

Understanding your Social Security benefits

Plain Talk In Focus™



If you're approaching retirement or you're already retired, you probably have many questions about the financial issues the years to come will bring. How will you pay for health care? Can you count on Social Security benefits? How should you manage your retirement plans? Learn about these and other retirement topics through our PlainTalk In Focus booklets. The In Focus series can help you become an informed consumer. Go to www.vanguard.com/visit/plaintalk.

For most people, Social Security represents a significant source of retirement income—about 40% of income for the average retiree, according to the Social Security Administration. So it's important to understand how much you'll receive from Social Security and when to begin taking your benefits.

The actual amount of your Social Security benefits is based on your birth year, your retirement age, and your lifetime earnings. Higher lifetime earnings result in higher benefits. The amount of your benefits also depends on when you begin receiving payments. And Social Security benefits are increased automatically each year to keep pace with inflation.

The information in this booklet will help you understand your Social Security benefits, including the best age for you to begin receiving payments, the impact on your benefits if you continue to work, and what happens to your benefits when you pass away.

When can you start taking benefits?

Anyone who has contributed to Social Security from his or her working income is entitled to receive Social Security benefits. To qualify for retirement benefits, you must be “fully insured.” This means you’ve compiled at least 40 work credits, or the equivalent of 10 years of earnings. Today, nearly 48 million people receive Social Security benefits.

If you stop working before you have enough credits to qualify for benefits, the credits remain on your Social Security record; you can add to them if you return to work at a later time. No retirement benefits will be paid if you don’t earn the required number of credits.

The amount of your benefit will depend upon how old you are when you start taking it. You have three options:

Early benefit. You can begin collecting benefits as early as age 62, but if you do, your monthly benefits throughout your retirement will be less than the full retirement benefit—about 20% less.

Full benefit. The retirement age for full Social Security benefits ranges from 65 to 67, depending on the year you were born.

Delayed benefit. You can delay taking benefits until after your full retirement age, and your monthly benefits throughout retirement will increase for each year you delay, up to age 70.

Use the following chart to see when you reach full retirement age and qualify for 100% of your Social Security benefits.

Birth Year	Full Retirement Age
1937 and before	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943–1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and after	67

Source: Social Security Administration.

Deciding when to take benefits

Some people may be inclined to begin receiving their benefits as soon as possible, even if it means reduced benefits. Whether this is the best financial decision depends on several factors, including your health, how long you expect to live, and your employment status.

In general, the longer you live beyond the average life expectancy for someone your age, the more it pays to put off taking Social Security benefits. Conversely, the shorter your life, the more it pays to start taking benefits as soon as possible.

Of course, you don't know how long you're going to live. But you can make an educated guess for planning purposes. For example, the healthier you are, the greater your potential longevity. Also consider your family's history: What is the likelihood of your living as long as other family members?

Another factor in determining when to start your Social Security benefits is whether you intend to work during retirement. If you have income from employment, you may want to delay taking Social Security and thus receive higher benefits later. But if you don't plan to work or if you need the money to live on, you may want to begin taking benefits earlier.

When to apply

You should apply for Social Security benefits about three months before you want the payments to begin. But you should discuss your plans with a Social Security representative about a year before you plan to retire.

Health considerations

Health problems may leave you no choice but to retire early. In such cases, you should consider applying for Social Security disability benefits. You will receive a benefit equal to a full, unreduced retirement benefit. Then, when you reach full retirement age, the disability benefits will be converted to retirement benefits.

> Web link

Get more information about applying for benefits from the Social Security Administration at www.socialsecurity.gov or by calling 800-772-1213.

Should you delay taking benefits?

In general, if you plan to work past normal retirement age and don't need the income right away, or if you're in good health and expect to live beyond your average life expectancy, it's probably best to delay taking benefits as long as possible to receive the higher monthly benefit throughout retirement. If you live into your 80s or 90s, you'll be happy to receive the higher payments.

If you delay taking Social Security benefits until after your full retirement age, your monthly benefits throughout retirement will increase by a certain percentage for each year you delay, until age 70. The percentage varies depending on your year of birth. If you were born in 1943 or later, your benefits will increase by 8% per year for each year you delay taking benefits beyond your full retirement age, up to age 70.

In addition, each extra year you work adds another year of earnings to your Social Security record, which could result in a higher benefit when you retire.

What if you plan to keep working?

You can continue to work once you begin receiving Social Security benefits. If you elect to take benefits before you reach full retirement age, your benefits will be reduced until you reach full retirement age (65 to 67, depending on the year you were born) if your earnings exceed certain limits.

If you've reached full retirement age, you can earn an unlimited amount without reducing your Social Security benefits.

Here's how it works:

- **If you're not at full retirement age,** \$1 in benefits will be deducted for each \$2 in earnings above the annual limit (\$12,000 in 2005).
- **In the year you reach full retirement age,** up until the exact month, your benefits will be reduced \$1 for every \$3 earned over the annual limit (\$31,800 in 2005).
- **Once you reach full retirement age,** your employment earnings no longer affect your benefits.

Keep in mind that the earnings limitation applies only to the money that you earn through employment, not to investment income such as interest from a certificate of deposit or dividends from a mutual fund.

Continuing to work while also receiving Social Security may actually increase your benefits, because Social Security automatically reviews your earnings record and replaces the lowest earnings year in your work record with your latest year of earnings if it is higher.

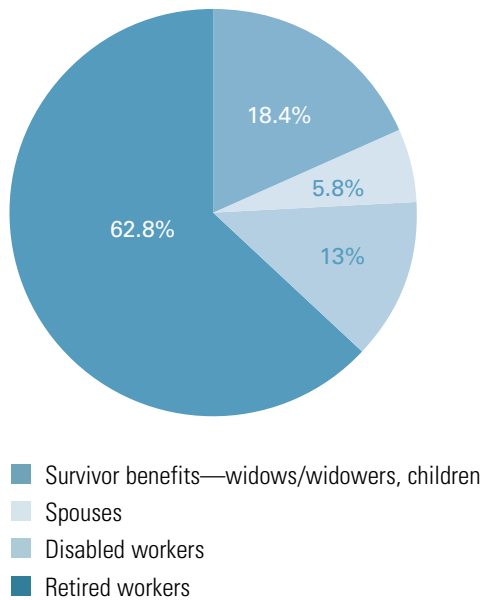
How Social Security benefits are taxed

If your total income—whether from a part-time job, pension, annuity, or other source—exceeds certain levels, you may owe federal income tax on up to 85% of your Social Security benefits. In fact, about one-third of people who receive Social Security have to pay income taxes on their benefits.

The formula is as follows: If the sum of your total taxable income (wages, interest, dividends, and other taxable income) plus tax-exempt interest plus one-half of your Social Security benefits is between \$25,000 and \$34,000 for a single filer or between \$32,000 and \$44,000 for a married couple filing jointly, up to 50% of your Social Security benefit may be taxable. If the sum exceeds \$34,000 for a single filer or \$44,000 for joint filers, up to 85% of your benefit amount may be taxable.

You should receive an SSA-1099 form every year showing the amount of your Social Security benefits. You may wish to consult a tax advisor to determine whether you'll owe tax on your Social Security benefits.

Who gets Social Security benefits



Source: Social Security Administration.

Spousal and survivor benefits

If you're married, some decisions concerning Social Security may affect your spouse as well as your overall financial situation. For example, your choice of when to begin taking benefits could affect the level of benefits to which your spouse is entitled.

A spouse is entitled to receive Social Security benefits based on his or her own earnings record, but a spouse may also be entitled to "spousal benefits." Social Security will pay the higher of the two benefits. In addition, a spouse is entitled to survivor benefits when you die.

Here's a closer look at each type of benefit.

Spousal benefits

Your spouse is entitled to a spousal benefit of one-half of your full benefit once you start receiving benefits—unless your spouse starts to collect benefits before reaching full retirement age. In that case, your spouse's benefit is permanently reduced by a percentage based on the number of months until he or she reaches full retirement age. However, if your spouse is taking care of a child who is under age 16 or disabled, your spouse gets full benefits, regardless of age.

If a spouse is eligible for his or her own retirement benefits and for benefits as a spouse, Social Security always pays the retirement benefits first. Then, if the spousal benefit is higher than the retirement benefit, it pays a combination of benefits equaling the higher spousal benefit.

For example: Ann qualifies for a retirement benefit of \$250 and a wife's benefit of \$400. At full retirement age, she'll receive her own \$250 plus \$150 from her wife's benefit for a total of \$400. If she elects to take her retirement benefit before she reaches full retirement age, there will be a reduction in both amounts.

Of course, this option is irrelevant if your spouse can receive higher benefits based on his or her own work record.

The spousal benefit will cease at your death and your spouse will then receive the amount of your retirement benefits instead—a potential income change that should be considered in your planning.

(Note: If you're divorced, your ex-spouse is eligible for benefits based on your Social Security record if he or she is age 62 or older and unmarried and your marriage lasted at least 10 years. The amount of benefits your ex-spouse receives has no effect on your or your current spouse's benefits.)

Family benefits

If you're receiving Social Security retirement benefits, some of your family members, such as your unmarried children through high school age, may also be eligible to receive benefits. Individuals eligible for family benefits will receive up to one-half of your full benefit. There is a limit, however, to how much one family can receive in benefits.

If the total benefits due to your spouse and children exceed this limit, their benefits will be reduced proportionately but your benefit will not be affected.

Survivor benefits

Upon your death, your spouse is entitled to receive the retirement benefit amount you would have been entitled to or were receiving at the time of your death. If you delay taking Social Security until after your full retirement age, it could increase your potential survivor benefits.

Survivor benefits can be paid to your spouse at a reduced level as early as age 60 or 50 if your spouse is disabled. People receiving widow or widower benefits (including divorced widows or widowers) can switch to their own retirement benefits—assuming they're eligible and their retirement rate is higher than the widow/widower's rate—as early as age 62.

Many times, a widow or widower can begin receiving one benefit at a reduced rate and then change to the other benefit at an unreduced rate at full retirement age. Because the rules vary with each situation, it's best to go over the options with a Social Security representative.

Unmarried children can get survivor benefits up to age 18 (19 if attending high school full-time). If they are disabled, children may get benefits beyond age 18.

In deciding the best course of action, your spouse should consider such factors as the amount of any life insurance proceeds he or she may receive and the adequacy of other sources of income.

Your right to appeal

If you don't agree with a decision on your claim for Social Security benefits, you have the right to appeal it and be represented by an attorney or other qualified person you choose. Two publications from Social Security are helpful: *The Appeals Process* (Publication No. 05-10041) and *Your Right to Representation* (Publication No. 05-10075). Call **800-772-1213** or visit **www.socialsecurity.gov**.

Your Social Security statement

Every year, three months before your birthday, you'll receive a Social Security statement that summarizes your earnings record and potential retirement benefits. The Social Security Administration sends this statement to all workers and former workers age 25 and older.

What your statement tells you

The four-page document contains:

- **An estimate** of the monthly retirement benefit that you would receive at early retirement (age 62), full retirement (65 to 67, depending on your birth year), and age 70.
- **An earnings** record and estimated taxes paid to Social Security and Medicare over your working career.
- **A projection** of the amount of monthly disability benefits you (and your family) could be entitled to, should you become disabled.
- **An estimate** of the monthly benefits that your family could receive should you die.

Your estimated benefit amounts are based on your average earnings over your lifetime. For future years, the Social Security Administration assumes that your earnings will stay at their current level until you retire. Your estimated benefits are also based on current laws and are provided in today's dollars, so that you can compare them with today's living costs.

> Web link

You can order an updated Social Security statement from the Social Security Administration at www.socialsecurity.gov or by calling 800-772-1213.

Social Security benefits can be complicated, especially when dealing with issues such as spousal and survivor benefits. You can get more information from the Social Security Administration at www.socialsecurity.gov or by calling **800-772-1213**.



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