

Social Security Changes for 2021

by Bruce D. Schobel

Every October, the U.S. Social Security Administration (SSA) announces certain changes in program amounts that occur **automatically**—that is, without any new legislation being necessary. The most widely publicized of these changes is the annual cost-of-living adjustment (COLA) affecting monthly Social Security benefits. Other automatic changes are important to people of working age as well as to beneficiaries. On Oct. 13, 2020, the government announced the Social Security COLA effective for December 2020 and the other increases effective for 2021.

BENEFIT INCREASE

Since 1984, Social Security's COLAs have been based on the third-quarter-to-third-quarter increase, if any, in the average Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). The CPI-W, which is computed by the U.S. Labor Department's Bureau of Labor Statistics, rose 1.3 percent (rounded to the nearest 0.1 percent) year-to-year from the third quarter of 2019 through the third quarter of 2020. Accordingly, all monthly Social Security benefits, in current-payment status or not, will rise by the same percentage, effective with benefits for December 2020. The 1.3-percent December 2020 COLA is slightly smaller than the 1.6-percent COLA effective for December 2019.

Usually, all December benefits are paid in the following January; as a rule, monthly Social Security benefits are paid in arrears, after the month is over. For January 2021, however, **some** December benefits will actually be paid in December, which is unusual. Most beneficiaries, whose payments dates are on the second, third or fourth Wednesday of the month, will receive their benefits in January, as they would expect. But mostly older beneficiaries who became entitled before the Wednesday payment-date policy was implemented in 1997, and some beneficiaries who became entitled later, are usually paid on the third of the month. In 2021, Jan. 3 is a Sunday, when banks are closed. In such cases, Social Security benefits are paid on the previous business day, which happens to be Thursday, Dec. 31, 2020. (Jan. 1 is a national holiday, and Jan. 2 is a Saturday.) Another interesting wrinkle, very deep in the nooks and crannies of Social Security's rules, is that benefit payments made on Dec. 31, 2020, will be reported on Form SSA-1099 as 2021 income, not 2020 income, preventing the distortion of reporting 13 benefit payments in one year and 11 in the next.

WAGE-INDEXED PARAMETERS

A long list of updated Social Security program parameters, some of which are rather obscure, is ordinarily announced simultaneously with the COLA each year. Unlike the COLA, changes in these parameters are based on changes in the national average wage, which the Social Security Administration computes from all W-2 forms filed by employers each year. Interestingly, workers who are self-employed, but not **also** employed by someone else, are excluded entirely from the average-wage computation. Workers who are both self-employed and employed during the year have only their earnings from employment included in the calculation of the national average wage, leading to some minor distortion in the resulting value and percentage change. The national average wage rose from \$52,145.80 in 2018 to \$54,099.99 in 2019. That 2019 value, which is used by SSA to calculate the program's wage-indexed parameters for 2021, is the most recent national average wage figure available now. At the time of the October 2020 announcement, 2020 obviously wasn't over, so the 2020 national average wage could not be known then. It will be calculable in 2021, after employers file all 2020 W-2 forms with SSA. That takes several months, including correction of errors. The 2020 national average wage is expected to decline significantly from the 2019 value, due to the coronavirus pandemic.

MAXIMUM TAXABLE AMOUNT AND TAX RATES

One very important change that affects higher-income workers (employees and the self-employed) is the increase in the maximum amount of earnings in the year that is (1) subject to Social Security payroll taxes (FICA and SECA) and (2) creditable for benefit-computation purposes. This program parameter can rise (it cannot fall) in any year following the effective date of a COLA. In a few recent years when no COLA was effective, due to the CPI-W declining, the maximum taxable amount did not rise in the following year. Because a COLA is effective for December 2020, the maximum taxable amount will rise from \$137,700 for 2020 to \$142,800 for 2021, based on the change in the national average wage. The maximum taxable amount is rounded to a multiple of \$300.

Social Security tax rates are not automatically adjusted but are set by law. The FICA tax rate, payable by employees and employers, each, has been 6.2 percent since 1990. The self-employed pay both halves of this tax and get to deduct, for income-tax purposes, the half representing the employer share. Employees cannot deduct Social Security taxes from their taxable incomes, but employers can. The tax treatment of SECA taxes is consistent with that practice.

RETIREMENT EARNINGS TEST

Another wage-indexed Social Security program parameter is the exempt amount under the retirement earnings test for beneficiaries who have not yet reached their normal retirement age, or NRA. (Social Security's NRA was 65 for workers born before 1938 and is rising gradually under present law to 67 for workers born after 1959.) The annual exempt amount for beneficiaries who will not reach their NRA during the current calendar year rises from \$18,240 for 2020 to \$18,960 for 2021. (A special monthly test applies in the first year of benefit entitlement only.) For beneficiaries who reached their NRA in 2020, the exempt amount was \$48,600 for earnings in the months prior to reaching NRA. That exempt amount rises to \$50,520 for 2021. Since January 2000, workers who have reached their Social Security NRA can earn unlimited amounts without causing any reduction in their Social Security benefits, starting with the month in which they reach that age. As always, additional covered earnings are reflected in annual benefit recomputations and can cause monthly benefits to rise (they cannot decline for this reason), effective each January after the previous year is over.

COVERAGE CREDITS

Interestingly, certain wage-indexed program amounts are permitted by law to increase (or even decrease) with or without a COLA occurring. The amount of earnings needed to receive one coverage credit was \$1,410 in 2020 and rises to \$1,470 in 2021. Workers who earn at least \$5,880 in Social Security-covered employment (or self-employment) during 2021 will receive the maximum four coverage credits for the year. Workers need 40 coverage credits to be eligible for retired-worker benefits at age 62 or older. (These coverage credits used to be known as "quarters of coverage"; since 1978, they have been granted based on **annual** earnings, making the old name somewhat inappropriate.)

BENEFIT FORMULAS

The so-called "bend-points" of the formulas used to compute primary insurance amounts (PIAs) and maximum family benefits (MFBs) are also wage-indexed and can increase or decrease with or without a COLA having occurred. The two PIA bend-points for workers first becoming eligible for benefits in 2021 (that is, born in 1959 with respect to retired-worker benefits) are \$996 and \$6,002. The three MFB bend-points for 2021 eligibilities are \$1,272, \$1,837 and \$2,395.

The complete list of wage-indexed program parameters for 2021 and corresponding values for previous years are available at www.ssa.gov/oact.

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