Avoiding Social Insecurity: Navigating the Social Security Maze

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Table Of Contents

I. Basic Structure of Social Security System . . . 3

II. Calculation of Social Security Benefits . . . 5

III. Taxation of Social Security Benefits . . . 6

IV. Factors Determining Eligibility for Social Security Benefits and Amount . . . 6

V. Factors Regarding Whether to Defer or Not Defer Social Security Benefits . . . 7

VI. Benefits of the "File and Suspend" Option and Other "Do Over" Possibilities . . . 9

VII. Spousal Social Security Benefits . . . 10

INTRODUCTION

How important are social security benefits to retirees? Such benefits are the largest single source of income for retirees, accounting on the average for approximately 45% of retirees' income and according to the Social Security Administration, the majority of most retirees' income. Almost 90% of the bottom 25% of retiree households' income consists of social security benefits versus about 75% of the middle 50% of retiree households, and approximately 30% of the top 25% of retiree households. It has been estimated that about 55% of retirees would be classified as poor without social security benefits versus 10% to 20% of retirees who have social security benefits. However, integrating social security benefits into an estate and financial plan is not only more important than most estate and financial planners realize, it is a more complex task than a high percentage of them frequently think to be the case.

With respect to married couples, such integration involves reviewing a myriad of election options with life expectancies (both statistically and personally) of the couple, the couple's contribution history to the social security system, their desires with respect to continuing employment prior to the time social security benefits are required to be taken (currently age 70), their income tax brackets during years they will be receiving social security benefits, whether they will need social security benefits prior to reaching full retirement age and whether they have sufficient other resources such that they are not likely to "outlive their money." With regard to a single person, although planning for social security benefits only relates to considering the foregoing factors as they apply to the recipient, it is nonetheless far from simple. In either situation, making the wrong social security election or decision can have significantly adverse financial consequences not only to the electing party, but also with respect to a spouse and the size of their estates.

Although there are also social security disability payments, death benefits, benefits to survivors of decedents who qualify for social security benefits, and benefits to minor children of social security recipients, this outline will focus solely on retirement benefits payable to an individual and individual's spouse, which account for the vast majority of payments under the social security system.

The discussion of this topic will be segmented into eight sections. The first section will address the basic structure of the social security system. The second section will address how the system calculates such benefits. The third section will discuss the taxation of social security benefits. The fourth section will address the factors which determine the eligibility and amount of such benefits. The fifth section will discuss the factors that go into whether the eligible recipient should defer receiving such payments beyond the age of initial eligibility. The sixth section will discuss the benefits of an often unknown and underutilized "file and suspend" option, as well as "do over" options to change elections or compensate for late elections. The seventh section will address the spousal benefits of an eligible social security recipient and how such benefits factor into the decision making process. The final section will present specific scenarios involving both single and married persons and the various considerations involved in making the right social security elections. Interspersed throughout is a discussion of the changes in such benefits wrought by the 2015 Budget Act.

As a final introductory comment, it is important to note that by virtue of a United Supreme Court decision in 2015, spousal social security benefits are now fully accorded same-sex married couples as well, irrespective of place of marriage.

I. BASIC STRUCTURE OF SOCIAL SECURITY SYSTEM

The social security system requires payroll taxes to be paid by the vast majority of employees. Two exceptions are the railroad retirement system and local and state government employees whose governmental unit has elected not to participate.

It is important to understand at the outset that the social security system was never designed to be a "401k" type of retirement fund in which workers contributed out of their wages with a co-contribution from their employers, the contributed money was invested in a fund, and the worker subsequently drew upon the fund to provide social security benefits at retirement. To the contrary, from the enactment of the original Social Security Act in 1935, the social security system was always intended as a "pay as you go" system in which the current contributions of employees to the system through payroll taxes were contemporaneously paid to fund benefits to those who were currently retired. Otherwise, following the enactment of the social security system, there would have been no money in the system with which to pay retired employees.

It is interesting to note that the same shortfall in funding would occur if the current system was converted totally into a

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hybrid "401k" system, as some have proposed, for while current employees would be paying into such system to fund their own retirement, there would be insufficient funds to pay current retirees. Such proposals are politically expedient in that they feed the public misconception that the current system is a "401k" hybrid system, which it obviously is not, and that it would be more desirable to let contributors invest their own contributions to be drawn upon at their retirement. Some more viable proposals, although politically controversial due to having higher investment risks, include permitting the surplus money paid into the payroll tax system, i.e., the amount by which current payroll tax revenues exceed payments to retirees, to be invested by the government in the stock market, which traditionally has yielded a much greater return than current fund investments in US government bonds, or increase payroll taxes and permit employees to invest such excess not needed to cover current retirees in equities. Should such investments in equities continue to yield, on a long term basis, a greater return for employees upon their retirement than US government bonds this would thereby diminish the amount of payroll taxes in the future necessary to provide retirees with social security benefits.

A second important initial understanding is that the social security system was not designed to fund the entire retirement needs of retirees. Instead, it was intended from its inception to be a supplement to the savings and investments of retirees and keep a substantial percentage of senior citizens out of poverty.

The funds from payroll taxes are collected by the Internal Revenue Service and held in the so-called "Social Security Trust Funds" to be paid to retired employees. Unless payroll taxes collected from current employees exceeded the payout to retired employees, there would be no surplus in the fund. However, the system has been modified in its collections over time so that payroll taxes would often exceed that necessary to pay retiring employees, so as to create a surplus in the fund to account for times when downturns in the economy and vicissitudes in the number of retirees versus those paying into the system are at a deficit. Such a surplus occurred from 1983 until 2009 as a result of Congressional statutory changes which provided for additional payroll tax revenue.

However, the surplus in payroll taxes in excess of that needed to pay current retirees does not legally have to be expended for the benefit of social security retirees. It can also be used for other federal programs or to retire the national debt. In the late 1990s through 2000, much of the surplus was used to retire a portion of the national debt. This ended with a downturn in the US economy at the end of the decade and excess funds were then proposed to be spent for other spending initiatives or to make up lost revenue from federal income tax cuts.

To the extent not appropriated by Congress for other federal programs or utilized to pay down the national debt, the surplus is invested in US government bonds, thus indirectly assisting in funding the federal deficit. In 2009, a second substantial downturn in the economy within a decade, coupled with an on-going lack of increased productivity in the workforce which could provide for real increases in employee income (which would in turn increase the amount of payroll taxes paid into the system), has resulted in the surplus becoming a deficit, thereby causing a drain on the trust funds needed to meet current social security benefits of retirees. As the economy has rebounded, the deficit was reversed, but is projected to ensue at a high level in upcoming years.

Such deficit situation is expected to continue and be compounded in future years due to a persistent downward demographic trend in the amount of workers paying into the system versus those who are receiving social security benefits, even in a normal economy. In 1950, there were 16 workers per social security recipient. In 1960 there were 5 workers per recipient. By 2033, due to the retirement of "baby boomers" (approximately 10,000 reaching social security eligibility age every day) and increasing life expectancies among other demographic trends, the approximate year in which the trust fund is estimated to be exhausted, it is estimated there will only be 2.1 workers per recipient.

In fact, unless there are substantial increases in productivity over the next twenty years or substantial changes are made in the structuring of the social security system (e.g., increased threshold for paying payroll taxes, increased rate of payroll taxes, moving back the age of eligibility for social security benefits, changes in the COLA adjustments for benefits), the consensus of actuarial experts is that the trust fund will be exhausted by the year 2033 or 2034. However, this does not mean that the social security system would then be broke, a common misperception. It merely means that, without any trust funds, the amount that could currently be paid to retirees would be limited to the current amount collected through payroll taxes, which is calculated by experts if current trends continue, to be about 75% of the benefits that would otherwise have been payable in 2033 or 2034 if trust funds were available to make up the difference.

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Note: Changes to certain social security benefits enacted into law in Section 831 of the Bipartisan Budget Act of 2015," ironically termed the "Social Security Benefit Protection and Opportunity Enhancement Act of 2015," which were signed into law by President Obama on November 2, 2015, and are discussed below, are likely to extend the exhaustion of the trust fund beyond 2033 or 2034.

Bottom Line: Planning for younger clients with respect to social security benefits that will ultimately be available, or with respect to estate planning provisions for clients which provide for the needs of their spouse or descendants under the provisions of their wills or revocable trusts, should not be undertaken with any significant prospect that there will be no social security benefits for themselves, their spouses or their descendants upon their retirement. Moreover, any "tweaking" by Congress between now and 2033 or 2034, or any later date to which it has likely been extended by changes to certain Social Security benefit options enacted in Section 831 of the "Bipartisan Budget Act of 2015," that are necessary to maintain the current level of social security benefits for retirees at that time, in the event that productivity increases between now and then do not otherwise make up the difference, is not likely to be substantial (although the later such changes are made the more substantial they would need to be). Such "tweaking" could include consideration of increasing or eliminating the cap on earnings subject to social security withholding, increasing payroll taxes, making social security fully subject to income taxation (but only if such additional income tax revenue was allocated to the social security trust fund), moving back the retirement age, "means testing" for social security benefits, a reduction of social security benefits, or any combination thereof. The political pressure to do so which would be expected to be brought upon Congress by the very large demographic voting block of senior citizens receiving social security benefits and those approaching retirement, as well as their lobbying groups, would be expected to be enormous as the date at which such exhaustion of the trust fund is likely to occur approaches.

Also, if US immigration laws are changed, as demographic politics would appear to eventually demand, providing for the naturalization of a substantial percentage of illegal immigrants (who tend to be younger on the average than the general population), or at least changing such laws or the administration thereof in a manner that would have illegal immigrants coming out of the underground economy and paying into the system, the ratio of those paying into the system versus those retiring would be expected to increase commensurately. If so, this factor also would be expected to delay the exhaustion of the trust fund and minimize the degree of "tweaking" necessary to further extend its viability.

On the other hand, the recent Supreme Court decision sanctioning same sex marriages under the due process clause of the federal constitution will require outlays for benefits for all divorced and surviving spouses of same sex marriages which will also increase the draw on the social security trust fund.

However, it is important to always keep in mind that even in the worst case scenario that Congress does not take steps to ensure there is no exhaustion of the trust fund and such event occurs, it would be expected that those currently paying in payroll taxes would nonetheless continue to pay benefits for current retirees. Thus, social security benefits would likely continue in that event, albeit at a reduced amount thereafter.

II. CALCULATION OF SOCIAL SECURITY BENEFITS

The calculation of social security benefits from the very beginning of the enactment of the social security system was designed to favor lower earning payroll payors/recipients over the higher earning payors, i.e., as the amount of income subject to payroll taxes increases, the amount of benefits paid in relation to such income decreases. Consequently, the amount of social security benefits higher income beneficiaries receive upon their retirement in relation to the amount they have paid in in payroll taxes is much less. Although the payroll tax is regressive in that lower income beneficiaries pay the same percentage of their income in payroll taxes as do higher income beneficiaries up to the income limit, and higher income beneficiaries don't have to make any contributions over the income limit, such regressive structure is substantially offset by the fact that such lower income beneficiaries receive a much higher return in terms of the benefits they receive than do higher income beneficiaries. Due to such progressive structure in terms of benefits paid in relation to the amount of payroll taxes paid into the system, it is estimated that social security benefits keep 20% of retirees above the poverty line. Moreover, higher income beneficiaries pay a higher percentage of their benefits in income taxes due to the progressive structure of federal income tax, a further offset to the basic regressive structure of payroll taxation which fund the social security system.

Over the years since its enactment, the amount of earned income subject to payroll taxes has increased, as well as the rate

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applicable to such earnings. In 2015, the earned income subject to the tax is $118,500 for social security with no "cap" for the Medicare portion of the tax. The applicable rate of payroll taxation currently, which has held steady for an extended period, is 6.20% of earnings for social security and 1.45% for Medicare, for a total of 7.65% of earnings. Such rate doubles for the self-employed. However, to put the self-employed on the same footing as employees, the self-employed only pay tax on 92.35% of self-employment income (100%-7.65%) and are allowed to deduct against their income one-half of the self-employment payroll tax.

III. TAXATION OF SOCIAL SECURITY BENEFITS

Social security benefits are subject to federal income taxation. Such taxation is related to modified adjusted gross income (MAGI). MAGI includes all sources of income, including earnings, taxable and tax-exempt interest, other investment income, capital gains, pensions and IRA and 401(k) distributions, and 50% of the social security benefit. There are three tiers of percentage income taxation on such social security benefits, i.e., 0%, 50% and 85%. For single persons, there is no income taxation on social security benefits if MAGI is less than $25,000, 50% for MAGI between $25,000 and $34,000, and 85% for MAGIs in excess of $34,000. For married persons, such increasing three percentage tiers are applicable on incomes of zero to $32,000, $32,000-$44,000, and in excess of $44,000, respectively.

Kansas exempts social security benefits from income taxation if federal adjusted gross income is less than $75,000.

IV. FACTORS DETERMINING ELIGIBILITY FOR SOCIAL SECURITY BENEFITS AND AMOUNT

To be eligible for social security benefits, a recipient must have paid in a certain amount to have sufficient credits to be so eligible. There are four possible credits per each calendar year (i.e., for four quarters) based upon a minimum amount paid per credit, irrespective of when such earnings occurred during the year. During 2015, a worker earns one credit for each $1,220 of earnings. For example, if a worker earns $2,440 during the first two months of 2015, the worker receives two credits, i.e, two quarters, notwithstanding the fact that all such earnings occurred during the first quarter of 2015. Although a person's age can dictate that lesser credits are necessary for full eligibility or fully insured status (a younger person needing lesser credits), a person who has paid in a total of 40 credits is always fully insured. Fully insured status is a prerequisite for eligibility for retirement social security benefits.

For eligible retirees, retirement benefits are based on "adjusted" average wages for the highest 35 years of earnings prior to retirement. Earnings over the maximum amount subject to payroll taxes each year have no effect on the amount of retirement benefits. The "adjustment" is to factor in the effect of inflation to determine such wages in current real dollars. If the recipient has less than 35 years of wages, the non-wage years are assigned a wage of zero. Such annual average is then divided by 12 to determine an Average Indexed Monthly salary or AIME. Such amount is then divided into three income level segments termed "bend points," which are periodically adjusted for inflation. The first and lowest segment of income is multiplied by 90%, the next segment by 32% and the highest income segment by 15%. The three quotients are then added together to create what is termed the "Primary Insurance Amount" or PIA. It is this weighting favoring the lower income amounts that results in social security benefits in turn favoring lower income employees over higher income employees in terms of benefits in relation to payroll taxes paid. If a worker had paid payroll taxes on the maximum amount of earnings subject to payroll taxes for 35 years prior to electing social security benefits, such worker's monthly PIA in 2015 would be $2,663.

The earliest age at which social security benefits are payable, albeit at a reduced amount that is less than the worker's PIA due to being taken at a younger age than full retirement age (FRA), is age 62. The FRA age is dependent upon date of birth. For those born on or after 1943 and prior to 1955, the FRA is age 66. For those born in 1955 and thereafter, the FRA increases by two months each year until 1960, such that those born in that year and thereafter will have an FRA of 67. If the worker retires at his or her FRA, the worker is entitled to his or her full monthly PIA. For all subsequent discussion purposes below, the FRA will be assumed to be 66, the current retirement age of all individuals who are either nearing eligibility for social security benefits or who are currently between 62 and age 70, the years in which elective options are still available.

A worker who elects to start benefits before his or her FRA is subject to a reduced benefit based on the number of months before the worker's FRA in which the worker starts benefits. The reduced amount is 5/9 of 1% for each month up to 36 and then 5/12 of 1% for each additional month. Such reduction gives a 75% benefit at age 62 for a worker whose FRA is 66 (i.e., a 25% reduction). Workers who delay taking their retirement past their FRA will have an increased amount they will receive equal

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to 8% of the benefits they would have otherwise received at FRA (the PIA amount) for each full year they delay receiving full benefits up to age 70, when the worker is required to take his or her retirement benefits. Thus, a worker who waits until age 70 to take his or her retirement benefits will receive a benefit 32% greater than the benefit that would have been the case had the worker taken his or her social security benefits at the normal retirement age of 66, and 76% higher than if taken at age 62. In addition, to the extent earnings of the worker during the years up to his or her FRA in which social security benefits are deferred is greater than the 35 highest years prior to age 62, the social security recipient will receive a higher base social security benefit (i.e., the PIA amount) at the time of retirement in addition to the benefits of deferral. However, the PIA amount will not increase after FRA (although the 8% per year increase in the benefit amount for each year of subsequent deferral will). This is the case even should the worker continue to defer taking social security benefits until age 70 (when the worker is required to take social security benefits) and have earning years subsequent to his or her FRA which would exceed any of the 35 earning years prior to FRA.

All social security retirement benefits are subject to annual cost of living adjustments (COLAs). Thus, such foregoing percentage increases in benefits achieved by deferring the receipt of social security benefits up to FRA (in determining the PIA amount) are in "real dollars" with such COLAs already having been factored in.

V. FACTORS REGARDING WHETHER TO DEFER OR NOT DEFER SOCIAL SECURITY BENEFITS

From the above discussion it becomes readily apparent that the benefits of deferral are substantial in terms of significantly increased monthly benefits by virtue thereof upon the commencement of social security benefits. However, whether such increased benefits will cumulatively exceed the economic benefit the worker would have received by taking a reduced amount earlier depends on several factors, including the worker's actual life expectancy. If the worker lives until approximately age 82, the total benefits the worker would have received by either electing social security at 66 or deferring until age 70 will be approximately the same, after which age deferring until age 70 will have yielded significantly greater total benefits due to a higher monthly benefit. For a worker who elects benefits at 66 instead of age 62, the total benefits under either scenario would have been the same at approximately age 77, after which age electing at age 66 would have yielded significantly greater benefits. Thus, the mathematics work out such that the number of years after electing to take benefits to make up the difference the recipient would have received by electing an earlier date does not vary substantially, with maximum deferral until age 70 yielding the oldest age, 82, for the approximate "break even" or "crossover point." In sum, the "crossover point" for all deferrals is between ages 77 and 82, approximately, with the greater age deferral extending the "crossover point" to a later age.

Although between ages 62 and 66 the increased annual benefit for each year of deferral is less than the 8% per year for deferrals between ages 66 and 70, thereby reducing the economic benefit of deferral, there is a greater number of years between date of election and age 81 to make up the deficit of the deferred election, thus yielding an earlier "crossover point" in the above examples. Moreover, the COLA adjustments are also applicable for each year of deferral until FRA. Under the unisex tables, a 62 year old is likely to live until approximately age 83, a 65 year old to 85.5 and a 70 year old until age 86.5. A man's life expectancy would be expected to be approximately one year less at such ages and a woman's life expectancy approximately one year more. Thus, under any deferral scenario, it would be expected that a worker with a normal life expectancy would have a significantly better than 50% chance of living past the "crossover point." The reduction in benefits due to electing to take social security benefits at an age earlier than 70, when social security benefits are required to be taken, was actuarially intended to approximately achieve the same total benefits at the age of life expectancy irrespective of when taken. However, with increasingly longer life expectancies, as demonstrated by the above statistics, the "crossover point" age at which deferred benefits are economically beneficial is significantly lower than current expected life expectancies. And there is no reason not to expect life expectancies to continue to increase in the future due to medical breakthroughs, if nothing else, thereby further enhancing the economic odds of benefitting from maximally deferring social security benefits.

Also to be considered is the effect on social security benefits for a worker who would otherwise elect to take benefits between ages 62 and 66, but who plans to continue to work between such ages. If a worker continues to work after attaining age 62, social security benefits are reduced $1 for each $2 of earnings prior to attaining full retirement age of 66 that is above a certain annually adjusted annual income limit. That limit for 2015 is $15,720. There is an exception. During the year the recipient turns age 66, benefits are reduced $1 for every $3 of earnings for all months prior to attaining age 66 for earnings during the year totaling another higher limit. That limit in 2015 is $41,880. However, such reduced social security benefits are not necessarily lost. They are recalculated by treating such reduced benefits as if the recipient's retirement had been deferred for a period of

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time commensurate with the amount of the total reduced benefit, thereby increasing proportionately the amount of the benefit upon attaining full retirement age (FRA). They would only be lost if the recipient did not live long enough to recoup the deferred benefit. Based on the foregoing life expectancies and "crossover points," from a statistical standpoint any economic detriment in having such benefits reduced by earnings between ages 62 and 66 is likely to be fully recovered if the recipient lives until his or her normal life expectancy.

But due to such deferral based on earnings, it is normally best for those who are desirous of continuing to work after age 62, but who would otherwise consider taking social security benefits at age 62, to not make such election in circumstances where such earnings will substantially reduce their social security benefits. Not only would the benefits of taking such early benefits be substantially reduced thereby (albeit such deferred benefits would be available as additional benefits upon attaining FRA), but workers making such early election will have lost the ability to make the most appropriate election to receive increased social security benefits in a later year based on financial and health circumstances existing at that time.

Although it would also appear that this loss of increased benefits would be further exacerbated if the worker's subsequent earnings until FRA would likely have increased the PIA amount of the worker at FRA as well, any earnings after the election was made which are in the highest 35 years of earnings will automatically increase the amount of social security benefits in subsequent years going forward. This is true irrespective of when social security benefits are commenced.

There are additional other factors beyond the worker's life expectancy that merit consideration in determining the economics of the years between 66 and 70 in which to receive social security. If the worker is in need of social security funds for necessities prior to age 70 (e.g., due to forced retirement or retirement due to health conditions), the election to take benefits may need to be made sooner than the year in which the election would make actuarial sense, notwithstanding jeopardizing the worker's financial ability to provide for living needs in later years. In addition, irrespective of the worker's estimated life expectancy, for the high percentage of retirees who are concerned they might "outlive their money," the "annuity factor" in waiting until age 70 to collect social security benefits cannot be overemphasized. Social security payments will be made for the entire remainder of the recipient's lifetime and thus should be considered in the same context as a pension or annuity. Thus, unless the worker is in need of funds not able to be satisfied from other sources prior to attaining age 70, the substantial increases in benefits from ages 62 to FRA (plus possibly increasing the PIA amount by working through those years), as well as the 8% subsequent annual increases in benefits from FRA to age 70 by further waiting until the latter age to receive benefits, will substantially reduce the risk of the recipient "running out of money" during the remainder of the recipient's lifetime, particularly should the recipient live beyond his or her life expectancy.

It goes without saying that personal financial security is the paramount goal of almost every financial goal or plan. For married couples, this includes the financial security of the surviving spouse. This aspect is particularly important with respect to the financial security of married women, for they are likely to survive their husbands, and when they do, widowhood for couples who are between ages 62 and 70 averages between ten and twelve years following the death of the husband if the couple is relatively the same age. Consequently, playing the actuarial total return/life expectancy game in determining when to elect social security benefits, i.e., determining whether the worker lives long enough to recoup benefits lost by deferring taking social security by virtue of the increased amounts payable later as a result of the deferral, normally should not be entertained by those who are concerned about "outliving their money."

In sum, except for a possible early election by the lower earning spouse discussed below in the "Spousal Social Security Benefits" section, the election to take social security benefits prior to age 70 normally should not be made except in one of three circumstances: (a) the benefits are financially needed to provide for the most basic life necessities prior to such age, notwithstanding so doing might result in the worker having insufficient living resources in later years; (b) the recipient has a physical or health condition which virtually precludes the recipient's attainment of the actuarial life expectancy needed to economically benefit in the long run from the increased amounts payable by deferring social security benefits; or (c) the resources of the recipient (and the spouse of the recipient) are such that the recipient (and the spouse of the recipient), irrespective of any social security benefit election they might make, are highly unlikely to have insufficient resources to sustain an acceptable living standard irrespective of how long the recipient (and the recipient's spouse) might live and electing to take benefits prior to age 70 appears to be the best economic decision from an actual life expectancy standpoint.

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However, such three circumstances would be expected to represent only a small minority of circumstances in which social security recipients find themselves. Thus, one would expect that most social security recipients would defer social security benefits as long as possible. However, such deferral is far from the norm. Statistics indicate that almost one-half of all eligible social security recipients, i.e., 41 percent of men and 46 percent of women take social security benefits at age 62 and only 14.3 percentage of men and 9.7 percent of women wait until age 66 to take their social security benefits. Even fewer wait until age 70.

For those in the last foregoing "sufficient outside resources" circumstance, such decision can be independently made without consideration of the recipient's immediate or long-term financial needs, but only on which decision is likely to result in an increased economic benefit to their estates upon their deaths. In that situation, such decision would be based upon the comparative amounts a recipient would have attributable to social security benefits at the time of their estimated life expectancy should they wait until age 70 to receive social security benefits or alternatively elect to receive them at an earlier age. As individuals in such circumstance will not need to spend social security benefits for living needs, such comparative amounts under both scenarios would be the net amount of social security benefits received after income taxation through such expected life expectancy, plus the net investment return after taxes on such social security benefits.

Because the increased deferral percentages discussed above are based on real dollars after COLA adjustments related to inflation prior to attaining FRA at 66, such expected investment return on the net social security benefits received after income taxes with respect to electing early benefits (to get the investment benefit of distributions earlier) would have to exceed not only COLA adjustments to be of any net economic benefit when comparing scenarios, but provide an additional increased return to account for the fact that only "after tax" social security benefits would be available to be invested. Moreover, for those continuing to work between the ages of 62 and FRA, there may be little or no net social security benefits to invest due to the aforesaid reduction in social security benefits resulting from earned income prior to age 66. Also, the time period to make such investment return on net social security benefits in comparing the benefits of an earlier election versus more deferral would be relatively short-term from an investment standpoint, resulting in the amount of such return being less predictable than with a long-term investment. All of such factors militate against attempting to "beat the odds" by not deferring social security benefits.

Further, to the extent deferral would have been of benefit in adding additional earning years so as to increase the average of the highest 35 earning years prior to FRA, any such benefit increase as a result of such deferral will be lost for prior years by taking benefits prior to FRA, although any such increased earning years while receiving social security will increase benefits in subsequent years. Finally, also to be factored in is any higher income taxation, and resultant economic detriment, by taking social security benefits early during high earning years, as opposed to deferring benefits until later years following retirement which normally would be expected to be taxed at a lower income tax rate. A possible countervailing factor in deferring social security benefits would be any increased rate of income taxation during retirement years caused by minimum required distributions on non-Roth 401(k)s and IRAs after the required beginning date, typically the year when the worker turns age 70½, as such required distributions would occur during social security distribution years following retirement.

Consequently, due to the substantial benefit in deferring social security benefits for the vast majority of the citizenry, all financial decisions for those desiring to maximize such benefits should be made with the "annuity factor" of delaying benefits as long as possible and thereby receiving a substantially increased amount for the remainder of one's lifetime firmly in mind. This would be concomitant with frugal spending habits and deferring retirement to avoid having to draw upon social security benefits prior to age 70 for living needs. It also includes spending savings rather than electing early social security benefits to meet living needs. And should a recipient be in need of additional funds during the deferral period that could only be made up by drawing upon taxable IRA distributions, it may nonetheless be advisable to do so to continue the deferral period. Although such IRA distributions are taxable and the deferral of taxation on distributed amounts is thereby lost, the substantial economic benefits of social security deferral, along with the fact that later increased social security benefits will be subject to a lesser effective income tax rate than are non-Roth IRA distributions due to social security benefits not being fully taxable, and individuals in that circumstance are not likely to find that their IRA distributions would be taxed at a very high income tax rate, there is often a "tilting of the scales" of nonetheless in favor of doing so.

VI. BENEFITS OF THE "FILE AND SUSPEND" OPTION AND OTHER "DO OVER" POSSIBILITIES

Due to a statutory change in 2000, the Senior Citizens' Freedom to Work Act, a social security recipient who has attained his or her FRA (age 66) and has not yet elected to take social security benefits could make an election to file for social security yet also

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elect to defer the benefits. This election permitted the recipient to subsequently change his or her mind as to the appropriate election prior to attaining age 70, at which age social security benefits are required to be taken based upon age 70 benefits (the PIA amount plus 32%). Thus, if such "file and suspend" election is made, the social security recipient who made such election could subsequently re-elect prior to attaining age 70 to take his or her social security benefits at his or her FRA, in which event the recipient would retroactively receive a lump sum social security payment for all such benefits which are then in arrears, with future payments being based on the recipient's FRA benefits (i.e., PIA amount) at 66. It was thus normally advisable to make this election, for except where such recipient is also desirous of making a "restricted application" for current spousal benefits based on the other spouse's PIA benefits, there usually was no detriment in doing so. However, the electing party must have understood that such "file and suspend" election would also result in automatic eligibility for Medicare Part A, thereby rendering the individual ineligible to make any subsequent contributions to a health savings account (HSA) with respect to which they would otherwise been eligible. Thus, for example, should a recipient who has made such "file and suspend" election subsequently contract terminal cancer at age 69, a retroactive election could have been made to maximize social security benefits for the recipient and the recipient's family. Moreover, as also discussed below, for married persons it also permitted the electing spouse who is otherwise qualified to do so to make a "restricted application" to take spousal benefits even if they were deferring their own social security benefits.

Note: This retroactive "do over" strategy for those making a "file and suspend" election after attaining FRA appears likely to have been eliminated by Section 831 of the new budget act. There does appear, however, to be an argument based on the strict language of the statute which purports to deny retroactive benefits that such strategy nonetheless remains viable.

Another possible "do over" is a recipient who elects to take social security benefits prior to attaining age 70 and thereafter changes his or her mind with respect to such election. If the recipient changes his or her mind within 12 months of filing, he or she can pay all of the benefits back without interest and rescind the prior filing, thereby preserving all election options in the same manner as if the election had not been made in the first place. Query: What are the income tax consequences of making a "do over" payback of social security benefits in a subsequent tax year?

A third "do over" scenario is a social security recipient who elected retirement benefits prior to FRA. At full retirement age, the recipient can nonetheless elect to defer further payments until age 70 without having to pay back any prior payments. Although the payments that are deferred are calculated based on the initial election, the deferred payments are entitled to the same 8% increase in benefits for each year of deferral as are recipients who either "file and suspend" social security benefits at age 66 or never elect to receive such benefits prior to attaining age 70.

Finally, for those who have reached FRA and did not file timely for benefits, retroactive benefits can be paid up to six months. This also applies to spousal survivorship benefits discussed below.

VII. SPOUSAL SOCIAL SECURITY BENEFITS

A spouse, irrespective of whether the spouse has paid enough into the system to qualify for social security benefits on his or her own behalf, may nonetheless elect to receive social security benefits if such electing spouse has attained at least age 62 based upon a percentage of the benefits of his or her spouse (the PIA amount) who either is then receiving social security benefits or has taken the "file and suspend" option to defer distributions between the ages of 66 and 70. Such percentage is 50% if the electing spouse is of FRA at 66, and a lesser percentage if the electing spouse is between 62 and 66. Such spousal election is termed a "restricted application" as it is limited to spousal benefits only.

For an electing spouse to be entitled to such benefits, his or her spouse must either be receiving benefits or if such spouse has attained FRA at age 66, has elected to receive such benefits at age 66 but deferred taking such benefits until age 70 (i.e., has made the "file and suspend" election). However, if the electing spouse is under his or her FRA, there is a percentage reduction in the amount of such otherwise available spousal benefit. The calculation is 50% of the other spouse's PIA amount, such percentage being reduced by 25/36 for each month for the first 36 months under age 66 and 5/12 of 1% for each additional month between 36 months and 48 months of normal retirement age, for a total possible reduction of 30% for a spousal election at age 62. There is only one such option that can be in effect at any given time, i.e., both spouses may not elect the spousal benefit during the same time period. Moreover, as noted above, a spouse who is making a "restricted application" should never also make a "file and suspend" election, for such election would not only suspend the spousal benefits, it would also make his or her spouse

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ineligible to make the spousal election.

Although the electing spouse's spousal benefit is reduced if elected prior to such electing spouse attaining his or her FRA, the electing spouse's benefit is not reduced from what it would otherwise have been due to the other spouse having elected social security benefits prior to attaining FRA. That is to say, the electing spouse's benefit amount in that circumstance is predicated upon what the other spouse's benefit would have been had such spouse waited until FRA based upon the earning record of such spouse when electing social security benefits early. In the event the other spouse has deferred spousal benefits past FRA under the "file and suspend" option until attaining age 70, or is already receiving such benefits after FRA, the electing spouse's benefit is nonetheless still predicated upon one-half of the other spouse's PIA amount at FRA.

There is also a caveat for a spouse who qualifies for social security benefits on such spouse's own earning record who is desirous of electing to take the spousal benefit prior to having attained FRA at age 66. If such spouse makes a "restricted application" for such benefits, such application will nonetheless be deemed to also be an application for benefits on the applicant's own record, such that the "restricted application" would result in the electing spouse in essence receiving the higher of the two benefits, i.e., the applicant's own benefits at such age plus any additional amount the spousal benefits would exceed such benefits. For example, if the normal one-half spousal benefit was $1,000 per month and the spouse elects at age 62 to take the spousal benefit when the spouse's own social security benefit was $300/month (75% of the $400 per month it would have been at age 66), the total spousal monthly benefit would be the sum of $300 and 70% of the difference between $1,000 and $400, i.e., $420 per month, i.e. a full 30% reduction of the difference due to taking such benefit at age 62. If electing spouses who qualify for social security benefits on their own have not made the election yet and want to elect only the spousal benefit after attaining FRA and continue to defer their own benefits, they would need to make a "restricted application" limited to spousal benefits only between the ages of 66 and 70.

This "restricted application" option is particularly important for otherwise qualifying spouses if their own benefits would be less than the spousal benefit. It is also important even in situations in which the electing spouse's social security benefits based on his or her own record would be more than that based upon the other spouse's record, for it permits the electing spouse to receive the spousal benefit between FRA and age 70 if the other spouse is either receiving social security benefits or is between FRA and age 70 and has made the "file and suspend" option, yet defer his or her own benefits until age 70, at which time the electing spouse can switch to receive the higher benefits available on the electing spouse's own earnings record. In short, both spouses can get all of the benefits they were otherwise entitled by deferring their own benefits until age 70, provided the electing spouse does not make the "restricted application" for spousal benefits between the ages of 62 and 66 (thereby also deeming to have also made an election on his or her own behalf and receiving the higher of the two benefits from then on), with the spouse making the spousal election receiving the "bonus" of the spousal benefit between ages 66 and 70 in the interim. At age 70, the electing spouse would then be eligible to receive his or her own benefit based on the electing spouse's earning record, if higher.

A little known fact is that this spousal benefit is available even if it is the higher earner spouse electing the spousal benefit off the lesser earning spouse's earning record and PIA amount. This might occur in the circumstance where the lesser earning spouse has already elected social security benefits which are greater than would have been the spousal benefit off of the higher earning spouse's PIA amount (otherwise it would have been the lesser earning spouse that would have made the spousal election) and the higher earning spouse after attaining age 66 has chosen to delay receiving his or her own benefits until age 70 while making a "restricted application" for spousal benefits in the interim. If the lower earning spouse was younger, the lower earning spouse, in order to maximize total security benefits, could have instead deferred his or her social security benefits until age 70 and made a "restricted application" for spousal benefits on the higher earning spouse's PIA amount upon the lesser earning spouse's attainment of FRA. Thus, this situation would probably mostly arise only if the lesser earning spouse in the situation was older and was already drawing social security when the younger higher earning spouse attained his or her FRA.

A divorced spouse may also apply for spousal benefits based on the ex-spouse's earnings record. The requirements are that the divorced spouse is at least 62, the divorce was at least two years previous, the prior marriage was at least ten years duration and the ex-spouse is currently single. Whether the ex-spouse has elected to take social security benefits at that time is not relevant as long as the ex-spouse is currently entitled to such benefits. The ex-spouse does not even need to be notified that the divorced spouse is applying for benefits on the ex-spouse's record. Such application for spousal benefits by an ex-spouse has no effect on the other spouse's social security benefits or that of his or her current spouse. In essence, the electing ex-spouse is making a

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"restricted application" based on the other spouse's entitlement to benefits. Consequently, the same caveat discussed above with respect to a married couple is equally applicable here when a former electing spouse chooses to make a "restricted application" on a former spouse's benefits. That is, if the electing spouse is between ages 62 and 66 and makes a "restricted application" between such ages on the ex-spouse's benefits, such application will also be deemed to have been made for the electing spouse's benefits on his or her own earnings record as well, thus ending the electing spouse's deferral options on his or her own benefits.

Important Note: Section 831 of the Bipartisan Budget Act of 2015, signed into law on November 2, 2015, generally limits the ability of one spouse to make an application to receive benefits on the other spouse's benefits to a situation where the non-electing spouse is already collecting benefits. It does this by making any spousal election made after turning age 66 to be "deemed" to also be electing one's own benefits, thus receiving the higher of the two benefits, in the same manner as under current law with respect to spousal elections made between attaining age 62 and 66, and any suspension of the non-electing spouse's benefits by the non-electing spouse to also suspend the electing spouse's otherwise available spousal benefits. The net effect of these changes is that if a non-electing spouse has made a "file and suspend" election after April 30, 2016, and the electing spouse makes a restricted application for spousal benefits after turning age 66, such spousal benefits also will be suspended unless and until the non-electing spouse's benefits are no longer in suspense. Moreover, in the absence of a "file and suspend" election by the non-electing spouse, the electing spouse would not have been eligible for spousal benefits in the first instance

However, there is an exception if the non-electing spouse has made a "file and suspend" election prior to May 1, 2016. In that situation, the electing spouse may elect upon attaining age 66 to take spousal benefits even if the non-electing spouse has not turned age 70 so as to not be currently deferring benefits, and further, if such non-electing spouse was age 62 prior to January 1, 2016, such electing spouse may also make a "restricted application" for spousal benefits only so as to be able to defer his or her own benefits until age 70.

In addition, as noted above, depending on the interpretation of certain wording in Section 831 of the 2015 budget act, the benefit to an individual making a "file and suspend" election for the purpose of activating the above-discussed "do over" possibility of changing his or her mind later and retroactively making an election back to age 66 so as to be eligible to receive a lump sum payment for prior periods may no longer be available, although deferring any future benefits at age 66 until age 70 for the purpose of receiving the benefits of an 8% return on such deferred benefits, as discussed above, appears to still remain available.

Survivorship Benefits

In addition to the above-discussed spousal benefit of a "restricted application" for the spousal benefit when both spouses are living, there is also a survivorship benefit available to a surviving spouse. The spousal survivorship benefit is perhaps the most important social security benefit from a financial security perspective, for as husbands are likely to predecease their wives, it has been estimated to provide approximately 60% of widows' incomes. The survivorship benefit is the higher of the two social security benefits of both spouses. Thus, unlike the "restricted application" which is always based on the PIA amount of the other spouse, the surviving spouse gets the benefit of the predeceased spouse's actual social security benefits, specifically including any increases which resulted from a deferral of the predeceased spouse taking his or her benefits until age 70, which is not the case with the "restricted application."

To be eligible for a spousal survivorship benefit, the couple must have been married for at least ten years, and the surviving spouse must be at least 60 years of age and unmarried. However, the survivorship benefit is reduced .396% for each month the spouse is younger than his or her FRA, such reduction cumulatively being 28.5% at age 60 with respect to a FRA of 66. Although the benefit is lost upon a subsequent remarriage of the surviving spouse prior to attaining age 60, the surviving spouse can reapply for such benefits upon a subsequent divorce or the death of his or her spouse.

With respect to married couples both of whom qualify for social security retirement benefits, the spousal survivorship benefit substantially changes the equation with respect to the determination of whether to defer social security benefits by both spouses. This situation militates even more, when compared to a single individual, in favor of the higher earning spouse electing to defer social security benefits until attaining age 70. This is because the amount of the higher income social security benefits will continue for one or the other spouse until the death of the surviving spouse. The joint and survivor life expectancy of a husband age 70 and a wife age 68 is approximately 22 years. This means that at least one of the spouses is likely to live until age 92 and

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thus the higher social security benefit of the higher earning spouse will likely be received by the higher earning spouse or his or her surviving spouse for at least approximately 22 years after attaining age 70. Thus, unless both spouses have significantly less than normal life expectancies, there is a much higher probability of the couple economically benefiting from deferral by at least one spouse living substantially past approximately age 81 with respect to taking social security benefits at age 70 rather than at age 66 or a younger age than is the case discussed above with a single social security recipient. Because of the likelihood that one of the spouses will receive the much higher benefit of the higher earning spouse for a much more extended period than would be the case with a single recipient, this actuarial economic benefit, along with the commensurate benefit of significantly reducing the possibility of spousal impoverishment of both spouses or the surviving spouse, are typically very strong motivating factors for maximally deferring the social security benefits of the higher income spouse until age 70. This factor becomes even more important in circumstances where the higher earning spouse is the husband, who normally is likely to predecease his wife, and also in any circumstance where the higher earning spouse is the much older spouse and likely to predecease his or her spouse by several years.

Conversely, the foregoing factor of the surviving spouse receiving the higher earning spouse's benefit also means that a lower earning spouse has less to lose from an economic perspective by not maximally deferring social security benefits and electing benefits prior to age 70. For actuarially speaking, the death of the first spouse with respect to a couple in which the man is age 70 and his wife is age 68 is approximately twelve years, i.e., at the time the husband would have attained age 82 and the wife age 80, the social security payments of the lesser earning spouse is likely to cease, and the surviving spouse would receive, or continue to receive, the higher social security benefit of the higher earning spouse. This is the approximate "cross-over" point at which the benefits of electing at age 70 rather than earlier approximates the same relative economic amount. The same is approximately true with respect to a husband who is 62 and his wife 60, for the first spouse is likely to die when the ages of the couple would be only approximately two years younger due to an 18 year first to die actuarial life expectancy, which also closely approximates the same "cross-over" point due to an election at age 62. That is to say, an early election by the lesser earning spouse is actuarially likely to be close to a "wash" in terms of expected benefits to life expectancy, which is not the case with respect to a single individual, who is likely to live beyond such "cross-over" point and would benefit actuarially to a much greater extent in deferring social security benefits.

Thus, the election of the lower earning spouse to receive benefits prior to age 70 has a reduced risk of not being the right economic decision for the lower earning spouse from an actuarial standpoint than would have been the case had the lower earning spouse been single, as the benefit of a deferral of social security benefits by the lower earning spouse has an actuarially shorter period for recoupment of lost earlier payments due to such benefits of the lower earning spouse terminating on the death of either spouse when the higher earning spouse's social security benefits are payable to the survivor. Should such actual probability be that the death of the first spouse is likely to occur prior to the economic "cross-over" point at which the lower earning spouse will have recouped the lost benefits occasioned by deferring social security benefits due to health situations or longevity issues with respect to either spouse, the benefits of an earlier election to take social security benefits by the low earner spouse would be expected to be more beneficial economically on the average in the long run. However, doing so prior to age 66 would preclude the lower earning spouse from making a "restricted application" after age 66 to receive an otherwise available spousal benefit between age 66 and age 70, while preserving the benefits of deferral of the electing spouse's social security benefits until age 70.

Also, in the event that the higher earner spouse dies when the lower earner spouse has not elected social security benefits on his or her earnings record, i.e., between the ages of 62 and 70, it is important to exercise caution in making a "restricted application" to claim survivor's benefits. As discussed above with respect to married couples and a former spouse electing benefits on his or her ex-spouse's earnings record, should such "restricted application be made between the initial qualifying age of 62 and 66, such application also will be deemed to have been made on the electing spouse's own benefits as well, thus, although permitting the higher of the two benefits, vitiating the deferral planning possibilities that had existed with respect to the electing spouse's social security benefits prior to making the election.

In sum, with respect to a married couple, the determination of whether the lower earning spouse will economically benefit from making an earlier election to take social security benefits is based upon the period until the first spouse is likely to die, which period is typically much shorter than that based solely on such spouse's sole life expectancy. On the other hand, the determination of whether the spouses are likely to economically benefit from an earlier election by the higher earning spouse is

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based on the joint life expectancy of both spouses, which is much longer than the life expectancy of either earning spouse. This is why the higher earning spouse should normally defer social security benefits until age 70, while the couple has a much less risk of a significant economic detriment should the lower earning spouse elect benefits prior to age 70.

Nonetheless, if the overarching consideration is whether the couple will "outlive their money," particularly should both spouses happen to live beyond their life expectancy, then the calculations as to whether an earlier or later election for social security benefits is likely to be of greater economic benefit actuarially speaking should become irrelevant. In that circumstance, both spouses will likely want to defer both of their social security benefits as long as possible in order to achieve the maximum amount of social security benefits of both spouses for the remainder of their lifetimes. For the average couple in which the husband is two years older than his wife, retirement of the husband at age 62 is actuarially likely to result in an approximate 29 year retirement period until the death of the surviving spouse, while retiring at 66 would yield an approximate 25 year retirement period, and retiring at age 70 an approximate 22 year retirement period. Thus, irrespective of the time of retirement, the surviving spouse is likely to live past 90. Most couples simply fail to grasp the significance of the financial commitment such extended retirement period will require and the concomitant risk that taking social security benefits of a lesser amount earlier than required will pose in leaving the couple with a lesser amount of assets in the long term to provide for their joint living needs at an acceptable level, as well as the living needs of the survivor, not only through such an extended expected retirement period, but also even longer should they live beyond their actuarial life expectancies.

"Takeaways" for Spousal Social Security Planning following Passage of the 2015 Budget Act

Consequently, for couples who recognize such economic risk and thus want to maximize their social security benefits through their expected retirement period and beyond so as to not outlive their money, as was the case prior to passage of the 2015 budget act, the higher earning spouse should delay social security benefits until attaining age 70. The other planning strategy includes the "restricted application" options which still remain available to eligible spouses under the provisions of Section 831 of the 2015 budget act.

If one spouse has made the "file and suspend" election prior to May 1, 2016, and the other spouse was age 62 prior to January 1, 2016, the other spouse may still elect to make a "restricted application" for spousal benefits on the other spouse's earnings record after attaining age 66 irrespective of whether the other spouse is currently receiving social security benefits, while at the same time deferring his or her own benefits until age 70.

If neither spouse has made a "file and suspend" election prior to May 1, 2016, but at least one spouse was 62 prior to January 1, 2016, a spouse who met such age requirement may make a "restricted application" to take spousal benefits upon attaining age 66, while still being able to suspend his or her own benefits until age 70, but only if the other spouse is currently receiving social security benefits.

If neither spouse has made a "restricted application" prior to May 1, 2016, nor was 62 prior to January 1, 2016, either spouse may nonetheless make an application for spousal benefits at any time between 62 and 70. However, irrespective of the age of the electing spouse when such election is made, such electing spouse: (a) may not defer his or her own social security benefits until age 70; (b) will only be eligible for such benefits if the other spouse is currently receiving social security benefits; (c) will always be deemed to also have made an application for his or her own benefits so as to receive their own benefits or the eligible spousal benefit, if higher; and (d) will have a reduced spousal benefit, as under prior law, if the electing spouse is under age 66.

WHERE TO FIND SOCIAL SECURITY BENEFIT RULES:

The Social Security eligibility and benefit rules are found in Title II of the Social Security Act which is in Title 42 of the United States Code. The accompanying regulations are found in Title 20, Part 404 of the Code of Federal Regulations.

The Social Security Administration administers the Act and occasionally issues rulings and policy statements which are published in the Federal Register and periodically by the agency itself. The agency also publishes the Program Operations Manual System (POMS), a large loose-leaf guide published by the agency as a reference for its employees. It is available both from the agency and on the Internet at http://policy.ssa.gov/poms.nsf. The cd-rom version is more useful than the internet version due to having a search function. The POMS, although entitled to respect as to persuasive interpretations of the code and regs, does not have the legal force of the regulations.

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In addition, the agency's own website at www.ssa.gov has publications, forms, statistical tables, actuarial information, rulings and the Social Security Handbook. Access requires a web browser that includes a security application called Secure Sockets Layer supported by most popular browsers. AARP's website (www.aarp.org) provides a calculator intended to assist in determining the elections which yield the maximum social security benefits.

Important Note: Don't make any determination or election with respect to social security benefits, or the potential loss of spousal benefits upon a remarriage, without consulting legal counsel and the social security administration at that time to confirm the effect of such determination, election, or contemplated remarriage on such benefits. These are highly technical rules and are always subject to change in social security laws or the social security's administration thereof.

FOR FURTHER INFORMATION

Foulston Siefkin regularly counsels clients on issues relating to Estate Planning and Probate. If you are interested in additional information regarding these matters, please visit our website at **www.foulston.com** or if you would like to discuss specific ways in which Foulston Siefkin can help you, contact **Tim O'Sullivan** at 316.291.9564, or at **tosullivan@foulston.com** or **Stewart Weaver** at 316.291.9736, or at **sweaver@foulston.com.**

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