USA

SOCIAL SECURITY

Maximize Social Security Benefits & Minimize Tax Burden

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Electing to receive Social Security benefits at early retirement age may result in higher personal income taxes and a smaller nest egg, particularly for high net worth individuals. In this guide, we'll shed light on common Social Security myths and provide options that, in certain instances, could decrease your payments to Uncle Sam and increase the financial legacy you leave.

WHEN SHOULD I COLLECT SOCIAL SECURITY?

Imagine you had to choose between the following two options:

1. **Postpone** receiving Social Security benefits beyond normal retirement age
2. **Collect** Social Security benefits as soon as possible (age 62)

For most, collecting Social Security benefits as soon as possible may seem like the most logical choice to maximize your lifetime benefit. In fact, 42% of men and 48% of women file for Social Security as early as possible, which is age 62 (**also called early retirement age**). But by doing so, high net worth individuals across the country inadvertently expose themselves to taxes as a result of receiving Social Security benefits earlier than necessary. In this guide, you'll learn two common myths that frequently motivate retirees to file sooner than is in their best interest.

SOCIAL SECURITY MYTH 1: MY SOCIAL SECURITY BENEFIT IS TAX FREE

How combined IRA income and Social Security income is taxed:		
IRA Income		$1
Tax Rate	x	25%
IRA tax (A)	=	0.25
Additional Social Security subject to tax % of Social Security income		$1
Subject to taxes	x	85%
Taxable Social Security income	=	0.85
Tax Rate	x	25%
Social Security tax (B)	=	0.2125
Effective Tax Rate in Cents [(A+B)/2]:	x	**0.23125**
Effective Tax Rate in Percentage:	**or**	**23.125%**

How every dollar of "delayed" Social Security income is taxed:		
Social Security income		$1
Combined income formula	x	50%
	=	0.50
% of Social Security income subject to taxes	x	$1
Taxable Social Security income	=	0.425
Tax Rate	x	25%
Social Security tax	=	0.1062
Effective Tax Rate in Cents	x	**0.1062**
Effective Tax Rate in Percentage	**or**	**10.62%**

Ideally, once you're eligible to collect Social Security, your objective is to receive the most benefit while paying the least tax possible. After all, your eligibility reflects decades of hard work and dedication. But without skillfully navigating the complexities of Social Security, Uncle Sam may tax up to 85% of the Social Security benefits you receive if your total income from Social Security and other sources exceeds $34,000 for single individuals and $44,000 for married couples filing jointly.

In other words, if you have income from other sources, **you'll likely pay income taxes on your Social Security benefits**. Unfortunately, when tax time arrives many are surprised to receive news they owe taxes on their benefits.

WHEN AM I ELIGIBLE TO RECEIVE SOCIAL SECURITY RETIREMENT BENEFITS?

Broadly speaking, eligibility is based on meeting **Social Security contribution thresholds** and one of the following:

1. You've reached **early retirement age** (62 years old) or
2. You've reached Full Retirement Age (**FRA**)

An individual qualifies for Social Security benefits by earning Social Security credits while employed and paying Social Security taxes. An individual's work history is used to determine eligibility for retirement or disability benefits or their family's eligibility for survivor's benefits. In 2020, you receive one credit for each $1,410 of earnings, up to the maximum of four credits per year. Individuals born after 1929 need 10 years of work (40 credits) to be eligible for retirement benefits.

To determine your Full Retirement Age (FRA), refer to the table below:

Birth Year	FRA
1937 or early	65
1938	65 & 2 months
1939	65 & 4 months
1940	65 & 6 months
1941	65 & 8 months
1942	65 & 10 months
1943-1954	66
1955	66 & 2 months
1956	66 & 4 months
1957	66 & 6 months
1958	66 & 8 months
1959	66 & 10 months
1960 & later	67

The amount of Social Security benefits you will receive is based on your Primary Insurance Amount (PIA). The Social Security Administration uses a weighted benefit formula and factors in 35 years of earnings to calculate your PIA. It is important to note that replacing a year with salary for a year in which you did not earn income will increase your PIA.

Those workers with sufficient Social Security credits also have the option to receive reduced benefits at **early retirement age**, which is age 62.

However, filing earlier than necessary to meet your income needs could not only possibly expose your Social Security benefits to personal income taxes, it can also **permanently and irrevocably decrease your PIA**. This is because the Social Security Administration makes an actuarial adjustment depending on when you claim. For example, if your FRA is 67 and you start receiving Social Security benefits at age 62, you will receive only 70% of the age-67 benefit (a permanent 30% reduction in your lifetime benefit!).

SOCIAL SECURITY MYTH 2: FIRST TAP INTO SOCIAL SECURITY BENEFITS, THEN QUALIFIED AND NON-QUALIFIED ACCOUNTS

By filing for Social Security benefits prior to your FRA, you may permanently decrease your PIA. As a result, you may need to tap into **qualified and non-qualified plans** beyond their minimum required distributions (RMDs) in order to meet your income needs. In other words, you be forced to draw down on investment principal to a greater extent than planned, reducing the amount of assets in your portfolio used to fuel earnings growth over time. The worse case scenario is an income shortfall in your later years.

The table below show examples of qualified and non-qualified plans:

Qualified	Non-qualified
IRA (many types)	SERPs
401(k)	Restricted stock unit awards
403(b)	Employer matching contributions
Keogh plans	Voluntary

Qualified plans are an essential part of any retirement savings strategy.

They offer the following three benefits:

1. Contributions can be tax deductible during the contribution year.
2. Earnings compound on a tax-free basis and are not taxed until distributed in retirement.
3. Rolling qualified plan assets, such as 401(k) contributions, into another qualified account, such as an IRA, can further delay tax exposure.

In addition to the long list of rules and regulations associated with qualified plans, the government caps the amount individuals can contribute. Non-qualified plans address this limitation. They allow individuals to contribute far more than qualified plans allow. This is one reason why companies frequently use non-qualified plans to meet the retirement planning needs of their highly-compensated employees. Like qualified plans, non-qualified plan contributions are tax-deferred. In general, non-qualified plans offer far more flexibility, but they lack the tax advantages of their qualified counterparts.

Depending on your particular situation, you may benefit from using qualified and eligible non-qualified accounts first, if it will allow you to postpone receiving Social Security until you reach FRA. Putting off retirement by working longer is another strategy to meet your income needs prior to filing for Social Security benefits at FRA or later.

DELAYING BENEFITS BEYOND FRA

For those who wait beyond FRA, the Social Security Administration provides another benefit. The Delayed Retirement Credit (DRC) is an additional amount you'll receive on top of your PIA. For each month you postpone filing for Social Security benefits after reaching FRA, you'll earn a DRC. You can collect DRCs until 70 years old, which is when benefits reach their maximum point. This can amount to a seven to eight percent increase annually. In this

scenario, you won't pay taxes on Social Security benefits and you will benefit from the 7%-8% annual actuarial increase.

LEVERAGING SOCIAL SECURITY TO INCREASE YOUR LEGACY

Using our friend Jack as an example, he sought to leave a legacy to his children and grandchildren. Part of his plan included providing tuition support for his grandchildren once they enrolled in college. Since delaying filing for Social Security benefits permanently increased his PIA, Jack was able to rely more heavily on his Social Security income to meet his daily living expenses. That enabled his qualified and non-qualified investments to continue working hard to support his legacy goals and help offset his grandchildren's education costs.

SOCIAL SECURITY: THERE'S NO ONE-SIZE-FITS ALL STRATEGY

Your anticipated Social Security benefit reflects decades of hard work, dedication, and discipline, making it critical to put a well-conceived strategy in place to determine your income needs in retirement and when to begin receiving Social Security benefits. In order to create a custom strategy that addresses your particular circumstances, consult your advisor. He or she will play an essential role in helping you make decisions that align with your short and long-term financial goals.

MANY PEOPLE LEAVE THEIR FINANCIAL ADVISOR CONFUSED ABOUT WHAT'S HAPPENING WITH THEIR MONEY.

Our advisors are just as good at explaining investments as they are at making them. Our clients fully understand what's happening with their money at every stage of their financial journey.

How we make the complex simple:

- Straightforward Fees
- Effective Game Plan
- Advice in Common Language

Our goal is to make your life easier. We exist to serve as your guide for life's big trade-off decisions and by working with us, we want you to be confident you made the right decisions.

Social Security Case Study

Jack was born in 1945. He spent his career as a hardworking and well compensated managing director of a large consulting firm. In 2011, he turned 66 years old and reached FRA.

In 2007, when he was 62 years old, he had the option of receiving his Social Security benefits. But because doing so would forever lock him into a lower PIA than the maximum benefit he would otherwise receive, he decided to postpone filing for benefits. As a result of prudent planning, he was able to meet his income needs through his qualified and non-qualified plan distributions and delay receiving Social Security benefits.

Upon reaching age 70, Jack's monthly benefit had increased to 132% of his PIA had he elected to receive Social Security Benefits at age 66. Now that Jack's Social Security benefits have increased, Jack has relied less on his qualified and nonqualified plans to meet his income needs, thereby limiting the exposure of his Social Security benefits to income taxation.*

*This is a hypothetical example and is not representative of any specific situation. Your results will vary.

CHEAT SHEET: SOCIAL SECURITY ACRONYMS	
401(k)	A retirement savings plan sponsored by an employer
403(b)	A tax-sheltered annuity plan
DCA	Dependent Care Accounts allow you to use pre-tax dollars to pay for eligible dependent care FSA expenses
FRA	Full Retirement Age (see table on page 2 to determine FRA)
IRA	Individual Retirement Account allows an individual to save for retirement with tax-free growth or tax-deferred basis
IRS	The Internal Revenue Service is the government agency responsible for tax collection and tax law enforcement
PIA	Primary Insurance Amount is the benefit received at FRA
RMD	Required Minimum Distribution is the minimum amount you must withdraw from your account each year
SERP	Supplemental Executive Retirement Plans provide retirement benefits to supplement basic retirement benefits
SSA	The Social Security Administration is an independent agency of the federal government that administers Social Security

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