amount, (which is 1⁄12 of the annual exempt amount), applies only in a beneficiary's grace year or years. (See § 404.435(a) and (b)). The annual exempt amount applies to the earnings of each non-grace taxable year prior to the year of full retirement age, as defined in § 404.409(a). A larger ''annual'' exempt amount applies to the total earnings of the months in the taxable year that precedes the month in which you attain full retirement age. The full annual exempt amount applies to the earnings of these pre-full retirement age months, even though they are earned in less than a year. For beneficiaries using a fiscal year as a taxable year, the exempt amounts applicable at the end of the fiscal year apply.

(2) We determine the monthly exempt amounts for each year by a method that depends on the type of exempt amount. In each case, the exempt amount so determined must be greater than or equal to the corresponding exempt amount in effect for months in the taxable year in which the exempt amount determination is being made.

(i) To calculate the lower exempt amount (the one applicable before the calendar year of attaining full retirement age) for any year after 1994, we multiply $670 (the lower exempt amount for 1994) by the ratio of the national average wage index for the second prior year to that index for 1992. If the amount so calculated is not a multiple of $10, we round it to the nearest multiple of $10 (*i.e.*, if the amount ends in $5 or more, we round up, otherwise we round down). The annual exempt amount is then 12 times the rounded monthly exempt amount.

(ii) The higher exempt amount (the one applicable in months of the year of attaining full retirement age (as defined in section 404.409(a)) that precede such attainment) was set by legislation (Public Law 104–121) for years 1996–2002. To calculate the higher exempt amount for any year after 2002, we multiply $2,500 (the higher exempt amount for 2002) by the ratio of the national average wage index for the second prior year to that index for 2000. We round the result as described in paragraph (a)(2)(i) of this section for the lower exempt amount.

(iii) The following are the annual and monthly exempt amounts for taxable years 2000 through 2005.

Year	For years through taxable year preceding year of reaching full retirement age — Reduction: $1 for every $2 over the exempt amount		Months of taxable year prior to month of full of retirement age — Reduction: $1 for every $3 over the exempt amount	
	Annual	Monthly	Annual	Monthly
2000	$10,080	$840	$17,000	$1,417
2001	10,680	890	25,000	2,084
2002	11,280	940	30,000	2,500
2003	11,520	960	30,720	2,560
2004	11,640	970	31,080	2,590
2005	12,000	1,000	31,800	2,650

(b) *Method of determining excess earnings for years after December 1999.* If you have not yet reached your year of full retirement age, your excess earnings for a taxable year are 50 percent of your earnings (as described in § 404.429) that are above the exempt amount. After December 31, 1999, in the taxable year in which you will reach full retirement age (as defined in § 404.409(a)), the annual (and monthly, if applicable) earnings limit applies to the earnings of the months prior to the month in which you reach full retirement age. Excess earnings are 33 1/3 percent of the earnings above the annual exempt amount. Your earnings after reaching the month of full retirement age are not subject to the earnings test.

[70 FR 28813, May 19, 2005]

§ 404.434 Excess earnings; method of charging.

(a) *Months charged.* If you have not yet reached your year of full retirement age, and if your estimated earnings for a year result in estimated excess earnings (as described in § 404.430), we will charge these excess earnings to your full benefit each month from the beginning of the year, until all of the estimated excess earnings have been charged. Excess earnings, however, are not charged to any month described in §§ 404.435 and 404.436.

(b) *Amount of excess earnings charged*—(1) *Insured individual's excess earnings.* For each $1 of your excess earnings we will decrease by $1 the benefits to which you and all others are entitled (or deemed entitled—see § 404.420) on your earnings record. (See § 404.439 where the excess earnings for a month are less than the total benefits payable for that month.) (See 404.415(b) for the effect on divorced wife's and divorced husband's benefits.)

(2) *Excess earnings of beneficiary other than insured individual.* We will charge a beneficiary, other than the insured, $1 for each $1 of the beneficiary's excess earnings (see § 404.437). These excess earnings, however, are charged only against that beneficiary's own benefits.

(3) *You, the insured individual, and a person entitled (or deemed entitled) on your earnings record both have excess earnings.* If both you and a person entitled (or deemed entitled) on your earnings record have excess earnings (as described in § 404.430), your excess earnings are charged first against the total family benefits payable (or deemed payable) on your earnings record, as described in paragraph (b)(1) of this section. Next, the excess earnings of a person entitled on your earnings record are charged against his or her own benefits remaining after part of your excess earnings have been charged against his/her benefits (because of the reduction in the total family benefits payable). See § 404.441 for an example of this process and the manner in which partial monthly benefits are apportioned.

(c) *Earnings test applicability.* Public Law 106–182 eliminated the Social Security earnings test, beginning with the month in which a person attains full retirement age (as defined in § 404.409(a)), for taxable years after 1999. In the year that you reach full retirement age, the annual earnings test amount is applied to the earnings amounts of the months that precede your month of full retirement age. (See § 404.430). The reduction rate for these months is $1 of benefits for every $3 you earned above the earnings limit in these months. The earnings threshold amount will be increased in conjunction with increases in average wages.

[70 FR 28813, May 19, 2005]

§ 404.435 Excess earnings; months to which excess earnings can or cannot be charged; grace year defined.

(a) *Monthly benefits payable.* We will not reduce your benefits on account of excess earnings for any month in which you, the beneficiary—

(1) Were not entitled to a monthly benefit;

(2) Were considered not entitled to benefits (due to non-covered work outside the United States or no child in care, as described in § 404.436);

(3) Were at full retirement age (as described in § 404.409(a));

(4) Were entitled to payment of a disability insurance benefit as defined in § 404.315; (see § 404.1592 and § 404.1592a(b) which describes the work test if you are entitled to disability benefits);

(5) Are age 18 or over and entitled to a child's insurance benefit based on disability;

(6) Are entitled to a widow's or widower's insurance benefit based on disability; or

(7) Had a non-service month in your grace year (see paragraph (b) of this section). A non-service month is any month in which you, while entitled to retirement or survivors benefits:

(i) Do not work in self-employment (see paragraphs (c) and (d) of this section);

(ii) Do not perform services for wages greater than the monthly exempt amount set for that month (see paragraph (e) of this section and § 404.430); and

(iii) Do not work in non-covered remunerative activity on 7 or more days in a month while outside the United States. A non-service month occurs even if there are no excess earnings in the year.

(b) *Grace year defined.* (1) A beneficiary's initial grace year is the first taxable year in which the beneficiary has a non-service month (see paragraph (a)(7) of this section) in or after the