



Understanding the Social Security System

The Social Security System has been a large and visible part of the American financial system since the 1930s. When President Franklin Roosevelt signed the law, it was designed to be a financial security net for older Americans. The system was set up with workers paying into it and beneficiaries getting retirement and other benefits. Since then, the demographic base of the country has changed, the system has grown and become a visible and controversial topic. With the current government surplus, maintaining the financial integrity of the system has become an important political issue.

In 2006, it is estimated that the system paid out over \$539 billion to over 49 million people. One half of those payments were to retired individuals with the rest going to disabled individuals, to cover medical costs and to the families of retired, disabled or deceased Americans.

Current issues

The controversy over the financial soundness of the system comes from the aging American population. Since the system is a pay-as-you-go system, the contributions of current workers are used to pay current benefits to those already retired and to accumulate for the benefit of those working. The difficulty comes from the reduction in the number of contributors for each person receiving benefits. Currently, there are only 3.3 contributors for each recipient and there will be only 2.1 contributing for each recipient in 2030.

Ultimately, to fund the retirements for today's workers, either contributions must increase, benefits must decrease, the earnings on accumulations must increase or additional money must come into the system. The big debate raging currently is whether and how the current surplus being generated by income taxes should be used for this purpose. There are also proposals that would enable individuals to have more control over how portions of their funds would be invested.

Here is some information that will help you understand how the system works.

Average monthly benefits for 2010.

- Retired workers \$1,153
- Retired couples \$1,876
- Young widow with two eligible children \$2,399
- Aged widow with no children \$1,112

Benefit levels are adjusted annually for the cost of living. The adjustment for 2009 was 5.8%

Contribution rates

The system receives income from employees as well as employers. Over the years the tax rate has increased as well as the earnings base subject to the tax. Currently, the rates for 2010 are:

For workers	Social Security tax of 6.20% on the first \$106,800 of wages. Medicare tax of 1.45% on all wages.
For employers	Social Security tax of 6.20% on the first \$106,800 of wages. Medicare tax of 1.45% on all wages.
For the self employed	Social Security tax of 12.40% on the first \$106,800 of wages. Medicare tax of 2.90% on all wages.

Here is a chart showing what you, as an employee would pay at different levels of wages.

Wage level	Social Security (6.20%)	Medicare (1.45%)	Total
\$25,000	\$1,550	\$362	\$1,912
\$40,000	\$2,480	\$580	\$3,060
\$80,000	\$4,960	\$1,160	\$6,120
\$110,000	\$6,622*	\$1,450	\$8,217
*Only income up to \$106,800 is subject to Social Security taxes while all income is subject to the Medicare tax.			

Here is another chart showing what a self-employed individual would pay.

Wage level	Social Security (12.40%)	Medicare (2.90%)	Total
\$25,000	\$3,100	\$724	\$3,824
\$40,000	\$4,960	\$1,160	\$6,120
\$80,000	\$9,920	\$2,320	\$12,240
\$110,000	\$13,243*	\$3,190	\$16,433
*Only income up to \$106,800 is subject to Social Security taxes while all income is subject to the Medicare tax.			

Taxation of Benefits

Since the middle 1980s, some portion of Social Security benefits has been subject to income tax. This taxation is based on the overall level of income the individual has. The rules are somewhat complex, but generally speaking, if you are married and file a joint federal income tax return and your adjusted gross income is above \$32,000, one half of your retirement benefits are subject to tax. As your income rises, increasing portions of your benefits are taxed. The portion subject to tax increases to 85% if a married couple filing a joint tax return has income above \$44,000. Consult your tax advisor to learn how this may apply to you.

How should you look at Social Security?

First, you must recognize that Social Security retirement benefits will probably not be large enough to fund all of your retirement expenses.

Second, you should make sure your Social Security records are accurate. The government has started a program of providing everyone with an annual statement that shows your income and contribution history and provides an estimate of retirement benefits. This report is called a Personal Earnings and Benefits Estimate Statement. You can also request this report by getting a form from a Social Security office.

Finally, you should make sure that as you review your financial plans for retirement, you are realistic in estimating how much of your needed income Social Security will provide.