DEPARTMENT OF THE TREASURY
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OFFICE OF CHIEF COUNSEL

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The Honorable Tim Holden
Lebanon County District Office
758 Cumberland Street
Lebanon, PA 17042

Attention:

Dear Congressman Holden:

I am responding to your inquiry, dated March 2, 2009, on behalf of your constituent, . wrote about the taxation of social security benefits and the accuracy of a post card mailing he received regarding the possibility of lowering the amount of taxable social security benefits.

Income Tax Treatment of Social Security Benefits

Prior to 1983, social security benefits were not subject to income tax. The income tax treatment of social security benefits is governed by section 86 of the Internal Revenue Code (the Code). The legislative history of section 86 of the Code says the Congress believed the prior policy of excluding all social security benefits from a recipient's gross income was inappropriate. The Congress reasoned that social security benefits are similar to benefits received under other retirement systems, which the law taxes if they exceed a worker's after-tax contributions. Consequently, taxing a portion of social security benefits improves tax equity by treating more nearly equally, all forms of retirement and other income designed to replace lost wages (for example, unemployment compensation and sick pay). See S. Rep. No. 98-23, 98th Cong., 1st Sess. 25 (1983), 1983-2 C.B. 326, 328.

In 1983, the Congress taxed up to 50 percent of social security benefits for taxpayers whose modified adjusted gross income plus 50 percent of social security benefits exceeded $25,000 for an individual or $32,000 for a married couple filing a joint tax return. The 1993 Omnibus Budget Reconciliation bill introduced the two tier system (sometimes referred to as a “graduated” system) for the calculation of taxable social security benefits. This bill taxed up to 85 percent of social security benefits taxable for taxpayers whose income modified adjusted gross income plus 50 percent of social security benefits exceeded $34,000 for an individual or $44,000 for a married couple filing a joint tax return. Accordingly, the taxable portion of social security benefits depends on the benefit amount, the amount of other income, and the filing status.

Calculation of Taxable Portion of Social Security Benefits

Taxpayers must include a portion of the social security benefits they receive in gross income and these benefits are taxable if the recipient's “provisional income” exceeds certain threshold levels [section 86 of the Code]. The term “provisional income” describes the sum of modified adjusted gross income and one-half of the social security benefits reported to the taxpayer on Form SSA-1099. The Code does not define the term “provisional income” but it is referred to in the legislative history of section 86. See H. Rep. No. 103-111, 103d Cong., 1st Sess. 654 (1993), 1993-3 C.B. 167, 230.

To determine the amount of taxable social security benefits, the taxpayer must first determine the taxpayer's adjusted gross income. Generally, the lower a person's adjusted gross income (and, thus their provisional income), the lower the portion of social security benefits, if any, that will be taxed. For this purpose, adjusted gross income does not include any of the social security benefits reported to them on Form SSA-1099.

Second, the taxpayer must calculate the taxpayer’s modified adjusted gross income [section 86(b)(2) of the Code]. To calculate modified adjusted gross income, the taxpayer must add the items below to the taxpayer's adjusted gross income:

- Exclusions for income on savings bonds used to pay higher education expenses under section 135
- Exclusions for amounts paid under an adoption assistance program of the employer under section 137
- Deductions for interest on qualified educational loans under section 221
- Exclusions applicable to citizens or residents of the United States living aboard under section 911
- Exclusions for income from sources within possessions of the United States under section 931
- Exclusions for income from sources within Puerto Rico under section 933
- Tax-exempt interest the taxpayer received or accrued during the taxable year

Third, the taxpayer must add 50 percent of the taxpayer's social security benefits to the modified adjusted gross income to determine provisional income. If the provisional income exceeds $25,000 for single taxpayer and $34,000 for a married couple filing a joint tax return, up to 50 percent of the social security benefit may be taxable. If the provisional income exceeds $32,000 for single taxpayer or $44,000 for married couple filing a joint tax return taxpayers filing jointly, up to 85 percent of the social security benefits may be taxable. The taxable amount depends on how much the provisional income exceeds the thresholds.

A detailed explanation of the taxation of social security benefits is available in the enclosed Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*. The publication contains worksheets for calculating the taxable portion of social security benefits.

Lowering Provisional Income

By lowering provisional income, a taxpayer could possibly lower the percentage of taxable social security benefits or even avoid taxation on social security benefits altogether. The postcard received suggests that application of section 72 of the Code might help reduce provisional income. Section 72 deals generally with commercial annuity products and retirement annuities. Both of these items, however, may result in additional taxable income. To judge the impact of annuities for all federal tax purposes, including the determination of provisional income, taxpayers would have to consider several factors, including one's tax bracket, itemized deductions, exemptions, and income requirements.

I hope this information is helpful. If you need further information, please contact me or at .

Sincerely,

Janine Cook
Chief, Employment Tax, Branch1
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosure