic basis until death may not be subject to tax as self-employment income under certain circumstances. A partner who is not recognized as such for federal income-tax purposes, as in the case of certain family partnerships, would not be recognized for self-employment tax purposes, notwithstanding the valid existence of the partnership for federal income-tax purposes. Note, however, that any net-operating-loss carryover or carryback from any partnership cannot be used to reduce self-employment income from another partnership.¹⁷
- e. **Distributive share** -- A partner's distributive share of the income or loss of a partnership is determined under §704. Consequently, only the ordinary net income or loss derived by the partnership in carrying on the partnership's trade or business is subject to tax.
- (i) Any ordinary net income or loss of the partnership derived from sources that are unrelated to the trade or business carried on by it is excluded in determining net earnings from self-employment.¹⁸
 - (ii) The distributive share of the income or loss of a **limited partner** may be excluded in determining net earnings from self-employment to the extent that such amounts are not received as **guaranteed payments** for services actually performed by the limited partner for the partnership.¹⁹
- f. **Taxable income** -- If the taxable year of a partner does not correspond to that of the partnership, the partner is required to base the partner's distributive share on the ordinary income or loss of the partnership for its taxable year ending within the taxable year of the partner.²⁰ However, if a partner's taxable year ends within, but not with, the taxable year of the partnership as a result of the partner's death, the partner's net earnings from self-

¹⁴ I.R.C. §1402(a).

¹⁵ Treas. Regs. §1.1402(a)-2(a).

¹⁶ See I.R.C. §1402(a)(10) and Treas. Regs. §1.1402(a)-17.

¹⁷ I.R.C. §1402(a)(8).

¹⁸ Rev. Rul. 54-223, 1954-1 C.B. 174. Gains from the sale or exchange of capital assets or I.R.C. §1231 assets treated as capital gains are excluded. I.R.C. §1402(a)(3).

¹⁹ I.R.C. §1402(a)(12) has been redesignated as I.R.C. §1402(a)(13) for taxable years beginning after 1989. Note such guaranteed payouts constitute ordinary gross income derived from the trade or business activity of the individual.

²⁰ Treas. Regs. §1.1402(a)-2(e).

employment for the taxable year ending with the partner's death include so much of his or her share of the partnership's ordinary income or loss for the partnership's taxable year as is not attributable to an interest in the partnership during any period beginning on or after the first day of the first calendar month following the month in which the partner died.²¹ Furthermore, the ordinary income or loss of the partnership is treated as having been realized ratably over the partnership's taxable year.

Mini-Case: A partner's distributive share of the partnership profits for the partnership year ending June 30, 2024, is \$8,000. The partner, who files a return on a calendar-year basis, died on August 18, 2024. For the partnership year ending June 30, 2025, the distributive share to the partner and the partner's estate is \$12,000. The deceased partner's self-employment income for 2024 is therefore \$10,000 (\$8,000 + 2/12 of \$12,000).²²

- g. **Rental income** -- Rental income and deductions attributable to leased real estate are not included in the computation of self-employment income subject to self-employment contributions if the real estate is held by the lessor for investment or speculation.²³
- (i) Payments for the use or occupancy of premises for business purposes, a single-family dwelling unit, or living quarters in a multiple-housing unit are generally excluded as rentals from real estate, except in the case of real-estate dealers, even though such payments are in part attributable to personal property furnished under the lease.²⁴
 - (ii) However, payments for the use or occupancy of rooms or space where substantial and significant services are also rendered to and primarily for the convenience of the occupant, and which are other than those customarily rendered in connection with the rental of real estate, do not qualify as excludable rental payments in determining net earnings from self-employment.²⁵ Thus, rent paid for rooms in hotels, boarding homes, tourist homes, or for space in parking lots, warehouses, or storage garages may **not** be excluded from the computation of self-employment income.²⁶ To the extent that the lessor provides services that are customarily rendered in connection with leased property and that do not constitute a material portion of the rental payments, such as heat, light, water, trash collection, maintenance of common areas, etc., such services are not considered to be rendered to the occupant.²⁷

²¹ I.R.C. §1402(f).

²² Rev. Rul. 58-607, 1958-2 C.B. 420.

²³ I.R.C. §1402(a)(1).

²⁴ Treas. Regs. §1.1402(a)-4(c)(1).

²⁵ Treas. Regs. §1.1402(a)-4(c)(2).

²⁶ See, e.g., *Folsom v. Poteet*, 235 F.2d 937 (9th Cir. 1956) (lessor who rendered significant services to tenants of an apartment house was subject to self-employment taxes); Rev. Rul. 57-108, 1957-1 C.B. 273 (Rental income from vacation homes qualifies as earnings from self-employment where significant services are rendered for the convenience of the tenants); *Johnson v. Richardson*, 60 T.C. 829 (1973) (rental of mooring space at a boat shed qualified as earnings from self-employment where the lessor provided gasoline and other significant services to tenants).

²⁷ Rev. Rul. 83-139, 1983-2 C.B. 150, obsoleting Rev. Rul. 72-331, 1972-2 C.B. 513. Rev. Rul. 55-559, 1955-2 C.B. 315 (office building owners who performed normal maintenance services did not have earnings from self-employment); *Bobo v. Commissioner*, 70 T.C. 706 (1978) (net rental income from mobile-home park was not self-employment income although laundry services were provided by the owner for the convenience of tenants), acq., 1983-2 C.B. 1.

Planning point:

There will be increased effort to convert compensation income or earned income into unearned income. This is generally much easier in a corporate form than in a partnership or limited liability company. Rent and interest have already been mentioned. Other possibilities include taking distributions or pass-through income in an S corporation or receiving compensation not treated as wages for employment-tax purposes, such as fringe benefits or qualified deferred compensation, or nonqualified deferred compensation taken into account as wages for Social Security purposes in an earlier year.

6. Excess earnings

Net earnings from self-employment during the period between the start of early retirement benefits and the full retirement age are taken into account in determining whether or not the individual has excess earnings that trigger a reduction in the benefits that would otherwise be received. This causes a double whammy because by taking a retirement benefit prior to the full retirement age, the permanent benefit has been reduced on that account, and the benefit is then reduced further by reason of the excess nature of the earnings.

Note:

One disadvantage to a self-employed person compared to an employee lies in the application of the monthly charging of earnings prior to the month the worker attains full retirement age. There is a difference in how the exempt earnings amount is applied to months. The SSA states that no part of the **excess earnings** of an individual shall be charged to any month: (i) in which such individual did not engage in self-employment **and** (ii) did not render services for wages of more than the applicable exempt amount; and (iii) that is both:

- A month for which the individual is entitled to benefits (without having been entitled for the preceding month to some other benefit); and
- A month in which the individual did not engage in self-employment and did not render services for wages of more than the applicable exempt amount.

Failure to meet one of the criteria means that excess earnings may be charged to such month. A self-employed person who is engaged in self-employment in any month is not insulated from the charging of excess earnings to that month. This raises the issue of whether an individual is engaged in self-employment in a particular month.

In the case of a self-employed individual, the Social Security Administration will consider how much work the individual does in the business to determine whether that person is retired, i.e., is not engaged in self-employment. One way Social Security Administration determines this is by determining the amount of time that person spends working. Generally: (i) if one works more than 45 hours a month in self-employment, that person is not retired and is engaged in self-employment; (ii) if one works less than 15 hours a month, the person is retired and is not engaged in self-employment; and (iii) if one works between 15 and 45 hours a month, one is considered engaged in self-employment if it is in a job that requires a lot of skill or one is engaged in managing a sizable business.

In summary, individuals who remain active in the management of a sizable business will not be engaged in self-employment only if they work less than 15 hours a month, while those who remain active in the management of a not-so-sizable business will not be engaged in self-employment only if they work less than 45 hours a month.

Individuals who perform work that requires a lot of skill will be engaged in self-employment only if they work less than 15 hours a month, while those who perform work that does not require a lot of skill will be engaged in self-employment only if they work less than 45 hours a month.

Individuals who work more than 45 hours in a month are per se engaged in self-employment.

Mini-Case: Jack, age 63, is entitled to a monthly benefit of \$1,000. Jack retains a relationship to an LLC that operates several apartment complexes and receives a distribution in October in the amount of \$24,960. Jack was engaged in 20 hours of management consulting in June, July, and August. The earnings test requires the excess earnings (\$11,480) to be allocated to June, July, and August, eliminating the benefits in that month. But because Jack is not engaged in self-employment in the other months of the year, the excess earnings do not impact the benefits in months other than the ones in which Jack is engaged in self-employment. Thus, Jack receives \$1,000 in nine of the months and \$0 in three of the months.

If Jack, however, had worked 16 hours in each of January, February, March, April, and May, Jack would be engaged in self-employment in the first eight months of the years and Jack would have no benefits in each of the first eight months of the year and receive benefits only in the final four months.

F. Limited liability companies

1. In general

The IRS proposed amendments to the self-employment tax regulations that outlined how LLC members will be treated for self-employment tax purposes.²⁸ They have recently withdrawn them in favor of new proposed regulations.

- a. As a general rule, an individual's net earnings from self-employment include the individual's distributive share (whether or not distributed) of income or loss described in §702(a)(8) from any trade or business carried on by each partnership of which the individual is a partner.²⁹ For this purpose, whether a person is a partner and whether the entity is a partnership is determined under the classification regulations.³⁰
- b. The new proposed regulations retain the concept that an individual's net earnings from self-employment do not include the individual's distributive share of income or loss as a **limited partner**. However, guaranteed payments made to the individual for services actually rendered to or on behalf of the partnership engaged in a trade or business are included in the individual's net earnings from self-employment.³¹

2. Limited partner

The IRS issued proposed regulations regarding self-employment tax and entities taxed as a partnership in 1994. The proposed regulations were withdrawn and reissued in 1997. The regulations create a test to determine if an owner of an entity taxed as a partnership is a limited partner or a general partner. The regulations generated controversy over many things, including the fact that the regulations ignored state law in determining the nature of the ownership interest. The regulations have never been finalized, and are not in effect until finalized. However, the IRS has stated that a taxpayer may rely on the proposed regulations. Under the proposed regulations, whether or not and the extent to which an individual is considered to be a limited partner for purposes of self-employment tax is determined by a set of three rules.³²

²⁸ EE-45-94, published in the *Federal Register* on December 29, 1994.

²⁹ Prop. Regs. §1.1402(a)-2(d).

³⁰ Prop. Regs. §1.1402(a)-2(f).

³¹ Prop. Regs. §1.1402(a)-2(g).

³² Prop. Regs. §1.1402(a)-2(h)(1).

- a. As a general rule, an individual is treated as a limited partner unless that individual meets one of three tests:³³
- The individual has **personal liability** for the debts of or claims against the partnership by reason of being a partner;³⁴
 - The individual has authority (under the law of the jurisdiction in which the partnership is formed) to contract on behalf of the partnership; or
 - The individual participates in the partnership's trade or business for more than 500 hours during the partnership's taxable year.
- b. As to a partner who is not treated as a limited partner under the general rule, they will be treated as a limited partner with respect to a specific class of interest in the partnership (the first alternative) if, immediately after the individual acquires that class of interest:³⁵
- Limited partners under the general rule own a **substantial**, continuing interest in that specific class of partnership interest; and
 - The individual's rights and obligations with respect to that specific class of interest are identical to the rights and obligations of that specific class of partnership interest held by such limited partners.

Note:

A class of interest is an interest that grants the holder specific rights and obligations. If a holder's rights and obligations from an interest are different from another holder's rights and obligations, each holder's interest belongs to a separate class of interest. An individual may hold more than one class of interest in the same partnership provided that each class grants the individual different rights or obligations. The existence of a guaranteed payment described in §707(c) made to an individual for services rendered to or on behalf of a partnership, however, is not a factor in determining the rights and obligations of a class of interest.³⁶

Planning point:

In essence, the regulations permit a person who holds the equivalent of a general partnership interest (causing them to fail the general rule), as well as another class of interest in the partnership that is identical to the interest held by individuals who are deemed limited partners under the general rule, to carve the distributive share of the second interest out from net earnings from self-employment.

- c. Even if the individual who failed the general rule does not own more than one class of interest in the partnership, the individual who failed the general rule solely by reason of participation may be treated as a limited partner with respect to the individual's partnership interest (the second alternative) if, immediately after the individual acquires that interest:³⁷

³³ Prop. Regs. §1.1402(a)-2(h)(2).

³⁴ Treas. Regs. §301.7701-3(b)(2)(ii) states that a member has personal liability if the creditors of the entity may seek satisfaction of all or any portion of the debts or claims against the entity from the member as such. This attribute of personal liability is not avoided even if the member makes an agreement under which another person (whether or not a member of the entity) assumes such liability or agrees to indemnify that member for any such liability. This determination is based solely on the statute or law pursuant to which the entity is organized, except that if the underlying statute or law allows the entity to specify in its organizational documents whether the members will have limited liability, the organizational documents may also be relevant.

In the case of an LLC, members do not have liability under the organizational law, but this can be altered in the articles of organization. In a limited partnership, many statutes render a designated limited partner subject to personal liability if the partner participates in the management or operations of the partnership, but this rule is changing to a more liberal standard in several jurisdictions so as to require a not insubstantial level of participation.

³⁵ Prop. Regs. §1.1402(a)-2(h)(3).

³⁶ Prop. Regs. §1.1402(a)-2(h)(6)(i).

³⁷ Prop. Regs. §1.1402(a)-2(h)(4).

- Limited partners under the general rule own a substantial, continuing interest in that specific class of partnership interest; and
 - The individual's rights and obligations with respect to the specific class of interest are identical to the rights and obligations of the specific class of partnership interest held by such limited partners.
- d. Whether or not there is a substantial interest in a class of interest is determined based on all of the relevant facts and circumstances. In all cases, however, ownership of 20 percent or more of a specific class of interest is considered substantial.³⁸

Many practitioners take the position that LLC members are only subject to SE tax on guaranteed payments, citing similarities between LLC members and limited partners. This position is growing increasingly dangerous due to recent judicial activity.³⁹

Note:

The practitioner should make the taxpayer aware that any attempt to reduce the total tax liability by reducing self-employment tax will likely reduce Social Security benefits in the future. Many taxpayers think that Social Security benefits are based on the last years of work, such as the last 10 years of employment. They are not aware of the fact that Social Security benefits are based on a lifetime of earnings. Reducing SE tax over a long period of time can reduce benefits to an extent that cannot be "caught up" later. The taxpayer may desire to reduce SE tax at the cost of reduced benefits, but they should plan for retirement based on the reduced Social Security benefits.

3. Exceptions

As noted above, guaranteed payments made to the individual for services actually rendered to or on behalf of the partnership engaged in a trade or business are included in the individual's net earnings from self-employment even if the individual is determined to be a limited partner under the definitional rules described in the previous section. In addition, an individual who is a **service partner** in a **service partnership** may not be a limited partner even though he or she is determined to be so under the general rule or either of the alternatives above.⁴⁰

- a. For this purpose, a **service partnership** is a partnership substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, or consulting.⁴¹
- b. For this purpose, a **service partner** is a partner who provides services to or on behalf of the service partnership's trade or business. A partner is not considered to be a service partner if that partner only provides a de minimis amount of services to or on behalf of the partnership.⁴²

Mini-Case 1: A, B, and C form LLC, a limited liability company, under the laws of State to engage in a business that is not a service partnership. LLC, classified as a partnership for federal tax purposes, allocates all items of income, deduction, and credit of LLC to A, B, and C in proportion to their ownership of LLC. A and C each contribute \$1x for one LLC unit. B contributes \$2x for two LLC units. Each LLC unit entitles its holder to receive 25 percent of LLC's tax items, including profits. A does not perform services for LLC; however, each year B receives a

³⁸ Prop. Regs. §1.1402(a)-2(h)(6)(iv).

³⁹ See *Renkemeyer, Campbell, and Weaver LLP v. Commissioner*, 136 T.C. 137 (2011); and C.C.A. 201436049 (May 20, 2014).

⁴⁰ Prop. Regs. §1.1402(a)-2(h)(5).

⁴¹ Prop. Regs. §1.1402(a)-2(h)(6)(iii).

⁴² Prop. Regs. §1.1402(a)-2(h)(6)(ii).

guaranteed payment of \$6x for 600 hours of services rendered to LLC and C receives a guaranteed payment of \$10x for 1,000 hours of services rendered to LLC. C also is elected LLC's manager. Under State's law, C has the authority to contract on behalf of LLC.

A is treated as a limited partner in LLC under the general rule because A is not liable personally for debts of or claims against LLC, A does not have authority to contract for LLC under State's law, and A does not participate in LLC's trade or business for more than 500 hours during the taxable year. Therefore, A's distributive share attributable to A's LLC unit is excluded from A's net earnings from self-employment.

B's guaranteed payment of \$6x is included in B's net earnings from self-employment. B is not treated as a limited partner under the general rule because although B is not liable for debts of or claims against LLC and B does not have authority to contract for LLC under State's law, B does participate in LLC's trade or business for more than 500 hours during the taxable year. Further, B is not treated as a limited partner under the first alternative because B does not hold more than one class of interest in LLC. However, B is treated as a limited partner under the second carve-out because B is not treated as a limited partner under the general rule solely because of B's participation in LLC's business and because A is a limited partner under the general rule who owns a substantial interest with rights and obligations that are identical to B's rights and obligations. In this example, B's distributive share is deemed to be a return on B's investment in LLC and not remuneration for B's service to LLC. Thus, B's distributive share attributable to B's two LLC units is not net earnings from self-employment.

C's guaranteed payment of \$10x is included in C's net earnings from self-employment. In addition, C's distributive share attributable to C's LLC unit also is net earnings from self-employment because C is not a limited partner under the general rule or either of the two alternatives. C is not treated as a limited partner under the general rule because C has the authority under State's law to enter into a binding contract on behalf of LLC and because C participates in LLC's trade or business for more than 500 hours during the taxable year. Further, C is not treated as a limited partner under the first alternative because C does not hold more than one class of interest in LLC. Finally, C is not treated as a limited partner under the second alternative because C has the power to bind LLC. Thus, C's guaranteed payment and distributive share both are included in C's net earnings from self-employment.

Mini-Case 2: X, Y, and Z form LLC XYZ under the laws of State J. The LLC is engaged in the practice of accounting. X and Y are actively engaged in performing accounting services on behalf of XYZ, while Z is retired, no longer provides services, but has not had his interest liquidated. The LLC is manager-managed, with X being the designated manager. Y performs approximately 490 hours of services in the current year, while X provides over 1,500 hours.

The LLC is a service partnership. X is not a limited partner under the general rule because he has the power to bind XYZ and performs more than 500 hours of service. But X is also not a limited partner by virtue of being a service partner. X's entire distributive share is net earnings from self-employment.

Y is a limited partner under the general rule because he has no personal liability, no authority to bind XYZ, and performs fewer than 500 hours of services to or on behalf of XYZ. However, this is a red herring, because any amount of work performed by Y to or on behalf of XYZ makes Y a service partner who cannot be treated as a limited partner under any circumstances. All of Y's distributive share is treated as net earnings from self-employment.

Z is a limited partner under the general rule for the same reasons as Y. However, as long as Z continues to perform no services for or on behalf of XYZ, Z is not a service partner. Hence, Z's classification as a limited partner permits him to exclude his entire distributive share from net earnings from self-employment.

Planning point:

If the idea is to enable some of the investors to avoid the self-employment tax, it is imperative that the LLC be organized as a manager-managed LLC in its articles. This assures that there is no question as to the authority of the member to contract on behalf of the LLC by virtue of the member's status as a member. Generally speaking, both members and managers may contract on behalf of the LLC in a member-managed LLC.

Planning caution:

The rush to avoid self-employment tax may come at a significant income-tax cost. The question of whether the member is treated like a limited partner or limited entrepreneur occurs in a number of contexts. One of the circumstances in which the cash method cannot be used is where 35 percent of the losses are allocated to limited partners or "limited entrepreneurs"⁴³ (investors that do not actively participate in management).⁴⁴ This issue was raised in a letter ruling involving a law firm that was member-managed and held inapplicable. However, structuring the LLC as manager-managed runs the risk that enough members will be treated as limited entrepreneurs to trigger mandatory use of the accrual method.

4. Effective date

The amendments to the proposed regulations are applicable beginning with the individual's first taxable year beginning on or after the date they are published as a final regulation in the Federal Register.⁴⁵ It is likely that due to the passage of time the regulations will be reissued, possibly in another amended form.

Caution:

The Taxpayer Relief Act of 1997 (TRA '97) precluded the implementation of the new proposed regulations through June 30, 1998. At present, the state of affair is uncertain. The proposed regulations, though not effective, are the best insight we have into the IRS's thoughts on these issues.

G. Employees of corporations

1. Wages

The shareholder-employees in a corporation are subject to FICA, which applies only to **wages received** by them.⁴⁶ Employer-corporations similarly pay an equal excise tax on the **wages paid** by them.⁴⁷ While there are many exceptions to the concepts of wages⁴⁸ and employment,⁴⁹ it may be difficult in a C corporation to get value out to shareholders in a form other than wages without triggering employment-tax consequences.

⁴³ Temp. Regs. §1.448-1T(b)(3). Recently, the Service has indicated that none of the following are treated as limited partners or limited entrepreneurs in the context of an LLC: (i) active members; (ii) former active members who participated in management for at least five years; (iii) estates of such persons; (iv) the spouses, children, grandchildren, or parents of a currently active member; and (v) estates of such persons where the assigning active member actively participates in management). PLR 9535036.

⁴⁴ I.R.C. §461(i)(3)(B).

⁴⁵ Prop. Regs. §1.1402(a)-2(j). TRA '97 delayed such publication until at least July 1, 1998. However, so far nothing has occurred.

⁴⁶ I.R.C. §3101.

⁴⁷ I.R.C. §3111.

⁴⁸ I.R.C. §§3121(a) and (v).

⁴⁹ I.R.C. §3121(b).

- a. Dividends are not earnings and do not trigger the earnings test (and do not themselves attract Social Security taxes). The 2003 tax legislation has made the double tax cost of dividend distributions less costly and in some instances less costly than paying wages (which do trigger the earnings test and require payment of Social Security taxes).

Note:

Tentative conclusions are based on federal taxes only. The effective tax rate on distributions for shareholder-employees with compensation in excess of the taxable wage base is 27.50 percent if they are in the 25-percent bracket (the 15-percent bracket on dividends), while the effective rate for such taxpayer on dividend distributions ranges from 27.25 percent if the corporation is otherwise in the 15-percent tax bracket, to 33.91 percent when corporate taxable income is \$100,000. Thus, dividends appear to be somewhat more tax-efficient for such shareholders for corporate taxable incomes up to \$50,000.

Thus, an individual who retires early and is subject to the earnings test can, during the interim, create dividends through a C corporation of up to nearly \$50,000 that will provide additional cash flow without causing an increase in taxes or reduction of the Social Security benefit under the earnings test.

- b. Alternatively, the taxpayer can enter into a deferred-compensation agreement that will defer the payment of compensation until the year following reaching full retirement age, when it will not be subject to reduction by the earnings test. However, Social Security taxes will generally be due in the year earned.

Planning point:

Nonqualified deferred compensation is taken into account for excess-earnings purposes in the later of the year in which it is earned or the year it becomes not subject to a substantial risk of forfeiture. In a large percentage of these cases nonqualified deferred compensation will not affect the Social Security benefits because the compensation will not be taken into account for these purposes in the year it is received, but in an earlier year (presumably before any Social Security benefits are received). However, any nonqualified deferred compensation accruing from services performed after the individual begins taking early retirement benefits will be taken into account unless there is a substantial risk of forfeiture.

Note:

Deferred compensation generally is not used in a partnership/LLC or sole proprietorship because of the current taxation of the amounts involved. The corporate model, whether S or C, enables individuals to potentially use nonqualified deferred compensation more efficiently than current wages paid during the period from, say, age 62 when the individual starts taking benefits and the full retirement age. Amounts paid will be subject to income tax in the year received and can increase the amount of Social Security benefits subject to the income tax but they will neither trigger nor increase a reduction of Social Security benefits on account of excess earnings in the year the nonqualified deferred compensation is received.

2. Family employees

Family members may be employees; therefore, an unincorporated business owner can reduce self-employment income below the exempt amount by splitting business income with the spouse and children.

- a. Business owners can comply with the substantial services test and work without a benefits reduction by shifting income to another entity or person. The SSA does not have the authority to reallocate corporate earnings to particular shareholder-employees if they choose to work for less or no pay, either actually or constructively, in excess of the exempt amount, as wages, salary, or dividends.

- b. Shareholder-employees can take the following steps to maximize retirement benefits and continue working:
- Between the ages of 62 and normal retirement age, work for low or no pay; and
 - All corporate earnings in excess of the exempt amount accumulate in retained earnings until normal retirement age. Then, accumulated earnings may be withdrawn by declaring a dividend without a benefits reduction, because there is no earnings limitation for beneficiaries normal retirement age or older. Care must be taken to avoid the accumulated-earnings tax for “unreasonable” corporate earnings.

3. S corporation planning

Salaries paid to an S corporation shareholder are of course subject to the Social Security tax on employment income. However, dividend distributions are generally not subject to Social Security tax. Thus, S corporations offer a special opportunity (generally not available in a C corporation) to save Social Security taxes.

- a. Note that the dividend distributions by an S corporation do not generally result in a double tax.
- b. The IRS will look beyond the label attached to the distribution to determine its character,⁵⁰ and may treat a payment by an S corporation to its shareholder-employee as compensation. In one case, a professional-services S corporation annually distributed all of the corporation’s taxable income to its sole shareholder-employee as a dividend. The corporation paid no salary to the shareholder. The courts determined that the amounts paid were paid for services rather than as a dividend. The Service’s success in this case is the flip side to the taxpayers’ success in reasonable-compensation cases in service-oriented businesses. So in the upside-down world of the S corporation, one may have to determine how **low** a reasonable salary can be to avoid recharacterization of a dividend as compensation.
- c. The Social Security tax cannot always be avoided. A shareholder-employee who receives less than an adequate level of salary for services performed will be treated as receiving salary (in spite of the corporation’s characterization of the **distribution** as a dividend) to the extent the IRS claims an adequate salary was not paid.⁵¹
- d. For shareholders who perform little or no services for the corporation, however, the use of an S corporation may enable them to save cash that would otherwise be paid into the Social Security system. In 2023, the rate is 15.30% (7.65% for the employee, 7.65% for the employer) with a taxable wage base of \$160,200.
- (i) Partners in a partnership cannot use these techniques; the Social Security tax applies whether or not a partner receives the partner’s distributive share. But in an S corporation, a shareholder who leaves income in the corporation or who performs no services for the corporation cannot be currently subject to the Social Security tax.⁵² This creates a potential savings of \$25,796 (15.3 percent x \$168,600) annually. The lack of salary does preclude building up credits for Social Security benefits. (Some taxpayers believe, however, that they can create

⁵⁰ See *Radtke v. Commissioner*, 89-2 U.S.T.C. ¶9466 (E.D. Wis. 1989), *aff’d* 90-1 U.S.T.C. ¶50,113 (7th Cir. 1990).

⁵¹ Note that the “family S corporation” rules may recharacterize payments to another person as salary to a shareholder-employee. I.R.C. §1366(e).

⁵² Rev. Rul. 74-44, 1974-1 C.B. 325.

a larger retirement benefit from their personal investment of the freed-up cash flow.)

- (ii) Another potential downside to this technique relates to the corporation's own private retirement plans. In the case of a shareholder-employee of an S corporation, it is unclear whether the current, undistributed pro rata share of corporate taxable income will be included in the compensation base that determines the benefit or contribution funding for the employee. But if this share is included, the shareholder-employee may save Social Security tax yet still obtain maximum benefit from a corporate qualified plan.

4. Transfers to family member

Instead of incorporation, the business may be transferred to another family member. Between ages 62 and full retirement age, the beneficiary can be an employee of the transferred business and earn wages or salary up to the exempt amount. After normal retirement age, the business could be transferred back to the beneficiary. It makes sense to transfer a business from the beneficiary before 62 and back again later when there is a considerable difference in the transferor and transferee's ages.

5. *Watson, P.C. v. U.S.* – Unreasonably low compensation

In a case published in 2010, a district court found that the payment of dividends by an S corporation to its accountant sole shareholder was not as a matter of law a dividend as declared by the corporation when the amount paid dwarfed salary payments, but rather could be recharacterized as wages subject to employment tax.⁵³ Four partners in an accounting firm retained the partnership for which each of their own S corporations provided an accountant to provide services to the partnership as an employee of the S corporation. The partnership paid the corporations for services rendered (not subject to employment taxes and the corporations in turn paid their principals a combination of salary (\$24,000 in the case of the principal of the taxpayer S corporation) and distributions.

The Court agreed that the S corporation's self-proclaimed intent to pay the individual accountant \$24,000.00 in salary did not limit the government's ability to recharacterize dividends paid to the principal as wages, even though it properly documented its claimed intent in its corporate records. Rather, the characterization of funds disbursed by an S corporation to its employees or shareholders turns on an analysis of whether the payments at issue were made as remuneration for services performed (see factors, below). These tax consequences are governed by the economic realities of a transaction, not by the form of the transaction or labels given it by the parties.⁵⁴ That is not to say that intent is insignificant to the analysis. Indeed, a determination of whether funds are "remuneration for services performed," must be made "in view of all the evidence," and intent is unquestionably a consideration in such an analysis. Intent often must be inferred from the totality of the circumstances, as one would hardly expect a

⁵³ *Watson, P.C. v. U.S.*, 714 F. Supp.2d 954 (S.D. Ia. 2010).

⁵⁴ See, e.g., *Boulware v. United States*, 552 U.S. 421 (2008) ("The colorful behavior described in the allegations requires a reminder that tax classifications like "dividend" and "return of capital" turn on "the objective economic realities of a transaction rather than ... the particular form the parties employed.") (quoting *Frank Lyon*, 435 U.S. at 573); *Pinson v. Commissioner*, T.C. Memo 2000-208 ("As a general rule, the substance of a transaction controls tax treatment." (citing *Gregory v. Helvering*, 293 U.S. 465 (1935)); *True v. United States*, 190 F.3d 1165 (10th Cir.1999) (stating that "substance over form" is a "fundamental tax principle [that] operates to prevent the "true nature of a transaction from being disguised by mere formalisms, which exist solely to alter tax liabilities"" (quoting *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945)); *Leisure Dynamics, Inc. v. Commissioner*, 494 F.2d 1340 (8th Cir.1974) ("For tax purposes, we must concern ourselves with actualities rather than the refinements of title; our concern is with the substance, not form.").

corporate entity to thoroughly document an actual intent to avoid federal employment taxes by disguising remuneration as dividends.⁵⁵

6. IRS Fact Sheet on wage compensation for S corporation officers

Corporate officers are specifically included within the definition of employee for FICA (Federal Insurance Contributions Act), FUTA (Federal Unemployment Tax Act), and federal income tax withholding under the Internal Revenue Code. When corporate officers perform services for the corporation, and receive or are entitled to receive payments, their compensation is generally considered wages. Subchapter S corporations should treat payments for services to officers as wages and not as distributions of cash and property or loans to shareholders.⁵⁶

- a. The Internal Revenue Code establishes that any officer of a corporation, including S corporations, is an employee of the corporation for federal employment tax purposes. S corporations should not attempt to avoid paying employment taxes by having their officers treat their compensation as cash distributions, payments of personal expenses, and/or loans rather than as wages. The fact that an officer is also a shareholder does not change the requirement that payments to the corporate officer be treated as wages. Courts have consistently held that S corporation officer/shareholders who provide more than minor services to their corporation and receive or are entitled to receive payment are employees whose compensation is subject to federal employment taxes.

Note:

The Treasury Regulations provide an exception for an officer of a corporation who does **not perform any services** or performs **only minor services** and who neither receives nor is entitled to receive, directly or indirectly, any remuneration. Such an officer would not be considered an employee.

- b. What's a reasonable salary?
 - (i) The instructions to the Form 1120S, *U.S. Income Tax Return for an S Corporation*, state "Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation."
 - (ii) The amount of the compensation will never exceed the amount received by the shareholder either directly or indirectly. However, if cash or property or the right to receive cash and property did go to the shareholder, a salary amount must be determined and the level of salary must be reasonable and appropriate.
 - (iii) There are no specific guidelines for reasonable compensation in the Code or the Regulations. The various courts that have ruled on this issue have based their determinations on the facts and circumstances of each case.

⁵⁵ See, e.g., *Tool Producers, Inc. v. Commissioner*, (6th Cir. 1996) ("In determining the intent behind a corporate distribution, we have held that a court should "look not to mere labels or to the self-serving declarations of the parties, but to more reliable criteria of the circumstances surrounding the transaction." (quoting *Jaques v. Commissioner*, 935 F.2d 104 (6th Cir.1991)); *Electric & Neon, Inc. v. Commissioner*, 56 T.C. 1324 (1971)., in support of its position. (finding that a corporation may deduct the amount of compensation that it pays so long as it "actually intended" to pay the relevant funds as compensation, but noting that "whether such intent has been shown is, of course, a factual question to be decided on the basis of the particular facts and circumstances of the case"); *Paula Construction Co. v. Commissioner*, 58 T.C. 1055 (1972) ("It is now settled law that only if payment is made with the intent to compensate is it deductible as compensation. Whether such intent has been demonstrated is a factual question to be decided on the basis of the particular facts and circumstances of the case.").

⁵⁶ FS-2008-25, August 2008.

- (iv) Some factors considered by the courts in determining reasonable compensation are:
 - Training and experience;
 - Duties and responsibilities;
 - Time and effort devoted to the business;
 - Dividend history;
 - Payments to non-shareholder employees;
 - Timing and manner of paying bonuses to key people;
 - What comparable businesses pay for similar services;
 - Compensation agreements; and
 - The use of a formula to determine compensation.
- c. Medical Insurance Premiums treated as wages.
 - (i) The health and accident insurance premiums paid on behalf of the greater than two-percent S corporation shareholder-employee are deductible by the S corporation as fringe benefits and are reportable as wages for income tax withholding purposes on the shareholder-employee's Form W-2. They are not subject to Social Security or Medicare (FICA) or Unemployment (FUTA) taxes. Therefore, this additional compensation is included in Box 1 (Wages) of the Form W-2, *Wage and Tax Statement*, issued to the shareholder, but would not be included in Boxes 3 or 5 of Form W-2.
 - (ii) A two-percent shareholder-employee is eligible for an AGI deduction for amounts paid during the year for medical care premiums if the medical care coverage is established by the S corporation. Previously, "established by the S corporation" meant that the medical care coverage had to be in the name of the S corporation.
 - (iii) The IRS has stated that if the medical coverage plan is in the name of the two-percent shareholder and not in the name of the S corporation, a medical care plan can be considered to be established by the S corporation if the S corporation either paid or reimbursed the two-percent shareholder for the premiums and reported the premium payment or reimbursement as wages on the two-percent shareholder's Form W-2.⁵⁷
 - (iv) Payments of the health and accident insurance premiums on behalf of the shareholder may be further identified in Box 14 (Other) of the Form W-2.
 - (v) Schedule K-1 (Form 1120S) and Form 1099 should not be used as an alternative to the Form W-2 to report this additional compensation.

7. Identifying the factors

- a. The nature of the business is important because when professional services, such as law, accounting, or consulting are involved, profits are generated primarily by the personal efforts of the employees; as a result, a significant portion of the profits should be paid out in compensation rather than distributions. No reported cases involve a business typically driven less by a shareholder's personal efforts and more by the corporation's capital and assets where a lower salary for the shareholder-employees and a dividend as a return on invested capital may be justified.
- b. A court will focus on what the principal was doing and not doing, so documentation of the extent of the principal's services must be considered in determining reasonable

⁵⁷ Notice 2008-1, 2008-2 I.R.B. 251.

compensation. The corporation is not required to, and would not be penalized, paying salary to a shareholder who provides limited services. In addition, the greater the experience, responsibilities, and effort of the shareholder-employee, the larger the salary that will be required; but a reduced role for a once full-time shareholder-employee may justify a decrease in salary or compensation to less than industry norms.

- c. A comparison of compensation to rank-and-file employees, if any, with that of the principal should not be unfavorable. Similarly, if a shareholder-employee has more responsibilities than the highest paid nonshareholder, the shareholder's wage should logically be higher than the nonshareholder's wage. If the corporation has enjoyed rising revenues but the shareholder-employee's salary has not increased, this may be an indication that compensation is unreasonably low. In addition, if the corporation recently elected S status and correspondingly reduced its amount of shareholder compensation, this will raise questions about whether the motivation behind the salary reduction was to avoid payroll taxes.
- d. Basic benchmarking tools from sources such as Bureau of Labor Statistics wage data will be useful in determining the relative reasonableness of the shareholder-employee's compensation when compared with **industry norms**.
- e. The financial ratios published in the RMA and industry-specific publications should be used to determine both the corporation's overall profitability and the shareholder-employee's compensation as a percentage of sales or profits. Whenever possible, these comparisons should be with similarly sized companies within the same geographic region. If the resulting ratios indicate that the S corporation is more profitable than its peers but is paying less salary to the shareholder-employee, in the absence of any other factors, such as the shareholder's reduced role or the corporation's need to retain capital for expansion, an increase in compensation to the industry and geographic norms provided for in the publications likely will be necessary.
- f. While large distributions coupled with a small salary may increase the likelihood of IRS scrutiny, there is no requirement that an S corporation pay out all profits as compensation. There is some indication reading between the lines that a court may stop at the taxable wage base for reasonable compensation, allowing amounts in excess of that level to escape the Medicare tax.
- g. If a careful analysis of the factors supports compensation equal to or above the Social Security wage base, setting a shareholder's compensation below that amount likely leaves a greater likelihood of IRS scrutiny. Conversely, as the salary amounts equal or exceed that wage base, the tax savings of the salary-for-distribution trade diminish greatly, and this may reduce the risk of an IRS challenge.
- h. The Service implicitly recognizes that an S corporation must pay a reasonable compensation but up to the amount that is paid, regardless of what the corporation may call it, may be recharacterized as compensation. Forgoing distributions or making written documented bona fide loans from the corporation that are recognized by the shareholder as loans avoid the employment-tax issue. That said; payment of no compensation to officers is a **clear audit red flag**.

II. Bend point planning

A. The importance of bend points

Recall the steps in determining Social Security benefits:

- Step 1:** Adjust all Social Security earnings for inflation up to the year the worker turns 60 years of age. This is done using the average national wage indices published by the Social Security Administration.
- Step 2:** Determine the sum of the highest 35 inflation-adjusted years. Divide the sum by 420. Round down to the nearest dollar. The result is average indexed monthly earnings (AIME).
- Step 3:** Apply the bend point formula to the AIME to determine the primary insurance amount (PIA).
- Step 4:** Adjust the PIA for early or delayed retirement. Round down to the nearest dollar to determine the benefit amount.

The bend point formula is an important element of the determination of benefits and is thus an important part of benefit planning. The bend points for 2024 are: 90% of the first \$1,174 of AIME, 32% of the amount over \$1,174 through \$7,078, and 15% of the amount over \$7,078. A worker with AIME of exactly \$7,500 would calculate the PIA received at full retirement age as follows:

| Bend point amount | Bend point percentage | PIA |
|-----------------------------|-----------------------|--------------|
| \$1,174 | 90% | \$ 1,056.60 |
| \$5,904 (\$7,078 – \$1,174) | 32% | 1,889.28 |
| \$422 (\$7,500 - \$7,078) | 15% | <u>63.30</u> |
| Total PIA | | \$3,009.18 |

The PIA is rounded down to the next whole dollar to determine the benefit received at full retirement age. If she retires at full retirement age, she will receive \$3,009. Bend point planning considers the cost versus benefit of raising the PIA. The cost versus benefit changes based on the level of AIME and the amount of tax paid to increase the AIME depend on a number of variables. A primary consideration must be given to whether income tax must increase to increase the AIME.

B. Bend point planning: Cost versus benefits

1. Bend point planning – Income tax is a factor

A worker with an AIME of exactly \$7,500 would have to raise AIME by \$6 to increase the PIA by \$1. Why? Because PIA rounds down and AIME rounds down. The current PIA of \$3,009.18 would round down to \$3,009. Any PIA amount over \$3,009.18 but less than \$3,010 will also round down to \$3,009, resulting in no increase. To increase the benefit amount to \$3,010 requires an increase in the PIA of at least 82 cents ($\$3,010 - 3,009.18 = \0.82). To increase the PIA by at least 82 cents requires an AIME increase of \$6. \$6 times the 15% bend point bracket increases the PIA by 90 cents to \$3,010.08. AIME is also rounded down to the nearest dollar, so an exact AIME to get an 82-cent increase is not possible. Notice if she wants to raise it by \$2, the AIME would have to increase by \$13. \$13 dollars x 15 percent is \$1.95. \$3,009.18 plus \$1.95 is \$3,011.13, which would round down to \$3,011. What if she wants to increase the benefit by \$50? The following steps determine how much the AIME has to increase to add \$50 to the benefit.

Step 1: Divide the desired increase by the bend point rate: $\$50 / .15 = \333.33 .

Step 2: Round down \$333. Since the AIME rounds down to the nearest dollar, \$7,833.33 would yield an actual AIME of \$7,833, which would increase the PIA by \$49.95 to \$3,059.13. \$3,059.13 rounds down to a benefit of \$3,059, a \$50 increase.

Step 3: How much does she have to earn to increase the AIME by \$333? Multiply \$333 by 420. 420 is the divisor used to determine AIME (sum of the highest 35 years/420 rounded down to the nearest dollar). $\$333 \times 420 = \$139,860$.

Step 4: Calculate the payroll tax. $\$139,860 \times .0765 = \$10,731.42$.

Step 5: Divide the result from Step 4 by the desired increase: $\$10,731.42/\$50 = 214.62$ payments.

Step 6: Determine how many years it will take to break even (when cumulative increase in benefits equals tax paid). $214.62/12 = 17.88$ years.

It will take almost 18 years to break even just on Social Security. If it is additional income for ordinary taxes, she won't live long enough to break even.

A worker, named Beverly, schedules an appointment with her tax advisor to discuss increasing Social Security benefits at retirement. After "number crunching," you have determined that her AIME establishes her in the 15% bend point bracket at \$7,500. She is in the 24% income tax bracket. She is married and files a joint return with her husband. Consider the following scenarios:

Scenario 1: Beverly has semi-retired. Her projected income for 2024 is about \$30,000 from wages. She is considering increasing her income to pay more to Social Security. Her employer will allow her to work more if she so desires. Should she?

Answer: Beverly's AIME is \$7,500. This equates to an average annual salary of \$90,000. It is likely that the increase needed for her 2024 income to replace one of her high 35 years of earnings is significant. The first step is not to determine how much to raise income to raise the AIME enough to raise the PIA, but to see how much current year income must be raised to replace a lower inflation-adjusted prior year. If the current year earnings will not be in the high 35, then all Social Security tax paid is wasted. If her only motivation to increase her income is to increase Social Security benefits, she should not do it.

Scenario 2: Beverly is comfortable with her income and amount of work that she performs for her employer. However, she is willing to work more to increase Social Security, and her employer would like her to work more. 2024 will be a high 35 year without the additional income, so the additional income will increase her AIME. Should she work more?

Answer: Her AIME is \$7,500, so, per the calculations above, she is in the 15% bend point bracket and needs to increase her PIA by 82 cents to increase her benefit at full retirement age by \$1.00. This requires an increase to her AIME of \$6, which will generate an increase to the PIA of 90 cents, raising it from \$3,009.18 to \$3,010.08, which rounds down to \$3,010. To raise her AIME by \$6 requires increasing earnings by \$2,520 ($\6.00×420). She is in a 24-percent income tax bracket, so, disregarding state income tax, the increase in earnings will cost her \$605 ($\$2,520 \times 24$ percent) in income tax and \$193 ($\$2,520 \times 7.65$ percent) in combined Social Security and Medicare tax. This is a total tax burden of \$798 to increase Social Security benefits by \$1! Disregarding the time value of money and COLA increases, if Beverly retires at full retirement age, it will take 798 months to recover the taxes paid. She won't live that long! If her only reason to increase earnings is to increase Social Security benefits, she should not do it.

The cost per dollar will vary for the second and future dollars, but she will not live long enough to break even.

Scenario 3: Assume the same facts as *Scenario 2* except that Beverly's 2024 earnings need to increase by \$4,000 to be equal to her current lowest year in her high 35. This means that her 2024 earnings would need to increase by \$6,520 to increase her benefits by \$1.

Answer: The cost of the tax on the \$6,520 is prohibitive. She should not increase her earnings if her only reason is to increase Social Security benefits.

Scenario 4: Assume the same facts as *Scenario 2* except Beverly's AIME is \$2,893 and her PIA calculates to \$1,606.68, which rounds down to a benefit of \$1,606. This puts Beverly in the 32-percent bend point. Should she increase earnings to increase her benefits?

Answer: To increase her benefit to \$1.00, she will need to increase her PIA by 32 cents. This means her AIME must increase by \$1.00 ($.32/.32 = 1$, round up to the nearest 1). To increase her AIME by \$1.00 requires \$420 of earnings. If Beverly increases earnings by \$420, her income tax will increase by \$100.80 ($\420×24 percent), and her total Social Security and Medicare tax will increase by \$32.13 ($\420×7.65 percent). The total tax cost for an increase to Social Security of \$1 is \$132.93. This is still a high price to pay. Disregarding the time value of money and COLAs, it would take eleven years to break even. The \$1 increase will be more because of COLAs, but not necessarily more in buying power. Meanwhile, she has lost the use of the \$132.93 necessary for the increase. Also, the cost is so low because she was so close to the next dollar increase. The second and future dollars will cost more.

Increasing her benefit by \$2 would take \$1.32 in additional PIA. This means AIME would have to increase by \$5 ($\$1.32/.32 = 4.125$ which rounds up to \$5). This would require \$2,100 of earnings. Social Security tax would be \$160.65, and income tax would be \$504. Total tax would be \$664.65. This means she would have to draw Social Security for over 22 years to break even ($\$664.65/\2 increase = 332.33 months / 12 = 27 years).

Planning point:

Beverly could increase earnings and contribute the increase to an employer retirement plan or an IRA. This would defer (not avoid) the income tax portion of the cost of increasing the Social Security benefit. Taxpayers in income tax brackets above 12% and in the 32% or 15% bend point brackets should consider retirement planning through tax-deferred retirement plans or ROTHs in lieu of paying the high cost to increase Social Security benefits.

Discussion question:

Judging by Beverly's calculations, is there ever a time to increase income to increase Social Security for people already above the very low 90% bend point?

2. Bend point planning – Income tax is not a factor (or is it)?

What if a taxpayer can increase Social Security without increasing income tax? This is often the case with S corporations.

Scenario 1: John is the sole owner of an S corporation, Enterprise, Inc. Currently, John is receiving a salary from the S corporation of \$100,000 and pass-through income of \$160,000, which is all distributed to John. John is eligible for a full §199A deduction. He has no other QBI. He is not limited by the wage limitation or the taxable income limitation. John is married, and he and his wife are in the 24% income tax bracket. John is looking ahead to retirement and is concerned about Social Security because in the past, he has minimized his salary to save payroll tax. Without the increase, his AIME will be

\$4,393. His PIA will be \$2,086.68, which will round down to a benefit of \$2,086 at full retirement age. Should he increase his salary?

Answer:

What if John increases his salary to the Social Security limit of \$168,600? This will increase his 2024 earnings by \$68,600 (\$168,600 - \$100,000 = \$68,600). This will increase his AIME to \$4,556 (\$4,393 + (68,600/420)) rounded down to the nearest dollar). John's new PIA will be \$2,138.84, which will round down to \$2,138. This is an increase in benefits of \$52 per month, but at what cost?

1. **The payroll tax cost:** Employee payroll tax will increase by \$5,247.90 (\$68,600 x 7.65 percent). The employer will be required to match the amount, so the total payroll tax cost is \$10,495.80.
2. **The income tax cost:** Prior to the addition of §199A by the Tax Cuts and Jobs Act of 2017, the only income tax impact of the increase in salary would be a decrease in income tax due to the increased payroll tax to the company. However, under §199A, the pass-through deduction is decreased by the shift of income from pass-through income to wages. Assume that John's wife retired from her job and draws retirement of \$20,000. Their income tax for 2024 without the increase in salary would be:

| | |
|-------------------------------|------------------|
| Pension income | \$20,000 |
| S corp wages | 100,000 |
| S corp pass-through | 160,000 |
| SE Health | -24,000 |
| AGI | <u>\$256,000</u> |
| §199A deduction ⁵⁸ | -\$27,200 |
| Standard deduction | -\$29,200 |
| Taxable income | \$199,600 |
| Income tax ⁵⁹ | \$34,018 |

What will the income tax cost be if the salary increases by \$68,600?

| | |
|-------------------------------|----------------------|
| Pension income | \$20,000 |
| S corp wages | 168,600 |
| S corp pass-through | 86,152 ⁶⁰ |
| SE Health | -24,000 |
| AGI | <u>\$251,395</u> |
| §199A deduction ⁶¹ | -\$12,430 |
| Standard deduction | -\$29,200 |
| Taxable income | \$209,122 |
| Income tax ⁶² | \$36,274 |

The increase to income tax is \$2,256.

The total tax cost of raising the salary from \$100,000 to \$168,600 is \$12,752 (\$10,496 payroll tax plus \$2,256 income tax). With an increase of \$52 a month benefits, disregarding COLAs and the time value of money, it would take 20 years to recoup the cost of the benefit.

⁵⁸ (\$160,000 - \$24,000 se health) x 20%.

⁵⁹ Using 2024 income tax brackets for married filing joint. Top bracket is 22%.

⁶⁰ \$160,000 - \$68,600 - 5,247.90 employer payroll tax.

⁶¹ (\$86,152 - \$24,000 se health) x 20%.

⁶² Using 2024 income tax brackets for married filing joint. Top bracket is 24%.

Planning point:

Even though in the S corporation environment, the income tax impact is lessened, the loss of a portion of the §199A deduction has changed the playing field. If not for the §199A deduction, John would recover the payroll tax in about 17 years, which is still a long time. Again, taxpayers with income above the 12% bracket may consider increasing other sources of retirement income instead of paying the high price of increasing Social Security.

Comment on QBI and SE Health:

In the example above, the self-employed health insurance deduction was deducted from QBI per IRS guidance. Many have argued that it should not be because it has already reduced QBI at the entity level by being deducted as salary. However, the IRS addressed this in a set of FAQs regarding QBI, stating that QBI should be reduced by the self-employed health insurance of an S corporation shareholder even though this results in deducting it twice, once at the entity level and once at the shareholder level.

The Impact of Inflation:

Larger inflation adjustments to the bend points and the national wage index will cause a heavier adjustment to prior year taxes that could increase the projected benefits significantly.

3. *Shifting income between spouses*

Suppose Joan is self-employed and averages around \$120,000 per year in self-employment income. Joan's husband Benny works on a part-time basis for Joan, and she pays him around \$30,000 a year. Due to Joan's lifetime of earnings, she is in the 15% bend point bracket. Benny, however, is in the 32% bend point bracket. Benny's benefits based on his own earnings would be equal to or more than a spousal benefit. Joan could increase Benny's salary and be increasing Social Security benefits at a higher rate. \$20,000 earnings for Joan for a year increases Social Security benefits by approximately \$7.00 per month ($\$20,000/420 \times 15\%$). A \$20,000 increase for Benny increases his Social Security benefits by \$15.00 per month ($\$20,000/420 \times 32\%$). As a couple, they gain \$8.00 a month in benefits by shifting income to Benny. The Tax Cuts and Jobs Act complicated this planning scenario. Before the §199A deduction, there was very little tax impact for shifting Social Security earnings between spouses in this scenario. The only impact would be: (i) Joan's self-employment tax would decrease, offset by an increase in John's payroll tax liability and Joan's employer payroll tax liability; and (ii) Joan's taxable income on Schedule C would decrease by \$1,530 for the employer payroll tax, offset by a decrease in Joan's adjustment to income for 50% of self-employment tax. However, now, with the enactment of §199A, Joan's §199A deduction would be reduced because of the shift in income. The reduction in the §199A deduction would be \$4,000 ($20\%(21,530 \text{ reduction in schedule C income salary and employer payroll tax, net of a decrease in deductible SE tax of } 1,530 = 20,000)$). In the 22% marginal tax bracket, this results in an increase in tax of \$880. It would take 110 months to recoup the cost of increasing the benefit.

Planning point:

Joan could add Benny to her business and operate the company as a husband-and-wife joint venture. Then, Benny's \$30,000 existing salary converts to self-employment income and increases the §199A deduction. Income could then be shifted between Joan and Benny to maximize Social Security benefits by utilizing the highest available bend point brackets.

Note:

The examples in this section are simplified calculations that are adequate for basic planning. To fine tune a Social Security plan, other factors must be considered, such as inflation adjustments from income and bend point brackets, the time value of money, possible changes to income tax rates, possible changes in the way Social Security benefits are determined, and retirement alternatives other than Social Security. For more complex Social Security planning, specialized software is beneficial.

III. When to take Social Security benefits

A. Modeling the problem

1. In general

As noted elsewhere in these materials, Social Security is a lifetime annuity (or joint and survivor annuity), that (i) has flexible beginning dates; and (ii) has differing amounts depending on the start dates. If we determine these at different start dates and add both a discount factor and annuity (life-expectancy) factors, we can determine the present values of each. While a present value is not as accurate as an actuarial valuation, it is still a relevant metric for making a decision. This methodology is applied in these materials. It is also noted that the numbers developed must be tempered by the fact that other considerations, such as need, may make the answers moot.

2. Factors

The time to claim and receive benefits depends on:

- Age;
- Gender;
- Marital status;
- Health;
- Tax-rate; and
- Rate of return.

B. Early versus normal versus delayed claim for retirement benefits

Note:

A fully insured individual, as noted earlier, means any individual who had not less than forty quarters of coverage if:

- The individual has reached **age 62**; and
- The individual has **filed an application** for such benefits.

This means that someone generally cannot claim *retirement* benefits before reaching age 62 (although they may qualify for *disability* benefits before age 62), the **earliest date** when a claim for such benefits can be made. However, a fully insured individual does not claim benefits merely by reaching age 62. An individual must make an affirmative application for benefits.

1. In general

For a single individual who was never married (and thus not entitled to a spousal benefit), deciding when to retire from a financial perspective is a question of whether the individual is better off taking a reduced benefit at age 62 or waiting to get 100 percent at full retirement age, or receiving in excess of 100 percent by delaying a claim for retirement benefits past the FRA (but not beyond age 70).

Note:

This is all that is involved in the case of a single individual, but matters are more complicated for a married individual who is subject to the same choices and consequences above and has additional considerations as well, as is discussed further below.

- a. By claiming benefits early, workers will receive a greater number of payments than when they wait until their FRAs because their lifetime income streams start earlier than their FRA. However, the amount of individuals' monthly benefit is further reduced if their monthly earnings for a month between age 62 and FRA exceed a dollar limitation, currently \$1,770. To the extent the individual has earned income in excess of this amount, the monthly benefit otherwise receivable by the individual is reduced \$1 for every two such dollars.

Mini-Case: Jeff is 62 in 2024 when he claims benefits. His full retirement age is 67. His PIA is \$1,000. In the first month following the claim he receives \$1,890 of earned income. Because of Jeff's early claiming at age 62, his monthly benefit at FRA is reduced 30 percent to \$700. In addition, because his earned income is \$120 more than the \$1,770 monthly earnings threshold, the monthly benefit for that month is reduced by \$60 (\$1 for every \$2 of the \$120 excess earnings). Jeff is entitled to \$640 for that first month. If, instead, Jeff received \$4,770, the \$3,000 excess results in a benefit reduction of \$1,500. Because the monthly benefit amount is \$700, this charge against benefits completely offsets Jeff's benefits for the first and second month and is reduced by \$100 in the third month.

- b. By taking benefits at their FRAs, individuals receive higher monthly payments than they would if they claimed benefit payments starting before their FRAs. Full benefits are computed for Full Retirement Age and then reduced for the number of months prior to FRA the benefits are claimed. Individuals turning 62 during 2023 were born in 1961 and have a full retirement age of 67. Their reduction for early retirement age at various ages is:

| | |
|--------|---------------|
| Age 62 | 30 percent |
| Age 63 | 25 percent |
| Age 64 | 20 percent |
| Age 65 | 13.33 percent |
| Age 66 | 6.67 percent |

Mini-Case: For an individual whose PIA is \$1,000, the effect of claiming benefits at 62, 63, 64, or 65, without regard to COLAs, is to reduce the initial year payments to \$700, \$750, \$800, and \$866, respectively.

Note:

Generally, the present value of full retirement payments commencing at age full retirement age will not equal the present value of reduced retirement benefits commencing at age 62 until many years in the future.

Full Retirement and Age 62 Benefit By Year Of Birth

| Year of Birth | Full (normal) Retirement Age | Age 62 Reduction Months | Total % Reduction | A \$1000 retirement benefit would be reduced to | Total % Reduction (spouse3_) | Spouse's \$500 benefit would be reduced to |
|-----------------|------------------------------|-------------------------|-------------------|---|------------------------------|--|
| 1937 or earlier | 65 | 36 | 20.00 | \$800 | 25.00 | \$375 |
| 1938 | 65 and 2 months | 38 | 20.83 | \$791 | 25.83 | \$370 |
| 1939 | 65 and 4 months | 40 | 21.67 | \$783 | 26.67 | \$366 |
| 1940 | 65 and 6 months | 42 | 22.50 | \$775 | 27.50 | \$362 |
| 1941 | 65 and 8 months | 44 | 23.33 | \$766 | 28.33 | \$358 |
| 1942 | 65 and 10 months | 46 | 24.17 | \$758 | 29.17 | \$354 |
| 1943-1954 | 66 | 48 | 25.00 | \$750 | 30.00 | \$350 |
| 1955 | 66 and 2 months | 50 | 25.83 | \$741 | 30.83 | \$345 |
| 1956 | 66 and 4 months | 52 | 26.67 | \$733 | 31.67 | \$341 |
| 1957 | 66 and 6 months | 54 | 27.50 | \$725 | 32.50 | \$337 |
| 1958 | 66 and 8 months | 56 | 28.33 | \$716 | 33.33 | \$333 |
| 1959 | 66 and 10 months | 58 | 29.17 | \$708 | 34.17 | \$329 |
| 1960 and later | 67 | 60 | 30.00 | \$700 | 35.00 | \$325 |

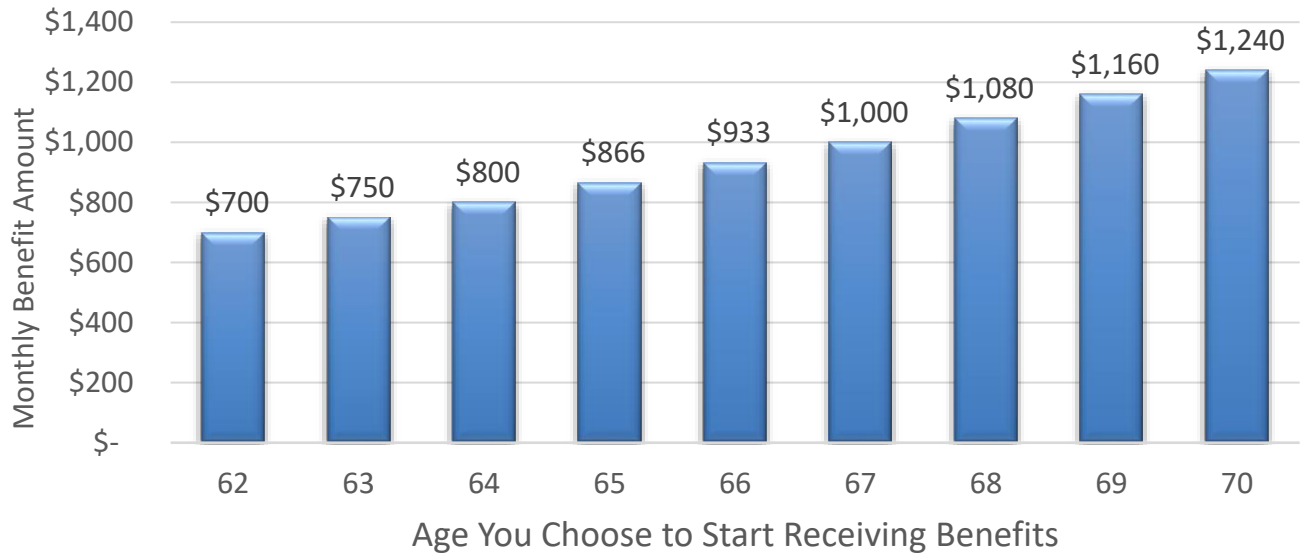
- c. A worker can earn a delayed retirement credit (DRC) for any month beginning with the month of attainment of FRA and ending with the month before attainment of age 70. Each credit is referred to as an increment month. An increment month is granted for any month in that period for which:
- (i) The worker was insured but benefits were not paid because an application was not filed; or
 - (ii) Benefits were due but the worker elected to have the benefit voluntarily suspended in order to earn DRCs.
- d. Conversely, by claiming benefits late, the worker will receive fewer payments than the FRA situation as the lifetime stream starts later than the FRA. By contrast, a taxpayer's calculated benefit is enhanced for each month one retires after reaching full retirement age based on the following table:

Delayed Retirement Credit Rates

| If you reached full retirement age... | Then your monthly percentage is...and | Your yearly percentage is... |
|---------------------------------------|---------------------------------------|------------------------------|
| Prior to 1982 | 1/12 of 1% | 1.0% |
| 1982-1989 | 1/4 of 1% | 3.0% |
| 1990-1991 | 7/24 of 1% | 3.5% |
| 1992-1993 | 1/3 of 1% | 4.0% |
| 1994-1995 | 3/8 of 1% | 4.5% |
| 1996-1997 | 5/12 of 1% | 5.0% |
| 1998-1999 | 11/24 of 1% | 5.5% |
| 2000-2001 | 1/2 of 1% | 6.0% |
| 2002-2003 | 13/24 of 1% | 6.5% |
| 2004-2005 | 7/12 of 1% | 7.0% |
| 2006-2007 | 5/8 of 1% | 7.5% |
| 2008 or later | 2/3 of 1% | 8.0% |

- (i) Currently, if the worker delays collection past FRA, the full benefits are increased 2/3 percent for the number of months after FRA the benefits are claimed. This is 8 percent annually:

Monthly Benefit Based on Age
Based on a Benefit of \$1,000 at Full Retirement Age of 67
Years



- (ii) In addition, the accrual of credits also is adjusted for inflation by the COLAs applied to FRA benefits.

Note:

This is not merely true for the delayed benefits but for all retirement benefits regardless of the claim date. Once a benefit is determined and commenced, it is generally adjusted annually to reflect a COLA to ensure that purchasing power of Social Security benefits is not eroded by inflation. Based on percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), the COLA as released in each year below applies as of January of the following year:

2023: 3.2%
2022: 8.7%
2021: 5.9%
2020: 1.3%
2019: 1.6%
2018: 2.8%
2017: 2.0%
2016: 0.3%
2015: 0.0%
2014: 1.7%
2013: 1.5%
2012: 1.7%
2011: 3.6%
2010: 0.0%

Planning point:

While not important to a single individual, a deceased worker's DRCs will be used to increase survivor benefits to the widow(er), but not spousal benefits.

2. When to retire?

Should a prospective retiree retire at age 62 or full retirement age? As noted above, the monthly retirement prior to normal retirement age is reduced by a percentage (see previous chart) for each month, so a 60-month early retirement (at age 62 for 2023) reduces the monthly payment by 30 percent. Some people decide to continue working full-time beyond retirement age. In that case, people can increase their Social Security benefit in two ways:

- Each additional year a person works adds another year of earnings to his or her Social Security record, which can have the effect of increasing the individual's full retirement age benefit (except, for all intents and purposes, those who have already maxed out benefits by having maximum taxable wages for 35 years); and
- Higher lifetime earnings may result in higher benefits when one retires. As noted above, a person's benefit will be increased by a certain percentage (DRCs) if he/she delays claiming retirement benefits. These increases will be added in automatically from the time an individual reaches full retirement age until that individual starts taking benefits or reaches age 70.

Mini-Case 1: Joe turns 62 in 2024 and his primary insurance amount is determined to be \$1,500. If Joe retires now, the monthly benefit will be \$1,050 ($\$1,500 - \450 ($30\% \times \$1,500$) rounded down to the nearest dollar).

If Joe retires at age 62, he will benefit from the additional 60 months of payments, albeit at 30 percent less than the payments beginning at age 67 years.

Mini-Case 2: Kal was born in 1958 and reaches his full retirement age of 66 years and eight months old in 2024. His primary insurance amount is determined to be \$1,500. If Kal delays retirement until age 70, the primary insurance amount is increased by (40 months \times 2/3 percent) 26.67 percent or \$400, to \$1,900 monthly.

If Kal had retired at age 62, he will benefit from the additional 56 months of payments, albeit at 28.33 percent less than the payments beginning at age 66 years and eight months.

Note:

As the preceding has indicated, a participant (and a spouse, as discussed below) may choose to take Social Security benefits along a continuum stretching from age 62 to age 70. Baby boomers are now approaching the middle bound of this range and are faced, in many cases, with an election that should be the result of an assessment of needs and a financial assessment.

C. Social Security benefits characteristics

1. Risk and reward

- a. There are at least two major interrelated risks that senior citizens confront:
 - (i) Running out of money/purchasing power before death because of inflation, poor investment performance, or longevity; and
 - (ii) Getting less than the maximum available retirement benefits.

Note:

Working more never results in a smaller Social Security benefit.

- b. The rewards of maximizing benefits include:
- (i) Social Security is an **annuity for life** with the following **unique features that cannot be purchased in the commercial markets**:
 - Inflation risk is eliminated by annual COLAs to monthly benefits.
 - Investment risk is eliminated as benefits are not linked to performance of specific aspects of the economy.
 - Nonpayment risk is eliminated because of backing by the federal government. (However, Congress can enact legislation changing benefit levels, instituting means testing, changing tax rules, amending plan provisions, such as the age one qualifies for full benefits, and altering any number of other related items that can adversely affect future benefit levels.)
 - One **cannot outlive the payments**.
 - (ii) In contrast, with respect to IRAs and profit-sharing/401(k) plans:
 - Investment risk exists as payments depend on performance of investments.
 - There is no protection against inflation.
 - One can deplete funds during one's life.

2. Effect of claiming benefits

In the case of a single worker who was never married, the choice essentially boils down to determining which annuity starting date for a single-life annuity maximizes the present value given a projected term (life) of the benefits.

- a. In the case of an unmarried individual, only the retirement benefits of the worker need be considered.
- b. The value of an annuity is the net present value of its payments. The number of payments depends on how long one lives and when the payments begin.
- c. The number of payments can be actuarially determined based on life expectancy factors at the time of each payment or, more simply but not as accurately, by assuming that:
 - (i) The individual will live his or her life expectancy at the time the payments begin, i.e., 18 years; or
 - (ii) The individual will live to a specified age, i.e., 85.
- d. Time of claiming and receiving benefits depends on several factors:
 - Age and gender;
 - Health; and
 - After-tax rate of return on money received.

3. Comparing choices

One could create a spreadsheet that computes the present values of lifetime Social Security benefits and the monthly benefit amounts based on tested specified collection dates, and given the assumptions, the dates generating the highest lifetime benefits. Monthly benefits are adjusted annually for COLAs.

- a. Because Social Security payments may in part be included in taxable income, one must determine the after-tax value of the payments by assuming an inclusion rate and a tax

bracket rate of the recipient. For purposes of illustration, we have assumed the inclusion rate to be 85 percent.

Note:

The major problem is that the number of possibilities of choice involved in the analysis of Social Security is estimated at 100 million. Commercially available software and online materials provide tools the financial planner can use to examine the possibilities. Examples of such resources include **SSAnalyzer**, **MaximizeMySocialSecurity.com** and products in the **E\$Planner** line (**esplanner.com**).

- b. The full retirement benefit is assumed to be \$2,500. The calculations used three percent and five percent before-tax rate of returns. We assume the individuals were born on May 3, 1959.
- c. The COLA was assumed to be 2.4 percent, the level the Social Security trustees set as their long-range projection.
- d. The income tax rate was assumed to be 35 percent. In most cases, retired taxpayers are likely to be in a lower bracket, and this variable can be programmed into a spreadsheet or be a variable parameter that a software program incorporates.
- e. The analysis can produce different conclusions based on gender because of the gender-based differential in life expectancies. The individual is generally assumed to live to life expectancy (which is generally less than the median age). We have used the online life expectancy calculator on the Social Security website.⁶³

Note:

Life expectancy is the average life measured by adding up the ages of all persons in the population and dividing the sum by the number of individuals in the population. This is not the same as the median age -- i.e., the age at which half of the population has died and half is still alive. There is thus more than a 50-percent probability that an individual will survive past the life expectancy.

- f. The full retirement benefit is assumed to be \$2,500. The calculations used 3 percent and 5 percent before-tax rates of return.

Note:

It is important in this (as well as the early versus normal retirement decision) to take into account the investment profile of the client because the after-tax yield of the Social Security benefits received bears on the net present value of the benefits from the starting date for the rest of the client's life. In deciding when to start taking Social Security benefits, the anticipated investment returns on the after-tax Social Security benefits that will be invested and the nature of the taxation of the annual earnings from those investments must be considered. In general, because of the higher yield on capital gains and dividends the greater the value of the earlier years and thus the "break-even" lifetime for later starting Social Security. A computer model is necessary to take into account actuarial factors and different investment performance.

- g. The value of an annuity is the net present value of its payments. The number of payments depends on how long one lives and when the payments begin.
- h. Assuming a 3-percent/5-percent return, viewed as a break-even issue where the only issue is the number of years actually lived by the recipient, the present value of the Social

⁶³ <https://www.ssa.gov/cgi-bin/longevity.cgi>.

Security payments beginning at full retirement age breaks even with the present value of the payments that would have been made beginning at age 62 after some period of time. If one knew that the individual would not live so long, the annuity beginning at age 62 would be superior to that beginning at full retirement age. Similarly, the break-even for an annuity beginning at age 70 vis-à-vis the annuity beginning at full retirement age is another period of time. If one knew that the individual would live beyond that age, the annuity deferred until age 70 would be superior to that starting at full retirement age.

4. Single males

The analysis looks solely at potentially claiming benefits at ages 62 (the earliest), 66 and 10 months, (FRA), and 70 (the latest age at which the amount of the benefit is affected). 66 years and 10 months is the full retirement age for someone who turns age 62 in 2021 (born May 3, 1959).

- a. For a male claiming at age 62, life expectancy is 21.4 years (age 83 years and 4 months). In addition, the full retirement benefit (\$2,500) is reduced by 29.17 percent to \$1,770.
- b. For a male claiming at age 66 and 10 months, life expectancy is 18 years (age 84 years and nine months). The full retirement benefit is increased by COLA. He will have five cost of living adjustments. He will turn 66 on May 3, 2025, and 66 years and 10 months on March 3, 2026. Therefore, he will have cost of living adjustments for 2023, 2023, 2024, 2025, and 2026. $(1.024)^5 \times \$2,500$ to \$2,814.
- c. For a male claiming at age 70, life expectancy is 15.7 years (age 85 years and eight months). If he defers until age 70, he will get additional cost of living adjustments for 2027, 2028, and 2029. Also, the benefit will be increased for the 38-month deferral at the rate of 2/3 of 1 percent for 38 months, or 25.33 percent. The initial payment is \$3,786 [$\$2,814 \times (1.024)^3 \times 1.2533$ (reflecting both the 25.33 percent premium for deferring 38 months and the COLAs for the intervening years)].
- d. Summary of present values for males at 3-percent before-tax rate of return:

| Live to | Claim at 62 | Claim at 66 and 10 months | Claim at 70 |
|---|-------------|---------------------------|-------------|
| Age 66- and 10-months FRA | 64,472 | 0 | 0 |
| Age 70 (No more benefit premium) | 106,047 | 58,802 | 0 |
| Age 79 1 month (where benefits at FRA exceed benefits at 62) | 221,139 | 221,247 | 203,881 |
| Age 80 11 months (where benefits at 70 exceed benefits at 62) | 243,613 | 252,997 | 243,671 |
| Age 83 1 month (where benefits at 70 exceed benefits at 66 10 months) | 269,875 | 290,095 | 290,163 |
| Age 83 4 months (LE 62) | 272,873 | 294,331 | 295,473 |
| Age 84 9 months (LE 66 10 months) | 289,835 | 318,286 | 328,959 |
| Age 85 8 months (LE 70) | 300,732 | 333,674 | 344,784 |

- The rate for males claiming at age 62 compares favorably for all such persons who do not live to age 79 years, 1 month. For those who will live past that age, waiting to normal retirement age produces higher lifetime benefits, but at age 83 years, 1 month the delayed retirement credits at age 70 are poised to become marginally better than claiming at age 66 years, 10 months. Waiting until age 70 will be superior to claiming at age 66 years, 10 months, if the male lives to age 83 years, 1 month.

- Assuming the male lives to his life expectancy (at age 62), the choice of claiming early is inferior financially to waiting until age 66 years, 10 months, or age 70.

e. Summary of present values for **males at 5-percent** before-tax rate of return:

| Live to | Claim at 62 | Claim at 66 and 10 months | Claim at 70 |
|--|-------------|---------------------------|-------------|
| Age 66- and 10-months FRA | 61,704 | 0 | 0 |
| Age 70 (No more benefit premium) | 98,173 | 51,658 | 0 |
| Age 81 10 months (where benefits at FRA exceed benefits at 62) | 211,393 | 211,631 | 200,739 |
| Age 83 7 months (where benefits at 70 exceed benefits at 62) | 225,447 | 231,488 | 225,628 |
| Age 85 9 months (where benefits at 70 exceed benefits at 66 10 months) | 242,051 | 254,947 | 255,030 |
| Age 83 4 months (LE 62) | 223,493 | 228,727 | 222,167 |
| Age 84 9 months (LE 66 10 months) | 234,507 | 244,288 | 241,668 |
| Age 85 8 months (LE 70) | 241,424 | 254,061 | 253,919 |

- The higher rate of return/discount rate increases the relative value of the earliest payments and:
 - Reduces the present values generally at every age;
 - Pushes the age 62/age 66 years and 10 months break-even from 79 years 1 month to 81 years and 10 months; and
 - Pushes the break-even for age 66 and 10 months/age 70 from 83 years and 1 month to 85 years and 9 months, which is beyond the life expectancy of a male at full retirement age.

5. Single females

A woman has a longer life expectancy than a man.

- For a woman claiming at age 62, life expectancy is 24.2 years (age 86 years two months).
- For a woman claiming at age 66 years and 10 months, life expectancy is 20.3 years (age 87 years 1 month).
- For a woman claiming at age 70, life expectancy is 17.8 years (age 87 years 7 months).
- Summary of present values for **females at 3-percent** before-tax rate of return:

| Live to | Claim at 62 | Claim at 66 | Claim at 70 |
|---|-------------|-------------|-------------|
| Age 66- and 10-months FRA | 64,472 | 0 | 0 |
| Age 70 (No more benefit premium) | 106,047 | 58,802 | 0 |
| Age 79 1 month (where benefits at FRA exceed benefits at 62) | 221,139 | 221,247 | 203,881 |
| Age 80 11 months (where benefits at 70 exceed benefits at 62) | 243,613 | 252,997 | 243,671 |
| Age 83 1 month (where benefits at 70 exceed benefits at 66 10 months) | 269,875 | 290,095 | 290,163 |
| Age 86 2 months (LE at age 62) | 306,677 | 342,076 | 355,311 |
| Age 87 1 month (LE at age 66 10 months) | 317,667 | 357,343 | 374,455 |
| Age 87 6 months (LE at age 70) | 322,008 | 364,234 | 383,079 |

e. Summary of present values for **females at 5-percent** before-tax rate of return:

| Live to | Claim at 62 | Claim at 66 | Claim at 70 |
|--|-------------|-------------|-------------|
| Age 66- and 10-months FRA | 61,704 | 0 | 0 |
| Age 70 (No more benefit premium) | 98,173 | 51,658 | 0 |
| Age 81 10 months (where benefits at FRA exceed benefits at 62) | 211,393 | 211,631 | 200,739 |
| Age 83 7 months (where benefits at 70 exceed benefits at 62) | 225,447 | 231,488 | 225,628 |
| Age 85 9 months (where benefits at 70 exceed benefits at 66 10 months) | 242,051 | 254,947 | 255,030 |
| Age 86 2 months (LE at age 62) | 245,150 | 259,325 | 260,516 |
| Age 87 1 month (LE at age 66 10 months) | 251,833 | 268,768 | 273,115 |
| Age 87 6 months (LE at age 70) | 254,805 | 272,967 | 277,611 |

6. And yet...

And yet, in an era where 5-percent returns are not exactly a sure thing, more than half of eligible workers claim before reaching FRA.

- a. Most individuals are unaware of the consequences of claiming early and are not sophisticated enough to give this important financial decision the analysis it is due.
- b. There are many variables to consider.

7. Other factors to consider

The examples above are calculated using the same beginning PIA. Also, the examples assume the same income tax rate through the years. Variables to these assumptions are:

- a. The individual may have several low years in their highest 35 years adjusted for inflation. If their income is now substantially higher than the lower years, continuing to work from age 62 until full retirement age can significantly increase the AIME and thus the PIA. For instance, assume that at age 62 Jim only has 31 years of earnings. His AIME is \$6,000, so he is in the 15% bend point. If Jim continues to work, he is replacing years counted as \$0 with substantial earnings. Suppose for the four years he continues to work and makes \$100,000 per year. This would add \$952 to Jim's AIME ($\$400,000/420$) and \$142.80 to his PIA ($\$952 \times .15$). To compare for decision-making processes, you must compare the benefit at early retirement based on the PIA without the four additional years' work to the full benefit with the additional four years' work.
- b. The taxpayer may be in a lower tax bracket at age FRA or 70 than at age 62. A good tax planning and Social Security planning strategy is to defer Social Security benefits and utilize taxable retirement income prior to drawing Social Security.

Example: Joey projects that he needs \$80,000 after tax income for retirement. His sources of retirement are \$400,000 in a 401(k) that will be taxable when withdrawn, \$400,000 in a Roth IRA, and Social Security. Joey would like to retire at age 62. Joey should wait to draw Social Security and utilize the taxable 401(k) distributions. If Joey waits to draw Social Security until he has withdrawn and paid tax on all of the 401(k) distributions, he will avoid paying tax on his Social Security. When the 401(k) moneys are exhausted, he can begin drawing Social Security and utilizing the Roth account. The Roth distributions will not cause the Social Security to be taxable.

- c. Consider non-monetary factors.
- An individual in bad health is more likely to start drawing Social Security early. If the individual has family history of medical problems and is already experiencing health problems, they may not live long enough to reap the benefits of the increased Social Security benefit from waiting. On the other hand, an extremely healthy individual with a healthy family history may benefit from delaying retirement.
 - The individual may need the money. Sometimes the decision to draw Social Security as soon as possible is driven by financial need. On the other hand, some individuals don't need the benefits at all. They may choose to delay drawing as long as possible and let the benefit grow.
 - Consider survivor benefits. A married couple is usually drawing two benefits. If one dies, they will only draw one benefit. The survivor will step into the shoes of the deceased individual if the benefit is more than what they receive from their own account. If the deceased individual was receiving a reduced benefit, the survivor will also draw a reduced benefit.
 - Some people are afraid Social Security will disappear. They will want to draw all that they can as soon as they can. We don't know what the future holds for Social Security. Measures to balance the Social Security budget may impact future payments.

Note:

For years, the model for planning when to take Social Security has been based on ages 62 and 66. However, an individual who turned 62 in 2021 has a full retirement age of 66 years and 10 months. This means the discount for retiring at age 62 has risen from 25 percent (FRA of 66) to approximately 29 percent. The retiree will draw for 58 months before reaching FRA, which gives them an additional 10 early payments before they would have otherwise started drawing at age 66 years and 10 months. Also, since the FRA is deferred, the amount of credits for deferring has decreased. The deferral credit rate is 2/3 percent per month. There are now only 38 months between FRA and age 70. When the FRA was 66 there were 48 months for a maximum deferral percentage of 32 percent. The maximum deferral credit percentage at FRA of 66 years and 10 months is 25.33 percent. These changes have made dramatic changes to break-even points.

D. Married workers

1. Complications

The above has assumed that the decision as to when to take retirement benefits was made by a single person. However, the decision to take an early retirement will have a consequence for the spousal benefit as well where the retiree is married. Therefore, we cannot apply the single-life annuity analysis used above for evaluating decisions in the case of a married couple. Instead, we have to make two adjustments in those cases where a spouse is not eligible for retirement benefits as a worker. First, any delay magnifies the total benefit received by the couple. Second, the life expectancy to be contemplated is a joint-life (or two-life) expectancy rather than a single-life expectancy.

This adjustment brings the break-even points down by several years, which will generally have the effect of making the early claim for benefits even more questionable than in the single-life case. Joint-life expectancy is a better predictor of the projected term of the annuities. Essentially, there are two possible scenarios:

- a. **Worker's and nonworking spousal/survivor:** Worker will claim a benefit. The nonworking spouse will claim a spousal benefit and, if the spouse survives the worker, a survivor benefit following the worker's death; and
- b. **Worker's and spousal worker/survivor:** Worker will claim benefits. Working spouse will claim his or her own retirement benefits and, following the death of the other spouse, a survivor benefit, if higher.

2. Joint lives

The joint-life expectancy of a couple determines the term that at least one of them will survive, that is, the expected number of years until the second death. It depends on the ages of the spouses.

- a. **Ages 66 and 66:** Median joint-life expectancy for these ages (50 percent) for a couple with normal health for their ages is 25.65 years (age 91 years, 8 months). Twenty-five percent (one-in-four) of such couples will have a survivor who lives at least 30.3 years (age 96 years, 4 months).
- b. **Ages 62 and 60:** Median is 30.43 years. Twenty-five percent of such couples will have a survivor who lives at least 35.19 years from this date.
- c. **Ages 66 and 62:** Median is 27.70 years. Twenty-five percent of such couples will have a survivor who lives at least 32.51 years from this date.

Note:

Joint life expectancies are generally longer than the longer of the single life expectancy of either spouse individually. Focusing solely on the sets of two individuals who are alive at age 62, there is approximately a 50 percent probability that one will die before age 78 and a 50 percent probability that one or the other will survive to 89. So, if the wife, say, takes Social Security at 62, she may succeed to a larger payment 6 years before her life expectancy because 50 percent of the time her husband will die before reaching age 78. If the husband made it to 70 to begin payments, then in 50 percent of the cases that stream will be paid to the husband or the surviving spouse for 19 years or more (from age 70 to age 89). Of course, these numbers apply only in the case where the spouses, by hypothesis, are the same age. Different numbers will be applicable where there are age differentials.

Note:

As noted by the *Wall Street Journal*, people now in their 80s would "give anything to have a bigger Social Security check. It is the only income they have that is adjusted every year for inflation."

3. Additional benefits

In the case of a single individual who has never been married, the only Social Security benefit that bears on timing is the worker's own retirement benefit. When a spouse (or a minor child) is involved, there are secondary, derivative benefits that themselves may be impacted by the choice made by the primary worker. Of course, spouses can have their own retirement benefit as well.

Among the benefits other than the worker's own benefit that need to be considered:

- (i) **Spousal benefit:** The spousal benefit is 50 percent of the worker's FRA benefit.
- (ii) **Survivor benefit:** The surviving spouse needs to claim the greater of the spouse's own (card) benefit or 100 percent of the deceased spouse's worker benefit.

4. One-earner couples -- spousal benefit

- a. For one-earner couples (both still alive), the spouse will choose the spousal benefit when it is available.
 - (i) Spouse must be at least 62 OR have a minor child in his or her care.
 - (ii) Worker must have claimed benefits. Generally, the worker may not claim benefits before age 62.
 - (iii) Amount of spousal benefit depends on two factors:
 - The benefit the worker would receive at FRA (even if claiming earlier); and
 - The age of the spouse when claiming the spousal benefit.

Mini-Case: Fred, age 62, is married to Wilma, age 30. Regardless of when Fred claims, Wilma may not claim spousal benefits.

Assume the same circumstances, except Wilma has an infant child of Fred's under her care. Wilma may be entitled to a spousal benefit equal to 50 percent of Fred's FRA benefit without reduction but only if Fred claims retirement benefits and the minor child is entitled to child benefits (i.e., is a dependent of Fred). Spousal benefits are not reduced even if Fred's are by reason of excess earnings or early claiming. The family maximum rules will apply to limit the total monthly benefit to somewhere between 150 percent and 185 percent of Fred's monthly benefit at FRA.

- b. When one spouse has zero or low benefit on his or her own card:
 - (i) The spousal benefit is only available if the worker has **claimed** benefits, and this can happen only if the worker is at least age 62.
 - (ii) Spouse must generally be at least age 62.
 - (iii) Spousal benefit is reduced if spousal claim is made before spouse reaches FRA to the same extent a retirement benefit would have been reduced.

Mini-Case: Jack has claimed benefits; his FRA benefits are \$1,000. Jill, age 63, is entitled to a spousal monthly benefit of \$500, but the spousal benefit will be reduced for early retirement.

Note:

There is no reduction regardless of the age when claimed by the spouse who has a minor child under her or his care. Thus, in May-December marriages where there is a child, the younger spouse with the minor child should virtually always claim the spousal benefit.

- c. **If the worker claims before FRA, he cannot claim and suspend.** This fixes the amount of the spousal benefit. See Discussion of claim and suspend rules below.
- d. The spousal claim, if made before the spouse's FRA, initiates a claim for the spouse's own benefit (dual eligibility). The size of the spouse's own benefit is not relevant in cases where the spouse's own benefit is less than one-half of the worker's FRA benefit.

Planning point:

In virtually no situations should a non-working spouse defer his or her spousal claim to age 70!

When a high-earner is wedded to a median-income spouse, the choice between a claim by the median-income spouse at age 62 versus FRA when the high-earner will claim at age 70 is a toss-up, but slightly better than the spouse waiting to age 70 to claim enhanced benefits. However, this toss-up may be broken in favor of FRA because the spouse will not have claimed a spousal benefit and thus might be free to defer a claim for the higher survivor benefit (assuming sufficient funds between date of the high-earner's premature death and the spouse reaching FRA).

However, one must still approach this strategy not as a cookie-cutter solution!

Since the spousal benefit does not get the 8% per year increase for deferred retirement, if one spouse has no work record and thus no Social Security to draw on their own account, the couple is giving up 150% of the working spouse's benefit at full retirement age to defer until age 70. This is a lot to give up for the return.

- e. If worker claims benefits before FRA, the spouse's claim for:
- Spousal benefits are not reduced if the worker claims retirement benefits before the *worker's* FRA, but rather only if the spouse is under the *spouse's* FRA when claiming those benefits.
 - Survivor benefits when the worker dies are permanently reduced.

Quick Q&A Exercise:

- Suppose the worker has reached early retirement age and the spouse has also. Can the spouse apply for spousal benefits? *Answer:* Only if the worker has claimed early retirement benefits. Spousal benefits are available only if the worker is entitled to benefits. This requires the worker to claim benefits.
- Suppose the worker has reached early retirement age but the spouse has not. Can the spouse apply for spousal benefits? *Answer:* No, the spouse may only claim if the worker has claimed benefits and the spouse has reached early retirement age.
- Can a spouse claim a reduced benefit at age 62 based on his or her own earning if the worker spouse is already collecting Social Security and then switch to a higher spousal benefit at the spouse's full retirement age? *Answer:* No, because when the spouse files for the benefit before attaining full retirement age the spouse is deemed to have filed for all benefits, including the spousal benefit.
- Can a spouse claim spousal benefits at age 62 if the worker spouse is already collecting Social Security and then switch to a higher benefit at full retirement age based on the spouse's record? *Answer:* No. Once the spouse files, the spouse is deemed to file on both bases and receives the higher worker benefit reduced by the early retirement.
- Can a spouse claim early retirement benefits at the age on the spouse's record if the worker spouse has not yet claimed benefits and then claim a higher spousal benefit when the worker retires at full (or delayed) retirement? *Answer:* Yes. When the spouse files the spouse is not eligible for a spousal benefit because the worker has not become entitled to the worker's own benefit by claiming it. However, when the spouse later becomes eligible for the spousal benefit by reason of the worker's filing, the amount of the benefit will not necessarily be one-half of the worker's benefit.
- Bob has a projected benefit at full retirement age of \$1,800. His wife Carol has a projected worker's benefit of \$800 at full retirement. If Carol waits until her full retirement age, she will receive a combined benefit equal to the sum of her own benefit (\$800) and her spousal benefit (\$100, the amount that when combined with her own benefit totals the spousal benefit).

If, instead, at age 62 Carol filed for benefits on her own record, she would receive a reduced early retirement benefit of \$600 ($\800 full retirement benefit - $0.25 \times \$800$ early retirement reduction). When Bob claims his benefits, Carol becomes eligible for her spousal benefit. Is it \$300, the amount necessary to take her combined benefit to \$900, one-half of Bob's benefit? *Answer:* No, but the amount of the benefit will depend on whether Bob filed for benefits before or after Carol reached her full retirement age. One common element: the starting point for determining the spousal benefit is the amount determined on the expected benefit. Thus, if Bob claimed after Carol reached full retirement age, her spousal benefit is still \$100, so her combined benefit is only \$700 ($\600 early retirement benefit + $\$100$ spousal benefit). However, if Bob claimed before Carol reached her full retirement age, the \$100 spousal benefit would be further reduced 25/36 of one percent for each month (up to 36) and 5/12 of one percent for each month over 36 before Carol reaches her full retirement age. Thus, if Bob is age 65 when Carol (age 62) claims early retirement benefits, then Carol is 63 when Bob turns 66 and claims benefits. Because at that time Carol is under her full retirement age (66) by 36 months, the spousal benefit is in turn reduced by 25 percent, or \$25, so Carol's spousal benefit is limited to \$75, and her combined benefit is \$675 ($\600 reduced early retirement benefit + $\$75$ reduced spousal benefit).

5. Survivor benefits

Married couples must also consider the benefit to a widow or widower (survivor benefit) based on the benefit of the deceased spouse. **REMEMBER THE JOINT-LIFE EXPECTANCIES.** The greater is the FRA (accrued DRCs), the greater also is the survivor benefit that can be paid to the lower-earning spouse if the higher-earner dies first. When one worker of a two-worker couple dies, the surviving spouse generally becomes entitled to a surviving spouse's benefit equal to 100 percent of the deceased spouse's benefit.

- a. A surviving spouse age 60 or over generally is entitled to a survivor benefit if:
 - (i) The spouse is not entitled to a benefit in excess of the deceased's benefit. (In such cases where the surviving spouse has a higher benefit than the survivor benefit, the survivor will continue his or her own higher benefit.)
 - (ii) The spouse **files** for the benefit.
 - The survivor benefit does not require the deceased to have made a claim prior to death.
 - It requires an application by the survivor to claim unless the survivor was already receiving a spousal benefit.
 - (iii) The spouse has not remarried.
- b. Claiming the survivor benefit before FRA permanently reduces the amount but may be necessary if the spouse has no other source of funds.
 - (i) The amount of the benefit is the deceased's FRA benefit (even if never claimed).
 - (ii) Reduction is only if survivor claims before survivor's FRA. Maximum reduction of benefit is 28.5 percent if survivor claims at age 60.
 - (iii) Reduction is reduced pro rata over the age of claim between 60 and FRA.

Mini-Case 1: If survivor claims benefit at age 64 and FRA is 67 years, the reduction of the survivor benefit is 12.21 percent ($28.5\%/84 \text{ months} \times 36 \text{ months}$)

Mini-Case 2: Jack, age 67, has an FRA monthly benefit of \$2,000; Jill is age 62 and has a \$500 FRA monthly benefit. Jill's full retirement age is 67 years. She elects a reduced spousal benefit ($(1 - 0.30) \times 0.5 \times \$2,000 = \$700$ (greater than her own claimed benefit of \$350 $(1 - 0.30) \times \$500$). When Jack dies that month, Jill's spousal benefit is converted to a survivor benefit of \$1,600 ($\$2,000 \text{ (Jack's FRA)} \times (1 - 0.20 [28.5/84 * 60 \text{ months}])$) because she had claimed the spousal benefit.

- c. The mere claim of the spousal benefit exposed the couple to the risk of a reduced survivor benefit if death occurred before the spouse reached FRA.

Mini-Case 3: Suppose Jill made no claim at age 62. When Jack dies, she has no current claim for benefits. She may:

- Claim her own benefit (no spousal benefit tied to the claim) reduced because taken before FRA; and
- Defer a survivor claim for a lesser reduction.

Note:

To reiterate, when it comes to joint life expectancies of married couples (assumed both spouses are age 62 when benefits could first be claimed), there is an 80-percent probability that at least one will live to age 85, a 57-percent probability that at least one will live to age 90, and a 27-percent probability that at least one will live to age 95. Because taking early retirement means taking a permanent reduction in benefits, and because the most a non-working spouse can succeed to at the working spouse's death is that reduced benefit, it would appear obvious that the higher benefit will almost always prove successful over the (now) long(er) run. Yet, as noted above in the discussion of individual unmarried beneficiaries, Social Security has reported that some 72 percent of retirement income recipients receive the reduced benefits. Benefit timing appears to be more animated by lifestyle choices than on strict financial principles.

Planning point:

As was noted above, the chances of a spouse reaching age 90 or 95 are not insignificant. This exacerbates any permanent reduction over the extended survival period. It does not matter who dies first, as the spouse receives the higher of the spouse's worker's benefit or the spouse's widow's benefit. One consequence of this is that starting the spouse's benefits early is not a permanent problem, because the spouse will succeed to the higher widow's benefits.

Planning point:

In the event the spouse has taken early retirement on her own card, but the other spouse dies before able to accumulate additional credits for delayed retirement what can be done to make the decision to take early retirement viable? The spouse may be able to reassess the situation, determine that she would be better off repaying her early benefits, and defer to FRA or beyond to a deferred enhanced benefit on her own card.

E. Additional factors

1. Background

Like private retirement plans, Social Security calls on the participant to make fundamental choices concerning their benefits. Fortunately, there are actually fewer decisions (although a huge number of potential choices) in Social Security than in a qualified plan or in the post-retirement receptacle for most individuals in a rollover IRA. Social Security involves neither the investment choices nor the expenses associated with the maintenance of say a §401(k) plan that might erode the benefits actually received or enjoyed.

- a. Social Security is a vestige of the defined benefit era. Up through ERISA, retirement plans, particularly those implemented by large corporations with large numbers of employees, were generally structured as a defined-benefit plan that eliminated investment risk from the employee in favor of a certain and guaranteed level of income that took the form of a lifetime annuity that also eliminated the actuarial risk of outliving a fixed sum amount. The entrepreneurial explosion of small companies with few employees was met in many, if not most cases, by the adoption of defined-contribution plans, whose investment rewards and risks largely mirrored what these companies themselves experienced. The emergence of the §401(k) plan that enabled employers to shift much or all of the funding to the employee accelerated the movement of even Fortune 500 companies to defined-contribution plans or surrogate defined-benefit plans, such as cash-balance plans, which largely shifted more and more of the responsibility to the employee for the ultimate benefit to be received. Inflation can erode the benefit: in a private retirement plan, equal minimum distributions actually reflect less and less

purchasing power by reason of the inflationary devaluation of the dollar, while Social Security through the COLA seeks to provide a relatively fixed benefit in terms of purchasing power. While plans offered the possibility of meeting or exceeding inflationary loss through investment gains, many of the historical returns that could give an individual confidence in achieving this have been eroding by changes in the global markets that ratchet down realistic expectations of income.

Note:

In general, all benefits received from a qualified plan or traditional IRA are tax-deferred until they are received, but then are subject to income tax as ordinary income at the taxpayer's highest current tax bracket rate; in contrast, Social Security benefits are nominally not subject to income tax (unlike traditional defined-benefit plans), although many taxpayers will be required to include some (but not all) of their benefits into income under a complex taxation scheme. That less than all benefits are included is fully equivalent to having all those benefits taxed at a lower rate than the taxpayer's higher tax rate AND not increasing the taxpayer's AGI to the same extent as the private plan distribution of the same amount, a fact that further reduces the effective rate of tax with respect to the phase out of itemized deductions, personal exemptions, medical expenses, active participation losses, etc.

- b. All that may be fine while working, and retirement seems a long way off, but when Social Security becomes a viable benefit, the time has arrived to examine the defined-contribution plan/IRA critically in comparison to Social Security. As noted above, Social Security provides a variety of timing options that also have an impact on setting the level of the benefits received. Similar timing options are generally available in a qualified plan and almost always in an IRA that gives the participant a menu of options determined by him rather than by his employer.

Comparison of Social Security and IRAs

| Social Security | IRA* |
|---|-------------------------|
| Tax-favored | Tax-deferred |
| No investment risk | Investment risk |
| Inflation protection | No inflation protection |
| Longevity protection | No longevity protection |
| Survivor protection | No survivor protection |
| * Individual Retirement Annuities can provide both longevity and survivor protection. | |

Planning point:

Social Security in a society of single-worker families provided a basic option, from which most other options were then determined. A spouse was entitled to a spousal benefit. Another sociological change that has arisen over the past 35 years is the two-wage-earner family, a fact that now gives the spouse a choice between a benefit based on being a spouse, a spousal benefit, or a benefit based on his or her own worker record, a worker benefit.

The greater financial security that Social Security offers relative to an IRA suggests consideration, when retirement comes, of deferring such benefits and looking to IRA distributions, if needed before taking Social Security. In addition, a spouse may have choices to make concerning his or her own Social Security that may now be somewhat independent of the Social Security choice made by the other spouse.

- c. Another factor to consider is that, except for Roth vehicles (IRA or §401(k)), usually the entire distribution from a qualified plan or IRA is fully included in adjusted gross income while Social Security payments are, at most, included only to the extent of 85 percent. In

light of the additional tax on net investment income that depends in part on levels of adjusted gross income, Social Security may be more tax-efficient than distributions from qualified vehicles.

2. Investment issues

The lump-sum distribution, traditionally the province only of a defined-contribution plan, is now available in almost all plans (many more employers are more than happy to eliminate any further overhead of administering the fund and its accounting), including defined-benefit plans. In doing so, the employee now shoulders the investment risk and reward that was generally eliminated by annuitization at retirement traditionally. One of the reasons why defined-benefit plans have lost their savor – in addition to the overhead issues – has been the increasing funding costs, an increase that reflects a downward adjustment of returns in the financial markets. Such lower returns have meant higher current contributions to generate a desired fund at retirement. It is into the maw of this environment that the retiring employee takes his or her retirement funds. These lower returns correspondingly increase the investment risk. (It is through enhanced returns that inflation and longevity are combated.)

The IRA solution produces a safe retirement only if the following occurs:

- Financial markets cooperate by providing sufficient returns;
- “Right” mutual funds are selected; and
- Investments are kept relatively intact to avoid churning costs when too much buying and selling happens.

Market cooperation: The average investor’s track record 1984-2003

| Market return | | Average investor | Timing the market |
|-----------------------------|--------|------------------|-------------------|
| S&P | 12.98% | 3.51% | -3.29% |
| Long-term Government Income | 11.16% | 3.75% | N/A |

The record is clear: in times where yields were in the 11% to 13% range, investors underperformed the market rather dramatically. Even apart from the investment vehicles chosen, the negative return on timing the market indicates that schemes and theories designed to advance greed only advance cataclysmic results.

Monte Carlo simulations have been used to develop safe withdrawal rates to strategize the preservation of the retirement fund but they involve assumptions that can be, and increasingly are, called into question:

- They ignore investment expenses;
- They ignore taxes;
- They rely on **historical average investment yields**; and
- They retain **investment in equity markets**.

Focus on the last two keys to the simulations that claim safe withdrawal rates. A survey of gurus at leading investment houses produced the following projected real rates of return over the next 40 years (but perhaps not at such levels for a couple more years):

| Stocks | Government bonds | Corporate bonds |
|--------|------------------|-----------------|
| 4.8% | 2.80% | 3.33% |

Real rates of return include an inflation factor, so nominal returns are approximately 3.1% higher. Nevertheless, they are significantly below the “historical” rates that have been employed up to this point. Hereafter, it’s apparently a different history, where potential rewards are less than in the past.⁶⁴

3. Inflation issues

The effects of inflation can be underestimated, particularly when inflation rates seem relatively low. The effects are not as pronounced over the short-term, but over the long-term (and the actuarial data above suggests a 25-year period) the effect is significant. At an historical inflation rate of 3 percent, the value of a dollar today is less than 50 cents $[\$1/(1.03)^{25} \approx \$0.48]$ after 25 years. Matters worsen where inflation rates increase. Historic Social Security increases have averaged 2.8%. However, the increase in 2021 for payments in 2022 was 5.9%, and the increase in 2022 for 2023 payments was 8.7%.

4. Spousal protection

In the simple one-earner situation, the taking of early benefits imposes a permanent limit on the spouse’s benefits as a spouse or as a widow. The spouse receives 50 percent of the amount determined for the worker during life, and the widow succeeds to 100 percent of the worker’s benefits. However, an early retirement benefit decision will fix the base, which provides survivor protection at approximately 56.5 percent of the amount available through a maximum deferred benefit strategy.

5. Effects of early retirement on Social Security benefits

The above discussion must be put into the context of the spousal benefit in relation to the benefit of the worker spouse.

6. Impact of taxes

As noted at the beginning of this section, distributions of Social Security benefits result in a different after-tax result than those from a private retirement vehicle of the same amount. In an environment of increasing tax rates, the effective tax rate of Social Security is enhanced when compared to the ordinary income treatment of IRA and §401(k) distributions.

- a. Another way to look at this is that Social Security is not taxed at all, but the other income from the IRA is.

| Nominal tax rate | Nominal tax | Additional tax rate ⁶⁶ | Additional tax | Total tax | Effective tax rate |
|------------------|-------------|-----------------------------------|----------------|-----------|--------------------|
| 22.0 | 0.22 | 18.70 | 0.1870 | 0.4070 | 40.70 |
| 24.0 | 0.24 | 20.40 | 0.2040 | 0.4440 | 44.40 |
| 32.0 | 0.32 | 27.20 | 0.2720 | 0.5920 | 59.20 |
| 35.0 | 0.35 | 29.75 | 0.2975 | 0.6475 | 64.75 |
| 37.0 | 0.37 | 31.45 | 0.3145 | 0.6845 | 68.45 |

- b. A suggested tactic to employ to preclude this disaster from happening is to trade the IRA income currently for Social Security income later. As noted above, many retirees still retire and claim Social Security early and use IRA distributions up to the required beginning date as a source of discretionary income to supplement the retiree’s needs above the public benefit. In doing so, such retirees look at the above tax problem straight in the face. If, instead, the retiree starts taking distributions to the full extent of his

⁶⁴ *Rethinking Social Security Claiming in a 401(k) World*, Mahoney and Carlson, PRC WP 2007-18 (January 2008).

⁶⁵ 2018 Social Security web site, “Benefit Examples for Workers with Maximum-Taxable Earnings, Retirement at Age 62.”

⁶⁶ Always assumed for illustrative purposes to be 85 percent of the nominal tax rate.

retirement needs from retirement to age 70 when he must claim Social Security benefits – benefits that are enhanced by the application of delayed retirement credits – he is subject only to the nominal ordinary income tax rate; in other words, he has more after tax than he would have using the part Social Security, part retirement plan distribution strategy.

- c. What is a dollar of Social Security worth compared to an IRA distribution? If one takes a dollar of Social Security in lieu of a dollar of distributions, both the AGI and the combined income are reduced by that dollar. As a result, the amount of Social Security that is included in gross income is reduced by \$0.50.

Mini-Case: Couple, each age 72, have Social Security income of \$24,000 and IRA income of \$45,000. They have no other income. Had they delayed retirement so that the Social Security income was instead \$39,000 and the IRA distributions were \$30,000, the total after-tax income would be over seven percent higher:

Case I: \$24,000 Social Security/\$45,000 IRA distributions

| | | |
|-----|--|-----------|
| 1. | 50% of \$24,000 | \$12,000 |
| | MAGI | \$45,000 |
| | Tentative total | \$57,000 |
| | Base amount | -\$32,000 |
| | Excess | \$25,000 |
| 2. | 50% of excess | \$12,500 |
| 3. | Lesser of (1) and (2) | \$12,000 |
| 4. | 50% of excess (not to exceed \$12,000) | \$6,000 |
| 5. | Lesser of (3) and (4) | \$6,000 |
| | MAGI | \$45,000 |
| | 50% of Social Security benefits | \$12,000 |
| | Total | \$57,000 |
| | Adjusted base amount | -\$44,000 |
| | Excess | \$13,000 |
| 6. | 85% of excess | \$11,050 |
| 7. | Total of (5) and (6) | \$17,050 |
| 8. | 85% of \$24,000 | \$20,400 |
| 9. | Lesser of (7) and (8) | \$17,050 |
| 10. | AGI (MAGI plus (9)) | \$62,050 |

Case II: Delay retirement and trade \$15,000 of IRA income for Social Security benefits

| | | |
|-----|---------------------------------------|-----------|
| 1. | 50% of \$39,000 | \$19,500 |
| | MAGI | \$30,000 |
| | Tentative total | \$49,500 |
| | Base amount | -\$32,000 |
| | Excess | \$17,500 |
| 2. | 50% of excess | \$8,750 |
| 3. | Lesser of (1) and (2) | \$8,750 |
| 4. | 50% of excess(not to exceed \$12,000) | \$6,000 |
| 5. | Lesser of (3) and (4) | \$6,000 |
| | MAGI | \$30,000 |
| | 50% of Social Security benefits | \$19,500 |
| | Total | \$49,500 |
| | Adjusted base amount | -\$44,000 |
| | Excess | \$5,500 |
| 6. | 85% of excess | \$4,675 |
| 7. | Total of (5) and (6) | \$10,675 |
| 8. | 85% of \$39,000 | \$33,150 |
| 9. | Lesser of (7) and (8) | \$10,675 |
| 10. | AGI (MAGI + (9)) | \$40,675 |

Regardless of the tax rates and standard deduction level, the federal income tax will be higher in the first case where the composition is weighed toward IRA distribution, because it produces a significantly higher AGI (\$21,375). Because the taxpayers in each instance have the same \$69,000 of cash flow income, they enjoy more economic benefit when they can include a higher level of Social Security by delaying the start of those benefits.

