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Social Security: Taxation of Benefits

In this Social Security resource guide we'll explain how and when social security benefits are taxed

Taxation of Benefits

Thus far in our Social Security blog series, we have covered the basics of how retirement benefits are calculated and how individuals become eligible for Social Security. We have also discussed benefits available for spouses, surviving spouses, and family members. In this fourth part, we will discuss how Social Security benefits are taxed.

It may come to the surprise of many that the retirement benefits you receive from Social Security may be taxable. At most, 85% of your benefit can be included in your annual tax bill. How much is taxable is determined by your total "combined income."

Social Security starts by looking at your Adjusted Gross Income (AGI). This includes any taxable income you have less specific deductions. They also include any non-taxable interest you receive. Many retirees like owning municipal bonds because they do not pay federal income tax on the interest. However, Social Security will add this tax-free bond income for purposes of calculating how much of your benefit is taxable.

The final component of "combined income" is one-half (1/2) of your actual Social Security benefit. One important note – qualified distributions from Roth IRAs are not included in this calculation.

For individual tax filers, if your annual "combined income" is:

- Less than $25,000, you may owe no tax on your benefit

- Between $25,000 and $34,000, you may owe tax on up to 50% of your benefit
- Above $34,000, you may owe tax on up to 85% of your benefit

For married filing-jointly, if your annual "combined income" is:

- Less than $32,000, you may owe no tax on your benefit
- Between $32,000 and $44,000, you may owe tax on up to 50% of your benefit
- Above $44,000, you may owe tax on up to 85% of your benefit

For those who will likely owe tax on their Social Security benefits, you can either have tax withheld from, or pay quarterly estimates to the IRS.

Clients often ask what, if anything, can be done to avoid taxes on their Social Security benefits. The answer is most often – not much. Many retirees have multiple income sources in retirement, be it other pension income, distributions from investment accounts, annuity income, or income from rental property.

Given the low thresholds on these income ranges, it can be very difficult to avoid these taxes. Even if you could, it may result in a significant change to your standard of living, one that most retirees are unwilling to make.

While you may not have much control over the taxation of your Social Security benefits, it is important to understand how these taxes are calculated. If you have questions regarding your own Social Security benefits, please feel free to contact us today.

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