The Social Security Earnings Test: Where it Applies and How it Works

There are many aspects of Social Security that are misunderstood, but few are misunderstood more widely than the Earnings Test. This article will attempt to make the Earnings Test more understandable

I like to tell the story of a retired individual we'll call "Don" who took on a part-time job driving executives to and from the airport. Don loved the job, but at some point in September, he would simply disappear until the beginning of January. The second time I noticed this I asked the question: "I haven't seen Don in quite a while. Does he still drive for the Company?" The answer sounded familiar: "Oh, he had to stop working for the rest of the year ***so he wouldn't earn too much***."

Don, like many of his contemporaries, knew that something "bad" would happen if his earnings exceeded a certain limit but, like many of the people with whom I speak about this subject, I suspect he wasn't quite sure how "bad" it would be. What I *think* he believed was that he would be essentially working for free if he exceeded that limit.

TO WHOM DOES THE EARNINGS TEST APPLY?

The Earnings Test applies to two categories of people:

1. A person receiving benefits based upon his or her own Earnings Record (the "Number Holder" or "NH" in Social Security-speak); I will refer to that person as the **Worker**.
2. Any other person who is eligible to receive a benefit based on the record of that Worker (an "Auxiliary Beneficiary" in Social Security-speak); I will refer to that person as the **Beneficiary**. A Beneficiary may be subject to the Earnings Test based on (a) the Worker's excess earnings and/or (b) the Beneficiary's excess earnings.

The Earnings Test applies to Workers who have <u>not</u> reached Full Retirement Age (FRA), as well as to Beneficiaries who have not reached FRA and who claim benefits on the Worker's earnings record. For those born between 1/2/1943 and 1/1/1955, FRA is age 66. See FRA chart at http://www.socialsecurity.gov/retire2/retirechart.htm. A special chart is used specifically to determine the FRA of the Beneficiaries of Social Security **survivor benefits**.
http://www.socialsecurity.gov/survivorplan/survivorchartred.htm

Examples:

1. Don is about to turn 62 years old and works part-time as a driver for the Company. His birthday falls on January 1. Don is planning to file for retirement benefits on his own record in December, so that he can begin receiving benefits in January, the month in which he turned 62. If Don's earnings for the current year exceed the earnings limit

(sometimes called the “**Exempt Amount**”), the Earnings Test will affect his benefits, because he has not reached FRA.

2. Same facts, except that Don’s wife Mary, who is 63, plans to file for spousal benefits on Don’s record as soon as Don files. **If Don’s earnings exceed the Exempt Amount by a sufficient amount, those excess earnings may affect both Don’s and Mary’s benefits**. Here, Mary is considered a Beneficiary, since she is eligible for spousal benefits on Don’s record. **Mary’s benefits may be subject to the Earnings Test based on both Don’s and her own excess earnings.**

3. Same couple, although Don is earning less than the Exempt Amount and Mary is earning more than the Exempt Amount. **Mary’s benefits, but not Don’s, will be subject to the Earnings Test as a result of Mary’s excess earnings.**

4. Same facts as #2, except that **Mary is 66**. If Don’s earnings exceed the Exempt Amount by a sufficient amount, Don’s excess earnings may affect both Don’s and Mary’s benefits. However, **the Earnings Test does not apply to Mary’s earnings, because she has reached Full Retirement Age**.

5. Same facts as #3, except Mary is 66. **The Earnings Test does not apply** to either spouse. It doesn’t apply to Don, because he is earning less than the Exempt Amount; it **does not apply to Mary, because she has reached Full Retirement Age**.

6. Don has passed away and Mary, who is 63, applies for **survivor benefits**. If Mary’s earnings exceed the Exempt Amount, the Earnings Test will affect her benefits.

WHAT IS THE EXEMPT AMOUNT?

- In 2014, the Exempt Amount is **$15,480** for the full year. However, if you file a claim for Social Security benefits other than at the very beginning of the year, that amount is pro-rated at $1,290 per monthly. For the calendar year in which you reach Full Retirement Age, the Exempt Amount is **$41,400**. This may be of little value if your birthday falls in February, for example, but it can make a significant difference for those whose birthday occur later in the year.

WHAT HAPPENS WHEN YOU EARN MORE THAN THE EXEMPT AMOUNT?

Again, keep in mind that the Earnings Test applies only if the relevant Worker or Beneficiary has **not yet reached Full Retirement Age**. That means that if you have earnings subject to Social Security tax that exceed $15,480 (in 2014), your benefits will be reduced by $1 for every $2 earned over the limit.[1]

[1] If, during the calendar year in which you reach Full Retirement Age, you earn more than $41,400 (in 2014), $1 is withheld for every **$3** of earnings over the Exempt Amount.

During this time, if a family member (e.g., spouse or dependent child) is receiving benefits on your record, their benefits may be reduced as well.

This is how it works: SSA asks you each year how much you expect to earn in the coming year. [In the year of your initial application, the Earnings Test operates on a monthly basis.] Then the Exempt Amount ($15,480) is subtracted from your anticipated earnings and divided by 2. The result of these calculations is called "**excess earnings**." Now you might think that it would make sense for SSA to withhold a proportional amount of the excess from each monthly benefit payment. If they did that, you would simply get smaller benefit payments each month for the entire year. But that, it seems, would be too easy.

In fact, SSA divides the excess earnings by the monthly benefit you are receiving, and rounds up the quotient to the next whole number. That will be the number of months, beginning in January, in which you will get <u>no</u> benefits. During the balance of the year you will get full benefits. Any extra amounts withheld will be paid to you early in the following year.

Now let's go back to our friend Don the driver in example #1. Let's say that Don's monthly benefit is **$1,500**, and if he were to work part-time for the entire year he would expect to earn **$35,480**. SSA would calculate $35,480 - $15,480 = $20,000; then $20,000 ÷ 2 = **$10,000**. This amount is the **excess earnings**, which is now divided by Don's $1,500 monthly benefit, with the quotient rounded up to 7 months. That means that Don will receive NO benefits from January through July; beginning in August, he will receive full benefits for the balance of the year.

[Notice that SSA withheld 7 months' worth of benefits, or **$10,500**, even though Don's excess earnings were only $10,000. SSA will true that up by sending him the extra $500 early the following year. But for our example, we'll simply assume that $10,500 has been withheld for seven months each year for four years.]

SSA stresses that these benefits are merely being "withheld" rather than "lost," and it's true that Don will likely recoup some or all of that money. When he reaches age 66, SSA will calculate how many months of benefits have been withheld and then they will adjust his benefit based on age. In other words, if by the time Don reaches age 66 he has had 28 months of benefits withheld, SSA will recalculate his benefits at age 66 by adding the 28 months to his original claiming age of 62. **Going forward he will receive an increased benefit, as if he had originally claimed at 64-4** (64 years and 4 months) instead of 62**.** In this case, his monthly benefits beginning at age 66 might be about **$1,778** instead of $1,500.

How does this work out for Don? He had a total of **$42,000** of benefits withheld between ages 62 and 66; he will start to recoup those withheld amounts at the rate of **$3,336 per year** ($278 per month). It will take **12.5 years** for him to get all of it back (age 78-6), and if Don lives to age

85, for example, he will have received nearly **$21,700** more in benefits than if he had quit working in September of every year. Moreover, by continuing to work he would actually earn a total of about **$80,000** more during that four year period than he would by staying within the earnings limit.

In addition, if Mary outlives him and takes a **survivor benefit** after his death, she will receive **$1,778** per month for the rest of her life, as opposed to the $1,500 she would have gotten if he had stayed within the earnings limit.

Of course, if Don dies before he has recouped the amounts withheld and Mary's own benefit is greater than the survivor benefit, or if she dies early as well, some of those withheld benefits will actually be lost.

Now let's go back to example #4 where Mary, assumed to be exactly 4 years older than Don, files for spousal benefits on Don's record. Let's assume that Mary's monthly spousal benefits are **$1,000**. Again, Don's excess earnings are $10,000, but the total benefits that are being received by the couple equal **$2,500** ($1,500 for Don and $1,000 for Mary). $10,000 ÷ $2,500 = 4. This means that **neither Don nor Mary will receive any benefits between January and April**, after which time they will both receive full benefits for the balance of the year. If the total number of months withheld is 16 by the time Don reaches 66, then the total amount withheld will have been **$24,000** (Don) + **$16,000** (Mary) = **$40,000**.

Don will have 16 months added to his original claiming age, so that his benefits beginning at 66 will be determined as if he had claimed at 63-4. In this case, his recalculated benefit might be around **$1,644**. That means that he will begin recouping the $24,000 of withheld benefits at the rate of **$144 per month ($1,728 per year)**, and it will be nearly 14 years before he has recovered all of it. However, **Mary's "withheld" benefits are simply lost**, as there is no recalculation of benefits available to her.[2]

Withheld benefits can also be lost if you switch to a different type of benefits. For example, let's assume that Mary predeceases Don at her age 75, and at the time of her death her own benefit was $2,200. At age 72, Don will switch to a survivor benefit of $2,200, which means that he can no longer recover the remaining benefits that had been withheld.

TO WHAT KINDS OF BENEFITS DOES THE EARNINGS TEST APPLY?

The simple answer is: to **all of them**:

- Retirement benefits on your own record
- Retirement benefits on your spouse's record

[2] If Mary had been **under** FRA and had benefits withheld based on either Don's or her own excess earnings, she would begin recovering withheld benefits as soon as she reached FRA. Earnings withheld based on Don's excess earnings after Mary reaches FRA are not recoverable.

- Child's benefits
- Child-in-care benefits
- Disability benefits
- Survivor benefits
- Divorced spouse retirement or survivor benefits

The only difference with divorced spouse benefits is that only the earnings of the Beneficiary are taken into account – not the earnings of the ex-spouse who is the Worker.

CONCLUSION

The Earnings Test presents more complexity than generally meets the eye. As a trusted advisor, consider encouraging careful thought – backed by reliable calculations – on the part of your clients before they or their family members make decisions in relation to claiming Social Security benefits while still working.