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Social Security Retirement Benefits

In the December 2012 newsletter, I made the point that 40 credits or about 10 years of work is the minimum needed to qualify for Social Security retirement benefits; however, the actual amount of benefits that you receive is calculated from and based upon your top 35 years of work. This month's article will review the new Social Security and Medicare Hospital Insurance tax rates for 2013 and explain how your retirement benefit is calculated.

Both you and your employer pay taxes for Social Security and Medicare Hospital Insurance if you receive a W-2 wage statement as an employee. Self-employed people pay both employer and employee rates themselves although there are some federal income tax provisions that help offset this double contribution. In 2013 both employer and employee will pay a Social Security tax of 6.2%. The 6.2% is made up of 5.3% for Old-Age and Survivors Insurance and 0.9% for Disability Insurance. Medicare Hospital Insurance adds an additional 1.45% to the 6.2% for a total of 7.65%. The combined amounts that an employer and employee pay into the system to support this social insurance program thus equals 15.3% (5.3 + 0.9 + 1.45 from employer and 5.3 + 0.9 + 1.45 from employee = 15.3%). In most cases a worker's pay stub would reflect the combined Social Security and Medicare Hospital Insurance taxes under a category called "payroll taxes" or FICA (Federal Insurance Contribution Act).

In 2013, Social Security tax will be taken out on earnings up to $113,700. This cut-off amount changes every year and is based upon the national average wage. Since 1994 there is no earnings limit for the Medicare Hospital Insurance tax. However, in 2013, an additional Medicare FICA tax of 0.9% will apply to high-income employees when annual earnings exceed $200,000 for singles and $250,000 for married couples filing jointly. The employer would not have to pay this additional tax, only the employee would pay. In most instances the employer will directly withhold the excess tax for an individual. In the case of married couples whose combined incomes exceed the $250,000 threshold, the married couple will have to pay the additional 0.9% Medicare tax when filing Income Tax Form 1040 if the withholding is not taken out by the employee. This extra tax may come as a surprise to married couples so please be aware of this possibility if you are a married couple exceeding $250,000 in earnings.

After all your years of hard work and FICA contributions, how are your Social Security retirement benefits calculated? It is estimated that 9 out of 10 Americans receive Social Security retirement benefits. All benefits are based upon your Primary Insurance Amount (PIA). The Primary Insurance Amount is the amount that you would receive if you retired at your Full Retirement Age (FRA). While many think of retirement as age 65, for Social Security calculations Full Retirement Age is somewhere between ages 65 to 67. It depends upon the year that you were born. The full retirement age will gradually increase from age 65 for those born in 1938 to age 67 for those born after 1959. Your FRA is the age at which you are eligible for your full monthly benefit and acts as a baseline.

The Social Security Primary Insurance Amount (the benefit amount that you actually receive each month) is calculated from your average earnings over your highest 35 years of work. Your actual earnings over your working career are "indexed" to account for changes in average wages over time. If you worked less than 35 years, the "missing" years are calculated as zero. Consequently, the amount that you actually receive in benefits each month is based upon the combination of the age at which you apply for benefits and how much you earned over your working career. At Full Retirement Age your benefit equals 100% of your baseline Primary Insurance Amount. Early retirement at age 62 will result in a permanently reduced benefit of about 25% of your PIA. Retiring up to age 70 will result in a Primary Insurance Amount bonus of 8% for every year beyond Full Retirement Age.

To complicate matters, if you claim benefits earlier than your Full Retirement Age and have wages and salary greater than $15,120 in 2013, then $1 of benefits is withheld for every $2 that you earn above $15,120. The Senior Citizens' Freedom to Work Act of 2000 eliminates the $15,120 earnings cap and penalty for people who have attained Full Retirement Age. In addition to the earnings limitation for those under FRA, a portion of Social Security payments for all recipients may be subject to federal income tax if certain thresholds are exceeded. As much as 85% of your Social Security benefits may be subject to federal income tax. Those calculations will be discussed in a future newsletter.

With all its rules, regulations and options, Social Security is not an easy program to understand. I hope that these newsletter articles will provide some insight into this very complex social insurance program. All these discussions are preliminary to the real question of when and how you should actually apply for benefits. Many of those answers are provided in the personal review and software analysis that I do for clients. If you know anyone nearing retirement, please pass this newsletter on.

This month's guest article on the U.S. debt is by my assistant, Patricia Thompson. Pat is the mother of 4 children, grandmother of 6 and loves to play golf. She spent twenty-plus years in the financial services industry, retired and then started a post retirement career as my assistant. She has been an invaluable asset to Haas Financial Services Inc. Hope that you enjoy her article. Take good care!!!

The U.S. Debt Ceiling — What???

By Patricia A. Thompson

As your average citizen, I watch CNN, FOX, and HLN News. The programming consisting of sensationalized word bites, with more commercials than information, likes to terrorize the public with dire warnings and predictions. As far as our House of Representative and Senate actions indicate, the only clear message I can pick up from our government body is constant disagreement and no resolutions. Lately an example of gloom and doom crisis, the "debt ceiling" has been bandied about quite a bit, and I wanted a better understanding of "what on earth" were they talking about. I have gathered the following information, in a shortened version (to prevent dozing), with my simple synopsis of the "debt ceiling".

What Is the U.S. Debt Ceiling?

The debt ceiling, legally known as the debt limit, is the total amount of money that the U.S. government is authorized to borrow to pay existing obligations, such as Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and disbursements for other programs.

The debt limit applies to federal debt held by the public, namely, securities held by investors outside the federal government, and to federal debt held by the government's own accounts. The debt limit does not create new spending commitments but allows the government to finance existing obligations already established by Congress.

History of the U.S. debt limit

Congress has the sole power to borrow money on the credit of the United States as authorized by Article I Section 8 of the U.S. Constitution. Until 1917, Congress authorized each debt issuance separately. In order to help finance the United States' involvement in World War I, Congress passed the Second Liberty Bond Act of 1917, which also established a limit on the total amount of bonds that could be issued.

Congress broadened the limit to apply to all federal debt in 1939 and 1941 through the Public Debt Acts. Congress authorized the Department of the Treasury to issue such debt necessary to fund government operations (as authorized by the federal budget) as long as the total debt remained below a stated ceiling. According to the Treasury Department, since 1960, Congress has acted 78 times to raise, extend, or revise the definition of the debt limit – 49 times under Republican presidents and 29 times under Democratic presidents.

What caused the crisis?

Back in 2001, we actually had a balanced federal budget, spending only as much as we took in in taxes. Why did that change? Economist Paul Krugman summarizes the causes of increasing debt: "What happened to the budget surplus the federal government had in 2000? The answer is three main things. **First,** there were the Bush tax cuts, which added roughly $2 trillion to the national debt over the last decade. **Second,** there were the wars in Iraq and Afghanistan, which added an additional $1.1 trillion or so. And **third** was the Great Recession, which led both to a collapse in revenue and to a sharp rise in spending on unemployment insurance and other safety-net programs."

Obama Signs Debt Ceiling Fix

On Monday, February 14 2013, President Barack Obama signed a measure allowing the government to borrow to meet its needs until May 18, 2013, staving off the threat of default. The limit is currently set at $16.394 trillion ($16,394,000,000,000) (WOW!), but the ceiling is under temporary suspension following a bill passed on January 23, 2013. The debt ceiling will need to be raised again on May 18, 2013, although the Treasury will be able to continue funding the debt through late summer via stop-gap measures.

Consequences

Briefly: **With a debt ceiling increase**, our debt will rise by about 8% a year in the near term, that's unpleasant, but it gives us time to bring spending back in line with revenues. Growth in the economy will give us more breathing room and enough new income to continue to pay our bills with less borrowing. **Without a debt ceiling increase,** we will have to decide immediately how to cut federal spending by a third, instantaneously wiping out all funding for discretionary items like, say, the *entire defense budget,* along with *our ability to pay the interest on the debt we already owe,* all the while *warring over the efficacy of huge cuts to Social Security and other entitlements.* Neither choice is pretty, but that's where it is.

Congress has until around August 2, 2013 to raise the legal limit on debt, or the United States will risk going into default, according to the U.S. Treasury Department. As Democrats and Republicans continue rocky negotiations to strike a deal on the debt limit increase, both sides have stepped up the rhetoric on the showdown. But both sides agree that a default would be bad for America's government and its economy.

Hopefully, the three-month extension signed by President Obama will give Washington more time to negotiate budget priorities, debate the contrasting visions and most important—figure out how to fix this on-going problem. No on knows for sure what will happen—the U.S. government has never gone into default—and the unpredictability would fuel market unrest. And yet, I remain an optimist, and have faith in greater minds than my own, to find a way to keep the wheels moving forward.

Sources: Internet; www.Dummies.com Kirk Bailey – What is the U.S. Debt Ceiling?, www.usnews.com, Alex M. Parker – 6 Consequence if the Debt Ceiling Isn't Raised. www.policymic.com Jonathan Miller – Debt Ceiling for Dummies: Why Compromise Is so Necessary. www.bonds.about.com – What is the Debt Ceiling? A Small Explanation of the Debate.

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