Social Security benefits

Generally, social security benefits are excluded from income. An exception to this rule is made for higher income taxpayers. The level of income associated with the taxation of Social Security benefits is not adjusted for inflation. Because the thresholds have not been revised since 1979, most taxpayers receiving retirement benefits and Social Security benefits will include at least part of the Social Security benefits received in taxable income.

> Comment: Social Security benefits may be subject to an income tax even though contributions into the system via social security taxes were made with after tax dollars.

The taxation of social security benefits falls under one of three categories:

. Not taxable
. Taxable to the extent of 50 percent of social security benefits
. Taxable to the extent of 85 percent of social security benefits

Items 2 and 3 above refer to the maximum amount of social security benefits that are included in a taxpayer’s taxable income calculation.

For purposes of determining the taxable amount of social security income, the following definitions must be discussed.

Modified adjusted gross income
Provisional income

Modified adjusted gross income is adjusted gross income (before the determination of the taxable portion of social security benefits) plus tax-exempt interest.

Provisional income is modified adjusted gross income plus one-half of the social security benefits received.

If a taxpayer’s provisional income is less than $25,000 for single taxpayers and $32,000 for married taxpayers social security benefits are not taxable.

If a taxpayer’s provisional income is at least $25,000 but less than $34,000 for single taxpayers and at least $32,000 but less than $44,000 for married taxpayers up to 50 percent of social security benefits received are taxable.

If a taxpayer’s provisional income is at least $34,000 for single taxpayers and $44,000 for married taxpayers up to 85 percent of social security benefits are taxable.

The term base amount refers to the minimum amount of income required to tax social security benefits at the 50 percent or 85 percent levels. The base amounts for the 50 percent level are $25,000 for single taxpayers and $32,000 for married taxpayers. The base amounts for the 85 percent level are $34,000 for single taxpayers and $44,000 for married taxpayers.

The taxable portion of social security benefits received is the lesser of one-half of the social security benefits received or one-half of the amount by which a taxpayer's provisional income exceeds the base amount. This formula is used only if at single taxpayer's provisional income is at least $25,000 but less than $34,000 or if married taxpayers' provisional income is at least $32,000 but less than $44,000. The base amounts are not adjusted annually for inflation.

EXAMPLE:

Example (1): Tom Tomes, a single retired individual, has an adjusted gross income of $12,000 (before determining if social security benefits are taxable), receives social security benefits of $7,000 a year, and has $1,500 of tax-exempt interest from a mutual fund. Tom must add his $1,500 of tax-exempt interest to his $12,000 adjusted gross income to arrive at a modified adjusted gross income of $13,500. He then adds $3,500 (one-half of his social security benefits) to his modified adjusted gross income to arrive at a provisional income of $17,000. Since Tom's $17,000 provisional income does not exceed his $25,000 base amount, none of Tom's social security benefits is includible in his gross income.

Example (2): John and Jane Mapes have an adjusted gross income of $24,000 for 2017 (Before determining if social security benefits are taxable). John, who is retired, receives social security benefits of $7,200 per year. The couple also receives $6,000 a year from a mutual fund that invests solely in tax-exempt municipal bonds. On their joint return for 2017, the Mapeses would make the following computation to determine how much (if any) of John's social security benefits must be included in their gross income.

(1) Adjusted gross income........ $24,000

(2) Plus: All tax-exempt interest... 6,000

(3) Modified adjusted gross income. $30,000

(4) Plus: One-half of ss benefits ... 3,600

(5) Provisional income $33,600

(6) Less: Base amount 32,000

(7) Excess above base amount $1,600

(8) One-half of excess above base. $ 800

(9) One-half of SS benefits 3,600

(10) Amount includible in gross income (lesser of (8) or (9)) $ 800

For single taxpayers with provisional income of at least $34,000 and married taxpayers with provisional income of a least $44,000 the formula for calculating the taxable portion of social security benefits received is:

The lesser of:

85 percent of social security benefits

OR

85 percent of the amount by which a taxpayer's provisional income exceeds the base amount ($34,000 for single taxpayers and $44,000 for married taxpayers) PLUS

The smaller of $4,500 for single taxpayers, $6,000 for married taxpayers

or

One-half of the social security benefits received

EXAMPLE:

Example (3): In 2017, Marcia Miller, who is unmarried, receives $10,000 in social security benefits and has $70,000 in modified adjusted gross income. Marcia's provisional income of $75,000 (modified AGI of $70,000 plus one-half of $10,000) exceeds the threshold amount for single individuals, $34,000. Thus, Marcia must compute the amount of her social security benefit that is includible in gross income in 2017 as follows:

(1) Provisional income............ $75,000

(2) Threshold amount $34,000

(3) Excess of (1) over (2) $41,000

(4) 85% of amount in (3) $34,850

(5) One-half of SS benefits....... $ 5,000

(6) Single factor .... $ 4,500

(7) Lesser of (5) or (6) .... $ 4,500

(8) Sum of amounts shown in (4) and (7) 39,350

(9) 85% of social security benefits...$ 8,500

(10) Amount includible in gross income (lesser of (8) or (9))... $ 8,500

Example (4): A married couple received dividend income of $41,000, tax-exempt interest of $2,000 and social security benefits of $4,000 during the calendar year. Modified adjusted gross income is $43,000 (calculated as $41,000 dividend income plus tax-exempt interest of $2,000). Provisional income is $45,000 (calculated as MAGI plus 1/2 of the $4,000 of social security benefits). The taxable portion of social security benefits is calculated as follows:

1) Provisional income........... $45,000

(2) Threshold amount $44,000

(3) Excess of (1) over (2) $1,000

(4) 85% of amount in (3) $850

(5) One-half of SS benefits....... $ 2,000

(6) Married factor .... $ 6,000

(7) Lesser of (5) or (6) .... $ 2,000

(8) Sum of amounts shown in (4) and (7) 2,850

(9) 85% of social security benefits...$ 3,400

(10) Amount includible in gross income (lesser of (8) or (9))... $ 2,850

It is important to remember that the above rules and terminology regarding the taxation of social security benefits are used only to calculate taxable social security benefits. Tax-exempt interest is **never** included in the calculation of taxable income. The taxable portion of social security benefits is included in a taxpayer's gross income.