7 Things You Need to Know About Social Security

In 1935, President Franklin D. Roosevelt established the Social Security program as part of his efforts to revitalize the country financially and bring the United States out of the Great Depression. The program was an attempt to help certain "less fortunate" members of society in particular, namely the elderly, the disabled, the unemployed, and widows and children of deceased workers. Over time, the program has become the standard pension plan of most Americans. There is a lot of information available about Social Security, but it's certainly a complicated program that has been heavily criticized by politicians and retirees alike. Still, Social Security has benefited many people for over 80 years, and it can benefit you, too. Here are the facts you need to know to make the most of your own Social Security.

How Social Security gets funded

If you have an employer, you pay 7.65 percent of your wages into the Social Security program each paycheck. Your employer pays the other half of your 15.3 percent obligation. They are required to do this by law. However, if you are self-employed, you must pay the whole 15.3 percent tax yourself. This is an important distinction to consider when you're considering a move from traditional employment to self-employment.

When you can claim benefits

When it comes to age and social security, there are a lot of numbers thrown around. You've probably heard the terms "full retirement" or "early retirement," but the details of the laws can be confusing. Here's the breakdown:

Full retirement is the age you can retire and receive 100% of your retirement benefits. You may retire earlier, but you will receive a reduced portion of your benefits. You may also retire later and receive a higher benefit.

For people born earlier than 1938, the full retirement age is 65. For people born between 1938 and 1942, there is a scale that adds two months for each subsequent year. For people born between 1943 and 1954, full benefits start at 66. If you were born between 1955 and 1960, you're subject to the sliding scale of two months for each year. After 1960, the current eligibility age is 67.

If you retire at age 62, you qualify for early benefits, which are 75 percent of your full benefits. That's why many people choose to wait until their full retirement age; that 25 percent reduction can make a huge difference over the course of a decade or two.

You may also elect to delay your retirement past your full retirement age, up to age 70. If you choose to delay your benefits, you will earn an increase each month you delay, up to 8 percent per year. Once you turn 70, you may still elect to delay, but you will no longer receive the increase.

Obviously, it makes the most sense financially to delay claiming Social Security until age 70 to maximize your benefit. If that's not possible, then you should delay as long as you can.

How you qualify for Social Security Benefits

Many people falsely assume that everyone qualifies for Social Security, but that's not necessarily true. In fact, you must earn a certain number of credits to qualify for the program. This guideline applies for everyone born in 1929 or later. You earn one credit for every $1,300 in wages, and you must earn four credits per year. You will need a total of 40 credits to qualify, which means you will need 10 years of full-time work.

Still, this is the minimum amount of credits needed for Social Security benefits. You should also note that the formula for determining your benefits is based on your highest 35 years of earned income. If you work less than 35 years, you will have an earned income of $0 for the years of unemployment, which will be averaged into your total. So, to qualify for a higher benefit, you should work at least 35 years. The higher your average income over these 35 years, the higher your benefit.

You should also note that many government employees will only qualify for a reduced Social Security benefit. Some employees won't qualify for Social Security at all. That's because many government employees, such as teachers, police officers, firefighters, and other public employees, have separate pensions they will receive instead.

What benefit to expect

Social Security is not meant to function as a full retirement program for retirees. In fact, the average monthly benefit was just $1,500 in early 2020. Retirees are expected to have their own private retirement fund or pension to supplement the Social Security benefits.

The calculation for Social Security benefits is complicated, but it is generally based on the average of your highest 35 years of wages. There is a calculator available online to determine your personal benefit. You should also know that cost of living (COLA) increases are common. The COLA for 2020 was a 1.6 percent increase.

Social Security isn't just for retirees

While Social Security is typically known as a retirement plan, it isn't just available for retirees. If you are older than your full retirement age, then you can claim Social Security benefits and keep working. In this situation, you will receive 100 percent of your total benefit. If you elect to tap into your benefits before your full retirement age, you may still be eligible for a portion of your benefit. There is an earned income cap, however. For 2020, that number is $18,240. Past that number, your benefits were reduced by $1 for every $2 you earned over the threshold. If you will reach your full retirement age within the year, the threshold is $48,600. At this point, your benefits are reduced by $1 for every $3 you make over the threshold. Once you become fully eligible, you will receive 100 percent of your benefits. You may also be eligible for Social Security if you become disabled.

Your spouse qualifies for Social Security, too

If your spouse meets the 40 credit requirement, he or she is eligible for their own Social Security benefits. However, if they don't meet the 40 credit requirement, then they may be eligible for a benefit equal to 50 percent of your benefit. If they meet the 40 credit requirement but their benefit is less than 50 percent of yours, then they may take the higher of the two numbers. Your spouse claiming benefits on your work record does not reduce the benefit you receive.

There are benefits for surviving spouses, too. If one spouse dies after reaching full retirement, the surviving spouse is eligible to receive 100 percent of the deceased spouse's benefits. If the surviving spouse was already receiving benefits but the benefits were less than the deceased spouse's benefits, then the surviving spouse will be eligible for the higher amount.

If the spouses are divorced, then the situation gets trickier. If you are divorced and remarried, then you are no longer entitled to any of your ex-spouse's benefits. If you are divorced and not remarried, you may be entitled to benefits based on your ex-spouse's work record. This only applies if you were married for a decade or longer and have been divorced for two years or more.

You may need to pay taxes on your benefits

Unlike some other forms of retirement income, Social Security benefits are eligible to be taxed. If you make more than $25,000 and are filing single, then you will owe some taxes. If you are married filing jointly, then you will pay taxes on income over $32,000. However, the maximum taxable amount is 85 percent of your total Social Security income.

Final Thoughts

Many people find Social Security confusing, but it doesn't have to be. Because your Social Security benefits can directly impact your quality of life and financial independence down the road, you should understand how the system works and how to make the most of your retirement. If you have any questions or need clarification about your Social Security benefits, please contact us for further assistance.

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