GFG Monthly

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Is It Time to Declare Your Financial Independence?

No matter how much money you have or which life stage you're in, becoming financially independent starts with a dream. Your dream might be to finally pay off the mountain of debt you've accumulated, or to stop relying on someone else for financial support. Or perhaps your dream is to retire early so you can spend more time with your family, travel the world, or open your own business. Financial independence, however you define it, is freedom from the financial obstacles that are keeping you from living life on your own terms.

Envision the future

If you were to become financially independent, what would change? Would you spend your time differently? Live in another place? What would you own? Would you work part-time? Ultimately, you want to define how you choose to live your life. It's your dream, so there's no wrong answer.

Work at it

Unless you're already wealthy, you may have had moments when winning the lottery seemed like the only way to become financially secure. But your path to financial independence isn't likely to start at your local convenience store's lottery counter.

Though there are many ways to become financially independent, most of them require hard work. And retaining wealth isn't necessarily easy, because wealth may not last if spending isn't kept in check. As income rises, lifestyle inflation is a real concern. Becoming — and remaining — financially independent requires diligently balancing earning, spending, and saving.

Earn more, spend wisely, and save aggressively

Earn more. The bigger the gap between your income and expenses, the quicker it will be to become financially independent, no matter what your goal is. The more you can earn, the more you can potentially save. This might mean finding a job with a higher salary, working an extra job, or working part-time in retirement. And a job is just one source of income. If you're resourceful and able to put in extra hours, you may also be able to generate regular income in other ways — for example, renting out a garage apartment or starting a side business.

Spend wisely. Look for opportunities to reduce your spending without affecting your quality of life. For the biggest impact, focus on reducing your largest expenses — for example, housing, food, and transportation. Practicing mindful spending can also help you free up more money to save. Before you buy something nonessential, think about how important it is to you and what value it brings to your life so that you don't end up with a garage or attic filled with regrettable purchases.

Save aggressively. Set a wealth accumulation goal and then prioritize saving. Of course, if you have a substantial amount of debt, saving may be somewhat curtailed until that debt is paid off. Take simple steps such as choosing investments that match your goals and time frame, and paying yourself first by automatically investing as much as possible in a retirement savings plan. Time is an important ally in the quest for financial independence, so start saving as early as possible and build your nest egg over time. (Note that all investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.)

Keep going

Make adjustments. Life changes. Unexpected bills come up. Some years will be tougher financially than others. Expect to make some adjustments to your plan along the way, especially if you have a long-term time frame, but keep going.

Track your progress. Celebrate both small milestones and big victories. Seeing the progress you're making will help you stay motivated as you pursue your dream of financial independence.

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Social Security in Four Parts

Part 3: Benefit Categories

The Social Security Act of 1935 and its amendments created four categories of benefits, each based on the earnings records of a covered worker, and each designed to provide a basic level of economic security. In the third segment of our four-part series, we'll focus on retirement benefits that are linked to the earnings of an individual worker. Benefits for disabled workers and the dependents and survivors of a covered worker constitute the remaining categories. These benefits, along with those for unemployed workers, are products of the original Act and serve as important pillars of economic security for millions of Americans.

Retired Worker Benefits

Retirement benefits are paid to eligible workers that have accrued a minimum of 40 quarters or credits based on employment that was subject to Federal Insurance Contributions Act (FICA) taxes. This tax of 12.4%, is split evenly between the employee and their employer and is assessed on wages up to the prevailing wage limit ($132,900 in 2019). Those eligible for benefits receive their full benefits, known as their primary insurance amount (PIA) upon attaining full retirement age, but may collect benefits as early as age 62, subject to a reduction. They may also opt to increase their benefits by delaying them beyond full retirement age to as late as age 70. When to collect retirement benefits is among the most important decisions facing many retirees, with important considerations attached to an early or delayed filing.

Consideration for early filers

Those filing prior to attaining their full retirement age will see a reduction in their benefits equal to 5/9 of 1% per month for claims filed within 36 months of their full retirement age, and 5/12 of 1% per month for each additional month. Thus, a person that files for benefits 3 years prior to their FRA would see their benefits permanently reduced by 20%. An additional year increases the total by 5%. Moreover, benefits collected prior to full retirement age are subject to the Social Security earnings test. The earnings test reduces benefits paid if the recipient's earned income exceeds the prevailing earnings limit. For those collecting benefits, and who will not reach their full retirement age at any point in 2019, the earnings limit is $17,640. Beneficiaries with earned income exceeding this threshold will see a reduction in their benefits equal to $1 of benefits for every $2 of earned income in excess of the limit. The reduction applies only to income derived from wages and specifically excludes pensions, annuities, and portfolio income such as dividends and interest. The earnings limit is more generous in the calendar year when full retirement age is attained, with $1 in benefits withheld for every $3 in earnings in excess of $46,920 (2019 limit).

The earnings test ends once a beneficiary reaches their full retirement age, and those impacted by the earnings test will have their benefits recalculated to remove the early-filing reduction that was applied for any payment not received as a result of the earnings test. The payments lost directly as a result of the test, however, are not repaid. Those that have filed for early benefits and return to the workforce may be eligible to withdraw their Social Security application, so long as they have received less than 12 payments and can afford to repay the benefits that they've received. Although potentially burdensome, repaying benefits is often preferable to losing them as a result of the earnings test.

Patience is a virtue

Full and unreduced retirement benefits equal to a worker's primary insurance amount (PIA) can be claimed when a worker attains their full retirement age; however, those seeking to increase their benefits may voluntarily delay them until as late as age 70 and earn delayed retirement credits as compensation. Included in 1972 as an amendment to the original Act, delayed credits apply to retirement benefits earned on the individual's own record and, for those born in 1943 or later, equal 2/3 of 1% for each month that benefits are delayed. This permanently increased benefit amount also serves as the base for future cost of living increases and surviving spouse benefits. Delayed credits are not available for benefits that are based on another person's earnings, such as those paid to a spouse, or qualifying ex-spouse. It's worth reiterating that in the case of surviving spouse or qualified ex-spouse benefits, while the survivorship benefits do not qualify for delayed retirement credits, any delayed credits earned by the worker may be passed on by way of a higher benefit amount. For this reason, married couples with a large disparity in their primary insurance amounts (PIA) are often advised to maximize the retirement benefits of the higher earning spouse by delaying their receipt.

Spouse Benefits

The original Social Security Act provided retirement benefits but restricted these benefits to covered workers. A 1939 Amendment to the Act added two new categories of benefits: payments to a spouse and minor children of a worker (referred to as dependent benefits), and survivor benefits paid to the family of the worker in the event of their premature death.

Social Security: Benefit Categories Continued

The Spouse retirement benefits are paid to current spouse aged 62 or older that has been legally married to the worker for at least one continuous year prior to the date of the benefits application. Benefits may also be paid to a former spouse(s) of the worker if their marriage lasted 10 years or more, and if they have been divorced from the worker for at least 2 years and did not remarry prior to attaining age 60. Divorced spouse benefits can be paid to more than one former spouse and have no effect on the benefit amount paid to the worker's current spouse.

The amount of the spousal benefit is determined by the amount of their own retirement benefit (if any), their current or former spouse's benefit and the age at which they collect. Benefits may be commenced as early as age 62 at a reduction of 25/32 of 1% for each month prior to their full retirement age, not exceeding 36 months, and 5/12 of 1% for each additional month. Applicants are paid their own benefits first. If the spouse or divorced spouse benefit is higher than their own retirement benefit, they are paid a combination of benefits equal to the higher spouse benefit. In cases where the applicant has not accrued retirement benefits based on their own work, they are generally entitled to 50% of their spouse or former spouse's full-retirement-age benefit. This amount is paid when they attain their full retirement age and is not eligible for delayed retirement credits. The flipside, however, is that spouse benefits are not reduced in cases where the worker filed for benefits prior to full retirement age.

There are several important considerations when evaluating spouse benefits, and some inconsistencies in the treatment of current and former spouses that favor the latter. First, those filing for benefits prior to full retirement age are subject not only to a reduction in benefits via the Social Security earning test but also to the deemed filing rule that applies to both retirement and spouse benefits. The deemed filing rule mandates that when filing for benefits you are in effect applying for any and all retired worker or spouse benefits to which you are entitled. In practical terms, the rule precludes those born on or after January 2nd, 1954 from filing for one type of benefit while delaying the collection of the other. The Bipartisan Budget Act of 2015 extended the deemed filing rule to include all benefit claims, including those made after full retirement age, but carved out an important exemption for those born on or before January 1st, 1954. The Act exempts them from the deemed filing rule if they collect benefits after attaining full retirement age. This allows for the "ordering of benefits", which typically means the collection of a spouse benefit while deferring their own retired worker benefit. A second rule included in the Act further complicates matters by mandating that a worker file for their retirement benefit before their current spouse is eligible to file a claim for a spousal benefit based on their earnings record. This rule, however, was not extended to a divorced spouse(s) filing a similar claim.

Thus, qualifying divorcees may file for spouse benefits based on the earnings of their former spouse, so long as that individual is age 62 or older and eligible for retirement benefits, even if they have yet to file for their own benefits. This inconsistency presents a potential planning opportunity for millions of Americans.

Survivor Benefits

Included in the 1939 amendments to the original Act, benefits paid to the surviving widow and dependent children of a deceased worker greatly enhanced protection to vulnerable populations (similar coverage for widowed men, however, would have to wait for future legislation). Survivor benefits can be paid to a surviving spouse or qualified ex-spouse, to unmarried children under age 18 (19 if enrolled in school), or indefinitely if they were disabled prior to age 22, as well as to qualifying dependent parents. The aggregate benefit is generally limited to between 150% and 180% of a deceased worker's benefit and is known as a maximum family benefit. Although not the focus of this article, child and dependent benefits serve as a financial lynchpin for many families.

Surviving spouse retirement benefits are paid to the deceased worker's current spouse if they were married for at least 9 months and the decedent was qualified to receive retirement benefits under their own earnings record. Benefits may also be paid to the former spouse(s) of the worker if their marriage lasted at least 10 years and they did not remarry prior to age 60. A surviving disabled spouse or ex-spouses whose disability started prior to or within seven years of the deceased worker's death must wait until age 50 to remarry in order to avoid losing the survivor benefit.

The amount of the survivor benefits is predicated on a few important factors:

- The deceased spouse's primary insurance amount.
- Whether the decedent had earned delayed retirement credits.
- Whether the decedent was collecting their retirement benefits at the time of their death.
- Whether the surviving spouse has attained their full retirement age.
- Whether the surviving spouse has filed for their own retirement benefits.

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Social Security: Benefit Categories Continued

The Survivorship benefits may be collected as early as age 60 at a reduction (age 50 for those qualifying as disabled). The benefit reduction formula reduces the surviving spouse benefit to approximately 71.5% of the basic amount if commenced at age 60, with the same reduction applied to disabled beneficiaries that commence benefits at age 50 through 59. The closer the beneficiary is to their full retirement age the smaller the reduction, with a 62-year-old receiving about 81% of the basic amount. And unlike retirement and spouse benefits, Social Security survivor benefits are NOT subject to the deemed filing rule. Beneficiaries may be eligible to file a restricted application and receive only the survivor or retirement benefit while delaying receipt of the other. This ability to order benefits, however, depends on whether the decedent and/or the surviving spouse filed for retirement benefits.

As survivor benefits are exempted from the deemed filing rule, they provide a wide array of potential planning opportunities. Outlined below are three common planning scenarios that apply specifically to survivor benefits and the possible outcomes associated with each.

Scenario 1: the surviving spouse has not attained their full retirement age and has not filed for reduced retirement benefits.

In this case, the surviving spouse has a few options and should carefully review the amount available to them as a survivor benefit. The survivor essentially steps into the deceased spouse's benefit, which may have been reduced due to early filing or increased as a result of any delayed retirement credits earned. There are three potential options available under this scenario, and the best result will be predicated on the respective benefit amounts and whether the surviving spouse has earned retirement benefits under their own earnings record.

1. File for survivor benefits at or before full retirement age and delay filing for retired-worker benefits to earn delayed retirement credits.

2. File for reduced retired-worker benefits and switch to survivor benefits at full retirement age.

3. File for surviving spouse benefits at full retirement age. This is the default if the survivor has not earned retired-worker benefits of their own earnings record.

Scenario 2: the surviving spouse has not attained full retirement age and has filed for reduced retirement benefits.

This time around the surviving spouse is already collecting their retired-worker benefits and is left with two choices.

1. Continue their own reduced retirement benefit until they attain full retirement age and switch to the survivor benefit. At full retirement age, they receive the higher of the two benefits.

2. If eligible, and if their retired-worker benefit is larger, or would be larger as a result of deferring its receipt, the survivor may wish to withdraw their application, repay the benefits received, and file a claim for survivor benefits. They would allow their retired-worker benefits to increase until age 70, at which point they would switch from the survivor benefit to their own retirement benefit.

Scenario 3: the surviving spouse has attained full retirement age and either has or has not filed for retirement benefits.

In this final case, the surviving spouse should consider whether their retired-worker benefit, if applicable, would be larger than the survivor benefit as a result of delayed retirement credits. If they have not filed for benefits, the first two options are available. The last option is the default for those already collecting their retirement benefit.

1. File for survivor benefits and switch to the larger retired worker benefit at age 70.

2. File for survivor benefits, if the surviving spouse does not qualify for a retired worker benefit, or if their age 70 benefit amount (including delayed retirement credits) is smaller than the survivor benefit.

3. If the surviving spouse has already filed for their retirement benefits, they will receive the higher of the two benefits.

Although the Bipartisan Budget Act of 2015 eliminated the so-called "file and suspend" strategy and extended the deemed filing rule to benefits claimed after full retirement age, numerous Social Security filing strategies remain available. In our next article, we'll discuss specific strategies to help maximize retirement and ancillary benefits, including spouse and survivor benefits. Identifying the right one can have an enormous effect on your standard of living in retirement.

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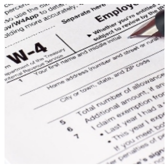

Have you checked your tax withholding lately?

If you were unpleasantly surprised by the amount of tax you owed or the amount of your tax refund when you filed your 2018 tax return, it may be time to check your withholding.

It may also be time if there are changes in your life or financial situation that affect your tax liability. For example, have you recently married, divorced, had a child, purchased a new home, changed jobs, or had a change in the amount of your taxable income not subject to withholding (e.g., capital gains)?

You can generally change the amount of federal tax you have withheld from your paycheck by giving a new Form W-4 to your employer. You can use a number of worksheets for the Form W-4 or the IRS Withholding Calculator (available at *irs.gov*) to help you plan your tax withholding strategy.

If changes reduce the number of allowances you are permitted to claim or your marital status changes from married to single, you must give your employer a new Form W-4 within 10 days. You can generally submit a new Form W-4 whenever you wish to change your withholding allowances for any other reason.

In general, you can claim various withholding allowances on the Form W-4 based on your tax filing status and the tax credits, itemized deductions (or any additional standard deduction for age or blindness), and adjustments to income that you expect to claim. You might increase the tax withheld or claim fewer allowances if you have a large amount of nonwage income. (If you have a significant amount of nonwage income, you might also consider making estimated tax payments using IRS Form 1040-ES.) The amount withheld can also be adjusted to reflect that you have more than one job at a time and whether you and your spouse both work. You might reduce the amount of tax withheld by increasing the amount of allowances you claim (to the extent permissible) on the Form W-4.

You can claim exemption from withholding for the current year if: (1) for the prior year, you were entitled to a refund of all federal income tax withheld because you had no tax liability; and (2) for the current year, you expect a refund of all federal income tax withheld because you expect to have no tax liability.

Do I need to pay estimated tax?

Taxpayers are required to pay most of their tax obligation during the year by having tax withheld from their paychecks or pension payments, or by making estimated tax payments. Estimated tax is the primary method used to pay tax on income that isn't subject to withholding. This typically includes income from self-employment, interest, dividends, and gain from the sale of assets. Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes reported on your income tax return.

Generally, you must pay federal estimated tax for the current year if: (1) you expect to owe at least $1,000 in tax for the current year, and (2) you expect your tax withholding and refundable tax credits to be less than the smaller of (a) 90% of the tax on your tax return for the current year, or (b) 100% of the tax on your tax return for the previous year (your tax return for the previous year must cover 12 months).

There are special rules for farmers, fishermen, and certain high-income taxpayers. If at least two-thirds of your gross income is from farming or fishing, you can substitute 66-2/3% for 90% in general rule (2)(a) above. If your adjusted gross income for the previous year was more than $150,000 ($75,000 if you were married and filed a separate return for that year), you must substitute 110% for 100% in general rule (2)(b) above.

If all of your income is subject to withholding, you probably don't need to pay estimated tax. If you have taxes withheld by an employer, you may be able to avoid having to make estimated tax payments, even on your nonwage income, by increasing the amount withheld from your paycheck.

You can use Form 1040-ES and its worksheets to figure your estimated tax. They can help you determine the amount you should pay for the year through withholding and estimated tax payments to avoid paying a penalty. The year is divided into four payment periods. After you have determined your total estimated tax for the year, you then determine how much you should pay by the due date of each payment period to avoid a penalty for that period. If you don't pay enough during any payment period, you may owe a penalty even if you are due a refund when you file your tax return.

Withholding and estimated tax payments may also be required for state and local taxes.