

# Shrinking Boomer Social Security Retirement Benefits

By Francine J. Lipman\*

In 2008, the oldest of 78 million baby boomers will celebrate their 62nd birthdays. Before they blow out their birthday candles, they will have considered and likely decided whether to elect to take early Social Security retirement benefits. For the next 20 years, a record number of seniors will face this and related retirement issues. The number of seniors will reach more than 70 million in 2030—20% of the U.S. population—with the number of new retirees hitting a record high in 2022 at almost 5 million.

Our aging population is an issue of global magnitude. The senior populations in the U.S. and the world are exploding. By 2050, the number of seniors will exceed the number of young people for the first time in the history of the world. Life expectancies are continuing to grow longer each year, with one year added about every decade. Not only are seniors living longer and healthier lives, but the fastest growth rate is in the 85+ year old category. At age 62, the average man, woman and couple have a life expectancy of 18, 21 and more than 25 years, respectively. The average person now spends one-third of their adulthood as a retiree.

While we are living longer and enjoying richer lives, there are striking changes on the horizon. Without thoughtful

consideration these changes could hit you and your clients unexpectedly and adversely where it hurts, especially during the “golden” years—and that is in the wallet. The average replacement rate of Social Security benefits for earned income will decrease dramatically from a consistent 40% to less than 30% by 2030. The decrease will be even greater for higher income retirees. The replacement rate will drop because of a number of changes that are not known or understood by many boomers who are nearing retirement.

As tax professionals advising clients on a myriad of financial and business matters, we must be prepared to assist boomers with their fast-approaching retirement decisions. Social Security and Medicare are critical components of the

boomer retirement package. Indeed, for two-thirds of all seniors Social Security retirement benefits (SSRBs), which currently average about \$13,000 for individuals and \$21,000 for couples, comprise more than one-half of retirement income. Therefore, as advisors we must understand the gritty details of Social Security so that we can assist them (and ourselves) with these critical decisions. This article provides an overview of issues on which we should be able to advise clients considering retirement.

## SOCIAL SECURITY 101: TIMING IS EVERYTHING—EARLY, NORMAL OR DEFERRED RETIREMENT

During the earliest days of eligibility for SSRBs in the 1940s-50s, the average age at retirement was 68. In the decades since early retirement at age 62 was first introduced in 1961, the average retirement age has dropped dramatically. Today more than 60% of all eligible seniors elect to take their SSRBs at 62 and about 90% make this election before normal retirement age (NRA).

At the same time that more seniors have been electing early SSRBs, they

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have been living longer and healthier lives—thus receiving benefits for a longer period. Perhaps to discourage early retirement, Congress has increased NRA for seniors born after 1937. While NRA was 65 for decades, it has been slowly and steadily increasing and is now and will continue to be 66 for seniors born through 1954. The NRA (for individuals born in years 1955-1959) will increase by two months every year up to 67 (for individuals born in 1960 and thereafter).

If an individual elects to take her SSRBs before attaining her NRA, her benefits will be reduced permanently. For boomers retiring at age 62 in 2008-2016, the reduction percentage will be 25% of SSRBs if NRA is 66. There will be further benefits reductions (at a rate of about .83% for each year)—for those retiring at age 62 in 2017-2021. Beginning in 2022 (the year that the greatest number of boomers will reach 62), SSRBs will be reduced by 30% for all age 62 early retirees. Because this reduction percentage was only 20% for early age 62 retirees born in 1937 and earlier, practitioners and clients may not be conversant with the significant limitations on the horizon. In addition to considering these reductions, computations must also factor in a potential benefits increase: SSRBs are increased permanently by eight percent for each year (up to age 70) a senior defers taking her SSRBs beyond her NRA.

The examples below assume NRA-SSRBs of \$1,500 per month for an individual born in 1960. Early retirement is defined as 62 years and one month (the earliest possible retirement date for this purpose); NRA is age 67; and deferred retirement is age 70. The potential benefits are shown for a married couple, one member of which receives spousal benefits rather than benefits based on his/her own work record.

**Early Retirement:** The monthly benefit would be reduced permanently to \$1,050 (versus \$1,200 in 1999) and to only \$488 (versus \$563 in

1999) for spousal retirement benefits, a \$1,538 monthly total. Annual Combined SSRBs: \$18,456.

**Normal Retirement:** The couple would receive SSRBs of \$1,500 and \$750, or \$2,250 each month. Annual Combined SSRBs: \$27,000.

**Deferred Retirement:** SSRBs would be increased to \$1,860 and \$930 for spousal retirement benefits or \$2,790 for the deferred retired couple. Annual Combined SSRBs: \$33,480.

**Comparative Analysis:** The differences between these elections are meaningful. Indeed, there is more than an 81% increase between the deferred retirement as compared to the earliest retirement amount—*more than a \$15,000 increase each year!* While these examples are notable and the foregoing discussion relevant, they are not comprehensive. The question regarding when to begin SSRBs must include a thoughtful consideration of work opportunities and alternatives.

#### **SOCIAL SECURITY EARNINGS LIMIT: TO WORK OR NOT TO WORK**

Almost 90% of all retirees draw SSRBs before NRA, but some of these individuals continue to work. Recent surveys indicate that most boomers plan to work longer than their predecessors. About 80% of boomers surveyed have indicated that they plan to work beyond early retirement age. This is not surprising given increased life expectancies, better health, and safer, less strenuous work environments. An individual should retire at age 74 (78 in 2065) to mirror the average retirement age of 68 that existed before Congress provided an early retirement option.

For most retirees, SSRBs do not even come close to replacing a worker's earnings. Therefore, from a pure cash flow perspective it will always be preferable to work versus to stop working and rely on SSRBs. However, the decision to elect to draw SSRBs does not preclude a worker from continuing to work. Unfortunately,

working and drawing SSRBs before NRA has significant implications regarding the amount of SSRBs a retiree can retain.

In most cases, a retiree should not elect to draw SSRBs before NRA if she plans to continue working full-time. If a retiree's earnings exceed a certain threshold amount SSRBs can be reduced entirely. From age 62 to NRA, a retiree's SSRBs are reduced if she earns more than approximately \$13,000 (indexed annually). She will lose \$1 of SSRBs for each \$2 of earnings in excess of this limit. Therefore, an average retiree receiving \$10,000 in early SSRBs would lose all of her benefits if she earned \$33,000 or more. Lost SSRBs are typically withheld from future SSRBs, but they do increase gross SSRBs after a retiree reaches NRA.

Retirees who work continue to pay Social Security and will possibly increase future SSRBs whether or not they have elected early SSRBs. That is because SSRBs are based upon the highest 35 years of earnings. Therefore, SSRBs should continue to increase every year that a retiree works, especially if her earnings increase every year (at a rate greater than wage inflation) or if she did not already have 35 years of earnings.

Another important factor that often weighs into the "to work or not to work" question is health care coverage. Retirees qualify for Medicare coverage at age 65 even though NRA now exceeds age 65. This is the case whether or not a retiree elects early SSRBs. In addition to enhanced cash flow and potentially increased future SSRBs, continuing to work could provide valuable health care coverage for the retiree and her family.

#### **MEDICARE PART B PREMIUMS: MEANS TESTING**

As most boomers well understand, health care costs have been and are continuing to skyrocket. For several years, Medicare premiums have been increasing at a greater rate than SSRBs have been increasing. Over the past five years, Medicare Part B premiums have



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skyrocketed 60%, while SSRBs have increased only 14%. In 2008, SSRBs are estimated to increase a mere 1.5% while Medicare Part B premiums will jump 17%. Fortunately for retirees federal law has provided that Medicare beneficiaries have paid a maximum of 25% of actual Medicare costs and after-Medicare SSRBs could not decrease from the prior year.

Beginning in 2007, Congress is shifting additional Medicare costs to higher income seniors. In 2007, 1.2 million (that is, three percent of all) beneficiaries will pay Medicare Part B premiums that are greater than the standard monthly amount. The increased premiums are based on modified adjusted gross income (MAGI, which includes tax-exempt interest) from recent tax return information provided by the IRS (generally 2005 MAGI for 2007 premiums and 2006 MAGI for 2008 premiums, etc.). If certain life-changing events (e.g., death, divorce or disability) cause this presumed income level to be overstated, retirees can provide information to rebut this presumption. If they are not able to convince the Social Security Administration that a lower level of income is appropriate, retirees can appeal an adverse decision.

The Medicare Part B premiums for higher-income individuals will increase every year through 2009—to 35% (\$80,001 to \$100,000 MAGI single) and up to 80% (more than \$200,000 MAGI single) of actual Medicare costs.

For 2007, the standard monthly Medicare premium amount is \$94. The increased premiums range from \$106 (for \$80,001 to \$100,000 MAGI single, with doubled ranges for married couples) to \$161 per month (for single individuals whose MAGI exceeds \$200,000). Based upon 2008 Medicare premium projections, beneficiaries in these MAGI ranges will pay monthly Medicare premiums of approximately \$140 and \$270 in 2008 and \$180 and \$400 in 2009, respectively, as compared to the 2008 and 2009 projected standard premium amounts of \$109 and \$128. These radically higher Medicare premiums will reduce net SSRBs dramatically.

#### TAXABLE SOCIAL SECURITY BENEFITS

In addition to higher Medicare premiums, many boomers will face higher tax costs on their SSRBs. Since 1983, SSRBs above certain threshold amounts are subject to federal income tax. Presently, up to 50% of SSRBs are included in taxable income if a beneficiary's MAGI plus one-half of SSRBs exceeds \$25,000 (\$32,000 for married filing jointly, \$0 married filing separately couples). If that total exceeds \$44,000 (\$54,000 for married filing jointly couples, \$0 for married filing separately couples), then up to 85% of SSRBs are included in taxable income.

Notably, SSRBs increase annually in dollar amount, because they are indexed for inflation, but the gross

income inclusion thresholds have not been indexed for inflation since 1983. As a result, more and more seniors are paying taxes on their SSRBs. This tax cost meaningfully reduces after-tax SSRBs and will continue to do so—capturing more and more seniors for larger amounts every year.

#### CONCLUSION

Millions of senior boomers will face critical retirement decisions over the next 20 years. Tax professionals can be of great assistance with these decisions. Recent and evolving changes in NRA and Medicare premiums and increased exposure to tax costs have reduced the net cash flow many senior boomers will enjoy from SSRBs. Unfortunately, because of the overall lack of transparency in the Social Security benefits formula and the complex interplay of continued work, Medicare, taxes, and the various timing options, many boomers are unable to make informed decisions about critical retirement matters. Sadly, uninformed early retirement decisions can lead to devastating circumstances when the senior is most vulnerable—with few or no alternatives in the increasingly experienced post-80 years. As informed tax professionals we should assist our boomer clients with their retirement decisions today so that when they (and we) are 84 (Sir Paul almost had it right) the retirement years are truly golden. ■