

## CELEBRATING NATIONAL SOCIAL SECURITY MONTH (MAY)

### SOCIAL SECURITY AND MEDICARE – UNDERSTANDING THE BASICS



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Social Security is a crucial piece of any retirement income planning for most retirees. On average, 40% of a retiree's income is from Social Security Benefits. But there's more to it than simply signing up. The monthly amount you receive can vary substantially based upon a number of factors such as age, marital status, and job status. Married couples have, on average, ten to twelve different options to choose from that can potentially maximize their benefits. Learning exactly what choices are available, and how each would impact on your benefit amount, can be a daunting task, but it is essential to effective retirement income planning.

Let's look at some **Social Security Basics**:

#### **Definitions:**

**Full Retirement Age (FRA)** – the age at which you qualify for the full amount of your Social Security benefit. This age has been increasing gradually on a pre-determined schedule. As an example, anyone born between 1943 and 1954 has a Full Retirement Age of 66. Those born in 1960 or later have a Fixed Retirement Age of 67.

**Primary Insurance Amount (PIA)** – the Social Security benefit amount for which you qualify at Full Retirement Age, which is determined by a calculation based on the amount of money you have contributed to the system through Social Security taxes.

**Average Indexed Monthly Earnings (AIME)** – a figure based on your lifetime earnings history adjusted for inflation, calculated by using your highest 35 years of indexed earnings.

**Delayed Retirement Credits (DRC)** – the amount of increase in Social Security benefits you can earn by deferring your collection of benefits beyond your FRA; these credits increase your benefit amount by 7% to 8% each year, up to the age of 70.

**Cost-of-Living Adjustment (COLA)** – a periodic increase in the amount of Social Security benefits to help offset some of the effect of inflation.

**Federal Insurance Contributions Act (FICA)** – a payroll tax that includes 6.2% for social Security beneficiaries plus 1.45% for hospital benefits for Medicare beneficiaries. Your employer matches that amount for each employee.

## Qualifying:

To qualify for Social Security benefits, an individual must have earned the required number of Social Security “credits”. For most people, the requirement is **40 credits**, which is equal to approximately **ten full years of work**. A “non-qualified” spouse, who has never paid Social Security or Medicare taxes, can collect a Social Security benefit based on a qualifying spouse’s record if they have been married at least one year. At Full Retirement Age (FRA), the non-qualified spouse would receive 50% of the Primary Insurance Amount of the qualifying spouse. If benefits are claimed before FRA, that percentage is reduced.

## When to start benefits:

The earliest age at which retirement benefits can start is 62. However, starting benefits prior to your Full Retirement Age will result in a **decrease** in your benefit amount, which becomes permanent. For people born between 1943 and 1954, the benefit amount at age 62 is **25% less** than it would be at FRA. On the other hand, you can earn Delayed Retirement Credits (DRC) for every month you defer the start of benefits after your FRA, up to age 70. The amount will **increase 8%** for each year benefits are delayed, up to four years.

## Working Penalty:

If you work and take benefits **before** Full Retirement Age, you could have some Social Security **benefits reduced** if you make more than the “earnings cap” amount. In 2014, that amount is \$15,480 (spousal earnings, if any, are not included in the earnings test); if you earn more than that amount, your Social Security benefit would be reduced up to \$1 for every \$2 you earn over \$15,480.

During the **year in which you reach FRA**, the earnings cap is increased to \$41,400 and the benefit reduction is \$1 for every \$3 you earn over the limit. **After you reach FRA**, you can work and earn any amount without a reduction in Social Security benefits.

**Income** that is considered in the earnings test **includes** any amount that is subject to **FICA taxes** such as income reflected on a W-2 or 1099, or self-employment. Income from rental properties, investments, IRAs, 401Ks and deferred compensation are **not counted** as income. Private pensions, early-outs, severance pay, and vacation pay-outs received after you retire usually are **not considered wages** even when you receive a W-2.

## Taxation:

Social Security benefits **may be taxable** depending on your combined provisional income (adjusted gross income, plus non-taxable interest, plus one-half of Social Security benefits). For example, a married couple filing jointly with a combined income of \$32,000 could pay taxes on up to 50% of their benefits. Higher income households (\$44,000) could be taxed on up to 85% of their benefits; for lower-income people, none of the benefits are taxable.

### Survivor benefits:

A surviving spouse can collect on his/her **own benefit** (at age 62 or older) or the benefit of the **deceased spouse** (if the survivor is age 60 or older and has not remarried). If the survivor starts benefits before reaching Full Retirement Age, the amount of the benefit will be reduced. The surviving spouse can collect either his/her own individual benefits or survivor benefits – but not both at the same time. When the surviving spouse is eligible for both benefits, he/she can choose to take one type of benefits first, and then switch to other benefits later.

### Filing strategies:

**File and suspend** – This option is available to a wage earner at **Full Retirement Age**. The qualified applicant would **file** for his/her own benefit, then **immediately suspend** the benefit. This allows the **spouse** with a lower benefit or no benefit (age 62 or older) to start to collect a spousal benefit. Because the qualified applicant is not actually receiving a benefit, **Delayed Retirement Credits** continue to accrue at 8% per year until the benefit is “unsuspended” or the applicant reaches age 70.

**File-restricted** – For this strategy, both spouses must qualify for Social Security retirement benefits. If one spouse is already receiving benefits or has filed and suspended, then the other wage earner, at **Full Retirement Age**, can file for a restricted application - filing **only** for a **spousal benefit**. This allows one wage earner to start collecting a spousal benefit, while continuing to accrue Delayed Retirement Credits on his/her own benefits.

Another benefit that must be understood and included in retirement planning is **Medicare**, which is a health insurance program for people age 65 or older. Here are the basics:

### Qualifying:

Qualifying for Medicare involves rules that are generally similar to qualifying for Social Security. But you may become eligible for Medicare the first day of the month you turn **age 65**. If you are receiving Social Security benefits in the month you reach age 65, you are automatically enrolled in Medicare, and the monthly premium is deducted from your benefit check. If you are not yet receiving retirement benefits, you should enroll in Medicare three months prior to your 65<sup>th</sup> birthday. You will also have to make arrangements for payment of the monthly premium.

### What is covered:

**Medicare Part A** provides coverage for **hospitalization**, limited skilled nursing home care, hospice care, and home health services; this care is basically free but does have some co-pays and deductibles.

**Medicare Part B** is **medical expense** coverage for medically necessary and preventive services such as doctor visits, checkups, tests, home health care, medical equipment, etc. Part B is not free – it is means-tested and involves a monthly premium.

**Medicare Advantage Part C** plans provide all of the services of original Medicare, but are offered by private companies that are approved by Medicare. People with Medicare Parts A and B can choose to receive **all** of their health care services through one of these provider organizations under Part C. These plans usually include Part D as well, and may offer extra benefits at an additional cost. Medicare Advantage Part C plans may also require the use of doctors and hospitals within their defined network.

**Prescription Drug Coverage Part D** helps pay for medications prescribed for treatment.

**Medicare Supplement Insurance (Medigap)** is offered by private insurance companies to provide **supplemental** coverage to help with co-pays and deductibles.

### What is generally not covered:

- Long-term care
- Routine dental or eye care
- Dentures
- Cosmetic surgery
- Acupuncture
- Hearing aids and fittings

### Hospital Status:

When you go to the hospital, you are designated as either an “inpatient” or an “outpatient”. This status is determined solely by the hospital, and may not be something you are told unless you ask your doctor directly. This status is critical because it determines how the charges are **billed to Medicare**.

**Outpatient** – If you visit the ER for a broken arm, get an x-ray and cast and go home, you are obviously deemed to be an “outpatient”. However, if you go to the hospital for chest pain and the hospital keeps you for **two nights of “observation”**, you are **still** considered to be an “outpatient”. As an “outpatient” Medicare Part A (hospital coverage) does **NOT** apply, so only the charges covered under **Part B** (doctor, lab tests, etc.) would be covered.

**Inpatient** - To be considered an “inpatient”, you must be formally **admitted** to the hospital with a **doctor’s order** (as opposed to be held for “observation”). As an “inpatient”, Medicare Part A will apply and your hospital services will be covered. Medicare Part B will also cover any doctor or lab services.

**Skilled Nursing Facility coverage** – If you require care in a skilled nursing facility (e.g., rehab) after your hospital stay, Medicare will cover those charges **ONLY** if you first have a “**qualifying hospital stay**”, which means you’ve been a hospital “**inpatient**” for at least **three days in a row** (counting the day of your admission but not counting the day of discharge).

Paul Fair, a National Social Security Advisor, understands the importance of sufficient retirement planning. He can generate a personalized report that presents a complete list of Social Security filing options based on your specific status and the age at which you plan to apply for benefits. Armed with a

*complete* picture of the possible options you have and the benefits each would provide, you can evaluate all of the alternatives and make an informed decision *before* entering the Social Security office. The only way to maximize Social Security benefits is to first understand *all* of your options, then formulate a plan that best meets your needs.

In addition to the issues outlined above, employment, investment returns, risk levels, and desired lifestyle must also be considered when creating an effective retirement plan. As a financial planner with over 24 years of experience, Paul is well-qualified to help you consider all of the variables while developing a successful retirement strategy tailored to your personal circumstances and goals. Seeing the big picture and making good choices can make a profound difference in the quality of retirement for you and your loved ones.

Services are available to individuals as well as businesses that would like to provide information to employees who are nearing retirement.

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