IN THIS ISSUE

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ASSET MANAGEMENT GROUP

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Don't leave any Social Security benefits on the table

Recently an acquaintance of ours applied for his Social Security benefits online. He's 68 and widowed, still working but far from his peak earning years. How was the experience, we wondered?

"Well, it was somewhat more involved than I expected, yet I suspect much easier than trying to get an in-person appointment at the Social Security office, which may involve delays. First off, you need to set up your *my* Social Security account (those are the colored typefaces you'll find on their website, socialsecurity.gov). I'm embarrassed to admit that at first, I could not remember my own Social Security number! I mean, the last four digits, sure, that comes up all the time, but what are the first three? I skipped over that for a time, and after a few minutes it came to me.

"Anyway, the first part of the application was easy enough, but then there is a section for confirming your identity, with questions generated from publicly available credit reports. This is information that could not be gleaned, for example, from a stolen wallet. I was taken aback by the questions—what credit card had I owned since 1984? Which of these streets had I lived on? I first thought none of them, then recognized the street of the apartment I had in grad school in the late 70s! I did not know the government has so extensive a dossier on me!

"One question concerned an estimate of my car payment, which I did not know. I called the company, was left on hold for 45 minutes, and finally had my answer. When I went back to the form to finish it, the application had timed out, so I had to start over! *At least now I knew how to answer*, I thought to myself. Then when I got to that page again, all the questions were different!

"All's well that ends well, I hope. I did get an automated confirmation of my application and a promise that I could track its progress online."

What made you apply for the benefits at age 68, as opposed to 66 (his full retirement age) or 70 (for maximum benefits)?

"I don't have an urgent need for the money, and because my wife died some years ago I don't travel much. So when I turned 66 I thought I'd take advantage of the 8% benefit boost I get for every year that I wait. The problem with that idea is that I started Medicare when I turned 65, as most people do to avoid penalties for joining late. You have to pay the Medicare

premiums every month yourself, instead of having them deducted from your Social Security benefits. That's a minor hassle, but it bugged me.

"When I was looking at *my* Social Security account, I was able to see my estimated monthly benefit and an estimate of what I would receive should I wait to age 70 to start. The difference did not seem that large to me. I did some rough math in my head and concluded that I would have to live to age 78 or later to break even from giving up benefits today for the larger future benefits from waiting. My health is fine, my parents are alive and over 90, so actuarially speaking I'm a good candidate for delay. But on the other hand, my home is 35 years old and seems to need more maintenance every year. Property taxes are going up and have been hard to budget for. The added cash flow will just make everything easier, so I did it."

Read your Statement

Each year—usually about three months before your birthday—you receive a Social Security Statement that provides a record of your earnings, estimates of your Social Security benefits for early retirement, full retirement, and retirement at age 70. It also provides an estimate of the disability benefits that you could receive if you become severely disabled before you're eligible for full retirement, as well as estimates of the amount of benefits paid to your spouse and other eligible family members as a result of your retirement, disability, or death. For more information, visit www.ssa.gov.

What is your full retirement age?

For those born in 1954, who are turning 66 in 2020, the full retirement age is 66, so they may begin drawing full benefits. Two months are added to normal retirement age each year, starting for those born in 1955. Those born in 1960 and later years have a full retirement age of 67.

Receiving benefits early

You can begin receiving Social Security benefits as early as age 62. If you do begin receiving benefits early, they will be reduced permanently, based upon the number of months that you receive checks before you reach full retirement age. For example, if your full retirement age is 66, and you retire at age 62, there is about a 25% reduction in your benefits.

In an actuarial sense, early retirement gives people about the same total Social Security benefits over their lifetimes as retirement at the normal age, but in smaller amounts so as to take into account the longer period during which you will receive them. In a personal sense, it all depends upon how long you live.

Starting benefits after normal retirement age

Social Security benefits are increased by a certain percentage if you choose to delay receiving them. These increases will be added in automatically from the time that you reach your full retirement age until you start taking your benefits, or until you reach age 70. The percentage varies depending on your year of birth, but is 8% per year for those born after 1943.

Working while collecting benefits

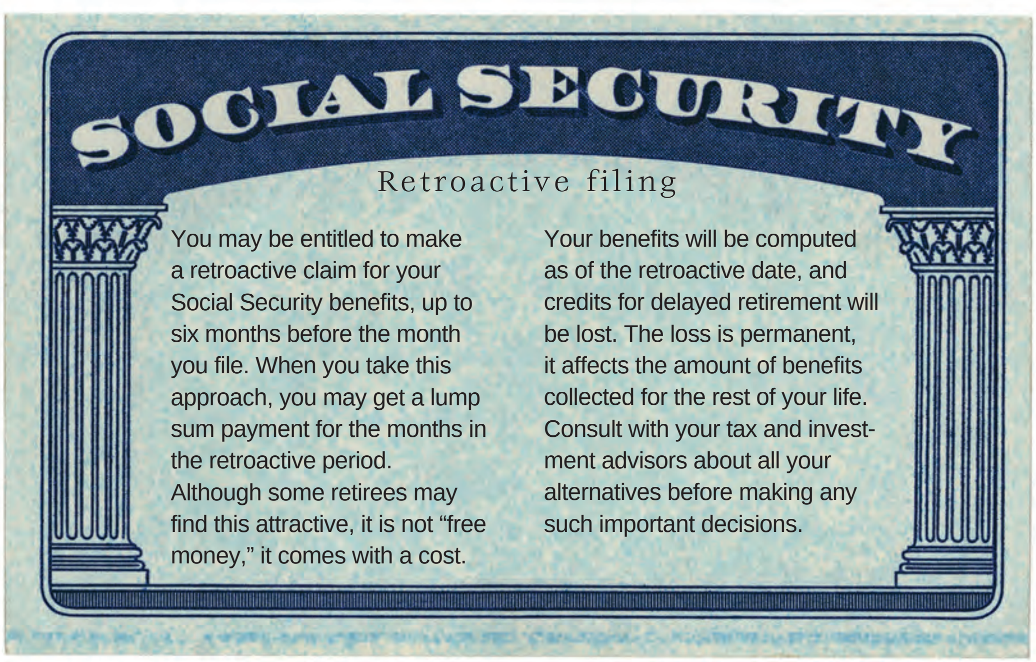
You may continue to work and still receive retirement benefits. Your earnings in or after the month that you reach your full retirement age will not affect your Social Security benefits. However, your benefits will be reduced if your earnings exceed certain limits for the months in the calendar year before you reach normal retirement age.

Note that "earnings" is not the same as "income;" it is limited to wages and remuneration received for services. It's a test of whether you are really retired. If you have $100,000 of investment income from dividends and interest ("unearned income"), that will not reduce your Social Security benefit at all.

Taxation of benefits

Under legislation enacted in 1983, the Social Security Trust Funds receive income based on federal income taxation of benefits. The funds receive taxes on up to 50% of benefits from single taxpayers with incomes over $25,000 and from taxpayers filing jointly with incomes over $32,000. "Income" in this context includes tax-exempt municipal bond income, but does not include Roth IRA distributions.

Legislation enacted in 1993 extended taxation of benefits. The legislation increased the limitation on the amount of benefits subject to taxation from 50% to 85% for single taxpayers with incomes over $34,000 and for taxpayers filing jointly with incomes over $44,000. All additional



Retroactive filing

You may be entitled to make a retroactive claim for your Social Security benefits, up to six months before the month you file. When you take this approach, you may get a lump sum payment for the months in the retroactive period.

Although some retirees may find this attractive, it is not "free money," it comes with a cost.

Your benefits will be computed as of the retroactive date, and credits for delayed retirement will be lost. The loss is permanent, it affects the amount of benefits collected for the rest of your life. Consult with your tax and investment advisors about all your alternatives before making any such important decisions.

tax income resulting from the 1993 legislation is deposited in Medicare's Hospital Insurance Trust Fund.

Planning for couples

When a husband and wife each have earnings records, the choices are more complicated and more important to understand. Each partner has a basic benefit plus a spousal benefit, but may only collect the larger benefit. They don't have to claim at the same time. For example, one spouse might begin benefits early, while the other waits until age 66 or later to begin.

How we can help you

We've worked with a broad spectrum of business owners, executives, and professionals to solve the problems—and maximize the opportunities—associated with stepping onto the retirement road. Our experience is yours to draw on. Whether you're retiring early, retiring late, or regrouping to start a new career, we stand ready to propose realistic strategies, geared to your personal requirements.

To learn more, make an appointment with one of our asset-management specialists. ☐

The persistence of marriage tax penalties

In a complex economy, one must have a complex tax system to achieve the sense that all taxpayers are being treated fairly and that those in similar situations face similar tax burdens. One source of frustration with tax complexity has been the "marriage penalty tax" that emerged after women began entering the workforce in large numbers.

If a single person and a married person have identical incomes, the married person will pay lower federal income tax by filing jointly with the spouse—that's a marriage tax bonus. But if two people are living together and both have incomes, they are likely going to be better off from a tax standpoint by staying single and not getting married. If they marry and file jointly, their incomes will climb to higher tax brackets. Returns of the married filing separately have the highest rates in the individual tax rate table. The rates for singles offer the better deal.

Over the years, Congress has taken steps to reduce the tax penalties on marriage, with some success. However, complete victory remains elusive. Law professor Alan I. Appel and practicing attorney Joshua G. Gamboa recently explored the problem in "The Hidden Marriage Penalty Inside the Tax Cuts and Jobs Act" [*Tax Notes*, August 18, 2020].

Real estate

The deduction for state and local taxes (SALT) was capped by the TCJA legislation at $10,000 per tax return. The authors point out that a married couple filing jointly have that $10,000 cap, and if they file separately the limit is $5,000 each. But two single people who are not married and who own property as tenants in common may each take $10,000 worth of a SALT deduction.

Similarly, mortgage interest payments are deductible only for principal loan amounts of up to $750,000 per tax return. Unmarried singles could potentially take deductions for up to $1.5 million of indebtedness.

Student loans

Flexibility in repayment of student loans may be provided by the Pay As You Earn repayment plan, the Income-Based Repayment plan, or the Income-Contingent Repayment plan. Each of these gears the debt service to the former student's income. However, if the student marries, the spouse's income will also be taken into account and will likely force larger annual payments.

Similarly, up to $2,500 of interest on student loans may be deducted, and this again applies on a per return basis. Two single people who remain unmarried could therefore take $5,000 worth of this deduction.

Retirement

The tax system has long had a marriage penalty on retirees who receive Social Security benefits, and that was not changed by the TCJA.

Single taxpayers with modified AGI between $25,000 and $34,000 are taxed on up to 50% of their Social Security benefits, and those with modified AGI of at least $34,000 are taxed on up to 85% of their Social Security benefits. In comparison, the thresholds for married taxpayers filing jointly are $32,000 and $44,000, respectively, far less than double the thresholds for singles. ☐

Hazards of intrafamily loans

Mary was in the habit of advancing funds to her children as loans, then forgiving a portion of such loans each year in the amount of the gift tax annual exclusion. However, her advancements to her oldest son, Peter, were substantially larger, in order to help him establish his architecture practice. After some initial successes, Peter suffered some financial reverses and was not able to pay the interest on his loans.

In 1995 Mary had a legal document drafted which acknowledged that Peter owed her $771,628, that he would not be able to repay it, and that this amount would be considered an advancement of his inheritance. Peter signed the document.

After Mary died in 2010, that transaction became an estate tax issue. The IRS argued that it was a taxable gift to be taken into consideration when calculating the estate tax on Mary's estate.

The Tax Court agreed with the IRS that a gift occurred, but in looking at the entire record, the Court concluded that the gift really took place five years earlier, in 1990. That was when Peter's financial difficulties became severe enough that Mary must have realized his loans would never be repaid.

Company loan

In another situation, Ron Van Den Heuvel's father founded VHC in 1985 to provide services to the paper manufacturing industry. Ron worked at VHC and founded two of its subsidiaries. Between 1997 and 2013, VHC advanced $111 million to Ron and his companies. The debt grew to $132 million, including interest, and only $39 million would ever be repaid.

As the prospects for the profitability of Ron's ventures began to fade, in 2004 VHC began writing off its payments to Ron as "bad debts," ultimately writing off $95 million by 2013. On audit, the IRS rejected all but $3 million of the deductions.

The Tax Court agreed with the IRS, saying that Ron and VHC lacked a bona fide debtor/creditor relationship, so there were no "debts" to be written off.

In 2004, VHC's banker had insisted that VHC itself join in guaranteeing Ron's debts to the bank. VHC did so. In the Tax Court, VHC argued that to protect its lines of credit its forgiveness of the loans to Ron was essential, an ordinary and necessary business expense. The Tax Court determined that VHC had neither met its burden to substantiate its claimed business expenses nor established that the claimed business expenses, if substantiated, qualified for the deduction.

Intrafamily loans may contain tax traps. The advice of tax counsel is a must before proceeding. ☐