Social Security

8532. Are social security and railroad retirement benefits taxable?

A taxpayer must include a portion of benefits in gross income if the taxpayer’s modified adjusted gross income (in most cases the taxpayer’s adjusted gross income) plus one-half of the Social Security benefits (including tier I railroad retirement benefits) received during the taxable year exceeds certain base amounts. The amounts that are required to be included in gross income are taxed as ordinary income. The more income the taxpayer has in addition to Social Security benefits, the greater the amount of those benefits are taxable. However, the amount of benefits taxable can never exceed 85% of the total benefits.

To calculate the extent to which social security benefits are taxable, add one half of Social Security benefits received during the tax year to all other income including wages, interest (including tax exempt interest), dividends, taxable pension distributions, etc. (modified adjusted gross income).[[1]](#endnote-1) Next, compare that amount with the base amount which are the following:

* $25,000 for single, head of household or qualifying widow
* $25,000 for married filing separately and living apart from other spouse for the entire tax year
* $32,000 for married filing jointly
* $0 for married filing separately and living with his or her spouse any time during the tax year[[2]](#endnote-2)

 If the modified adjusted gross income plus one half of Social Security benefits is equal or less than the base amount, no portion of the Social Security benefits are taxable.

On the other hand, if the sum of modified adjusted gross income plus one half of Social Security benefits exceeds the base amount, then a portion of those benefits are potentially taxable. The computation, however, involves the “adjusted base amount” which is the following:

* $34,000 for all filers with the exception of joint filers and a married taxpayer filing separately and living with his or her spouse any time during the tax year.
* $44,000 for joint filers.
* $0 for married taxpayer filing separately and living with his or her spouse any time during the taxable year.[[3]](#endnote-3)

If the sum of modified adjusted gross income plus one half of Social Security benefits is *greater than* the base amount but *less than* the adjusted base amount, the amount included in gross income is the lesser of 1) one-half of the Social Security benefits received during the tax year; or 2) one-half of the excess of the sum of modified adjusted gross income plus one half of Social Security benefits exceeds the base amount (referred to as the “Section 86(a)(1) Amount”).[[4]](#endnote-4)

*Example.* Married couple files a joint return. During the taxable year, they received $12,000 in Social Security benefits and have a modified adjusted gross income of $35,000. Their modified adjusted gross income plus one-half of their Social Security benefits [$35,000 + (½ of $12,000) = $41,000] is greater than the *base amount* of $32,000 but less than the *adjusted base amount* of $44,000.

So in computing the taxable amount of Social Security benefits, consider the following: The taxpayers’ Social Security benefits are $12,000 and the excess between modified adjusted gross income plus one-half of their Social Security benefits over the base amount is $9,000 ($41,000 minus $32,000). However, referring back to the formula, the amount includible is one-half of the lesser amount. Therefore, the amount of Social Security benefits included in gross income is $4,500 (one half of $9,000) because it is less than one 6,000 (one-half of the $12,000 total Social Security benefits).

If the sum of modified adjusted gross income plus one half of Social Security benefits is *greater than* the adjusted base amount, the amount included in gross income is the lesser of the sum of 1) 85% of the amount of modified adjusted gross income over the adjusted base amount plus the lesser of (a) the Section 86(a)(1) Amount or b) one half of the difference between the adjusted base amount and the base amount) or 2) 85% of the Social Security benefits received during the tax year.

*Example.* During the taxable year, a single individual had a modified adjusted gross income of $33,000 and received $8,000 in Social Security benefits. His modified adjusted gross income plus one-half of his Social Security benefits [$33,000 + (½ of $8,000) = $37,000] is greater than the applicable *adjusted base amount* of $34,000.

So tracking the formula above: The lesser of

 1) 85% of the amount of modified adjusted gross income over the adjusted base amount $3,000 ( $37,000 modified adjusted gross income minus $34,000 the adjusted base amount), or **$2,550** plus the lesser of a) the Section 86(a)(1) Amount $6,500 (which is one half of $13,000, i.e., the excess of $37,000 modified adjusted gross income over the base amount $24,000) or b) **$4,500** (which is one half of $9,000, the difference between $34,000 adjusted base amount and $25,000 base amount; or

85% of total Social Security benefits of $8,000, or **$6,800**.

So consolidating the above formula, 85% of $3,000, or $2,550 plus $4,500 equals $6,550 which is less than 85% of $8,000, or $6,800. So, the amount included in gross income is $6,500.

8532.02. What other issues relate to the taxation of social security and railroad retirement benefits?

Railroad retirement benefits (other than Tier I benefits) are taxed like benefits received under a qualified pension or profit sharing plan. For this purpose, the Tier II portion of the taxes imposed on employees and employee representatives is treated as an employee contribution, while the Tier II portion of the taxes imposed on employers is treated as an employer contribution.[[5]](#footnote-1)

As mentioned above, the base amount and adjusted base amount of a married taxpayer filing separately who lives with his or her spouse anytime during the tax year is zero. This means it is much more likely that 85% of his or her Social Security benefits will be taxable even if the other income is on the low end. So the issue of whether separated taxpayers are living apart is significant.

To this point, the Tax Court held that the term “live apart” means living in separate residences for purposes of IRC Section 86(c)(1)(C)(ii). Thus, where the taxpayer lived in the same residence as his spouse for at least 30 days during the tax year in question (even though maintaining separate bedrooms), the Tax Court ruled that he did not “live apart” from his spouse at all times during the year; therefore, the taxpayer’s base amount was zero.[[6]](#footnote-2)

A taxpayer may elect to treat a lump sum payment of benefits as received in the year in which the benefits are attributable.[[7]](#footnote-3)

Any workers’ compensation pay that reduced the amount of Social Security received and any amounts withheld to pay Medicare insurance premiums are included in the figure for Social Security benefits.[[8]](#footnote-4)

Another issue that has arisen is whether Social Security disability payments should be lumped in with regular Social Security benefits. In *Green v. Comm*.,[[9]](#footnote-5) the taxpayer argued that his Social Security disability benefits were excludable from gross income[[10]](#footnote-6) because they had been paid in lieu of workers’ compensation. The Tax Court determined, however, that Title II of the Social Security Act is *not* comparable to workers’ compensation, which provides benefits based on a taxpayer’s employment. Instead, the Act allows for disability payments to individuals regardless of employment. Consequently, the taxpayer’s Social Security disability benefits were includable in gross income.

In a case of first impression, the Tax Court held that a taxpayer’s Social Security disability insurance benefits (payable as a result of the taxpayer’s disability due to lung cancer that resulted from exposure to Agent Orange during his Vietnam combat service) were includable in gross income under IRC Section 86 and were not excludable under IRC Section 104(a)(4). The court reasoned that Social Security disability insurance benefits do not take into consideration the nature or cause of the individual’s disability. Furthermore, the Social Security Act does not consider whether the disability arose from service in the Armed Forces or was attributable to combat-related injuries. Eligibility for purposes of Social Security disability benefits is determined on the basis of the individual’s prior work record, not on the cause of disability. Moreover, the amount of Social Security disability payments is computed under a formula that does not consider the nature or extent of the injury. Consequently, because the taxpayer’s Social Security disability insurance benefits were not paid for personal injury or sickness in military service within the meaning of IRC Section 104(a)(4), the benefits were not eligible for exclusion under IRC Section 104(a)(4).[[11]](#footnote-7)

1. IRC Sec. 86(b)(2). [↑](#endnote-ref-1)
2. IRC Sec. 86(c)(1). [↑](#endnote-ref-2)
3. IRC Sec. 86(c)(2). [↑](#endnote-ref-3)
4. IRC Sec. 86(a)(1). [↑](#endnote-ref-4)
5. . See IRC Sec. 72(r)(1). [↑](#footnote-ref-1)
6. *. McAdams v. Comm*., 118 TC 373 (2002). [↑](#footnote-ref-2)
7. . IRC Sec. 86(e). [↑](#footnote-ref-3)
8. . Rev. Rul. 84-173, 1984-2 CB 16. [↑](#footnote-ref-4)
9. . TC Memo 2006-39. [↑](#footnote-ref-5)
10. . Under IRC Section 104(a)(1). [↑](#footnote-ref-6)
11. . *Reimels v. Comm.,* 123 TC 245 (2004), affi’d, 436 F.3d 344 (2d Cir. 2006); *Haar v. Comm.*, 78 TC 864, 866 (1982), aff’d, 709 F.2d 1206 (8th Cir. 1983), followed. [↑](#footnote-ref-7)