READY FOR RETIREMENT?
Tools to Achieve Peace of Mind

Social Security and Taxes

Social Security is a safety net for the middle class and a lifeline for millions more. For more than 60 percent of Americans age 65 and over, it provides over 50 percent of their retirement income, and it is a guaranteed life-long source of retirement security that keeps pace with inflation and income growth. While many people rely solely on Social Security to help them afford the basic necessities of retirement, some retirees also have income from other sources.

Most retirees do not have to pay federal income taxes on their Social Security benefits, but for those who receive substantial income in addition to Social Security, up to 85 percent of the benefits may be taxable. According to the Social Security Administration, about one third of benefit recipients pay federal taxes on their Social Security benefits. The Social Security benefits may become taxable when retirees' "provisional income" exceeds certain limits.

In addition to federal taxes, Social Security may sometimes be subject to state and local income taxes. Currently, 35 states exempt Social Security. Check with the state you live in to determine if you have to pay both federal and state taxes on a portion of your Social Security benefits.

Calculating Provisional Income

The first step in estimating any taxes you might have to pay on your Social Security benefit is to calculate your provisional income. Provisional income is defined by the Internal Revenue Service (IRS) as the sum of wages, taxable and nontaxable interest, dividends, pensions, self-employment and other taxable income plus half (50 percent) of your annual Social Security benefits.

Calculating Taxable Social Security Benefits

Start with:	*50 Percent of Social Security Benefits Received* **[$ ________]**
Add:	*Additional Income** **[$ ________]**
Equals:	*Total Combined Income* **[$ ________]**

**wages, self-employment income, pension benefit, interest earned (taxable and nontaxable), dividends received, and other taxable income*

Income Limits Which May Trigger Taxation of Social Security

The second step is comparing your provisional income to the limits applicable to your tax filing status and situation. The IRS requires you to include Social Security benefits in your income calculation if your provisional income exceeds the limits. For retirees above the limits, up to 50 percent of Social Security benefits must be included. As income increases, the share of included benefits increases to 85 percent. When benefits are included in income, they may become subject to taxes, but this is not necessarily the case due to various tax deductions.

The amounts of the limits depend on a retiree's filing status. For single taxpayers, 50 percent of Social Security benefits may become taxable when their provisional income exceeds $25,000. For single retirees with provisional income over $34,000, up to 85 percent of Social Security benefits may be taxable. The same limits apply to heads of households, and married taxpayers filing separately, who have lived apart from their spouse for the entire tax year and in certain other situations.

If you are a married taxpayer filing jointly and your total combined income is greater than $32,000, then up to 50 percent of your Social Security benefit may be taxable. If your total

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combined income is greater than $44,000, then up to 85 percent of your benefit may be taxable.

For married taxpayers filing separately who have lived together at any time during the tax year, limits are zero ($0). This means that for such taxpayers, up to 85 percent of their Social Security benefits may be taxable.

Income	**Tom**	**Carole**
Pension Received	*$22,000*	*$0*
Interest earned	*$500*	*$0*
1/2 Social Security	*$3,750*	*$1,750*
Total	*$26,250*	*$1,750*
Tom and Carol's Provisional Income	*$28,000*	

Tom and Carol's Social Security benefits will not be taxable

Consider this example of Tom and Carol who filed a joint return for 2010 in which both received Social Security benefits. Tom's annual Social Security benefit was $7,500 and Carol's was $3,500. Tom also received a taxable pension of $22,000 and interest income of $500. The couple's provisional income was $28,000 (pension plus interest plus half of each spouse's Social Security benefits). Under the IRS rule, their Social Security benefits are not taxable because their total combined income did not surpass the $32,000 threshold for a married couple filing jointly. If Tom's pension was $30,000, however, then 50 percent of their Social Security benefits may become taxable.

U.S. citizens who live in Canada and certain other countries (Egypt, Germany, Ireland, Israel, Italy, Romania or the United Kingdom) are exempt from U.S. tax on Social Security benefits regardless of their income. A lump sum death benefit is not subject to tax either.

If you claim a Social Security benefit, you will receive a SSA-1099 form that tells you your total benefits for the year. The SSA-1099 form should also come with a worksheet to help you figure out if any of your benefits are taxable.

How Much of Your Benefits Are Included in Income Computation?

The third step for those retirees who have provisional income above the limit is calculating how much of their Social Security income is actually included in income. This is a fairly complicated calculation and is best performed using appropriate worksheets or software. For example, if a retiree is required to include 50 percent of the Social Security benefits in his or her income calculation, the includible amount is the lesser of:

- ❑ one half (50 percent) of the annual benefits received, or
- ❑ one half (50 percent) of the excess of taxpayer's provisional income over the threshold.

The calculation is more complicated for those retirees who must include 85 percent of their Social Security benefits in income. The instructions for IRS Form 1040, an individual tax filing form, contain a worksheet for this computation. Tax preparation software may perform this calculation automatically. Alternately, you may want to consult a tax advisor to assist you with this calculation.

Paying Taxes on Social Security

It is important to make tax payments during the year if you expect to owe them at the end of the year. You have several choices available to you. You can choose to have the federal taxes withheld from your monthly check when you apply for benefits. Alternatively, you can make quarterly estimated payments. If taxes were overpaid during the year, taxpayers receive a refund at the time of tax filing. If insufficient taxes were paid during the year, taxpayers send a tax due payment at that time. If the deficiency was large, however, taxpayers may owe penalties, which makes timely and sufficient payments important.

If you decide to have taxes withheld you will need to request that the Social Security Administration withhold taxes by submitting the IRS form W-4V which can be obtained from either the Social Security Administration or the IRS. On the form you will need to select the percentage (7 percent, 10 percent, 15 percent, or 25 percent) of your monthly benefits that you want withheld.

After completing the form it will need to be signed and returned to the Social Security Administration. To find out what a percentage is equal to in dollars you can call the Social Security Administration at 1-800-772-1213.

Your To Do List:

- ❏ Call the Social Security Administration at **1-800-772-1213** to get a copy of your Social Security benefits.
- ❏ Calculate your total income using the worksheet provided.
- ❏ Determine how much in taxes you will have to pay on your benefits.
- ❏ Use AARP's Social Security Benefits Calculator to see how your earned income may impact your Social Security benefits: **www.aarp.org/socialsecuritybenefits**.
- ❏ Make sure you're on track to reach your retirement goals. AARP's *Ready for Retirement? Tools to Achieve Peace of Mind*SM can help you get started: **www.aarp.org/readyforretirement**.
- ❏ Contact the Social Security Administration at **1-800-772-1213** or **www.ssa.gov** for additional questions.

Worksheet to Estimate Taxes Owed

If you do surpass the income limit and have to pay taxes on a portion of your Social Security, you can use the following worksheet to estimate how much tax you will pay on your benefits.

For the most accurate estimate, please see the IRS Publication 915, Social Security and Equivalent Railroad Retirement Benefits.

Scenario 1 - Single People with Income Between $25,000 and $34,000

Steps

1.	*Start with 50% of your total annual SS benefit*		$ ________
2.	*Sum your additional wages for the year*	+	$ ________
3.	*Add the two together to arrive at Total Combined Income (Must be between $25,000-$34,000)*	=	$ ________
4.	*Subtract $25,000*	–	$ 25,000
		=	$ ________
5.	*Multiply by 50%*	x	0.50
	Total	=	$ ________
6.	**Compare Total** *to 50% of SS benefit* **(Line 1)**		
	Your Social Security benefits subject to taxes is the lesser of the two items		$ ________

Scenario 2 - Married Filers with Income Between $32,000 and $44,000

Steps

1.	*Start with 50% of your total annual SS benefit*		$ ________
2.	*Sum your additional wages for the year*	+	$ ________
3.	*Add the two together to arrive at Total Combined Income (Must be between $32,000-$44,000)*	=	$ ________
4.	*Subtract $32,000*	–	$ 32,000
		=	$ ________
5.	*Multiply by 50%*	x	0.50
	Total	=	$ ________
6.	**Compare Total** *to 50% of SS benefit* **(Line 1)**		
	Your Social Security benefits subject to taxes is the lesser of the two items		$ ________

Scenario 3 - Single People with Income Greater Than $34,000

Steps

1.	*Start with 50% of your total annual SS benefit*		**$** ________
2.	*Sum your additional wages for the year*	**+**	**$** ________
3.	*Add the two together to arrive at Total Combined Income (Must be greater than $34,000)*	**=**	**$** ________
4.	*Subtract $34,000*	**–**	**$** 34,000
		=	**$** ________
5.	*Multiply by 85% to arrive at the*	**x**	0.85
	Base Amount	**=**	**$** ________
6.	*Calculate three possible options and choose the smallest:*		
	Option A.		
	Start with the Base Amount (Line 5)		**$** ________
	Add $4,500	**+**	**$** 4,500
	Option A Total	**=**	**$** ________
	Option B.		
	Start with Total Combined Income (Line 3)		**$** ________
	Subtract $25,000	**–**	**$** 25,000
	Subtotal	**=**	**$** ________
	Multiply by 50%	**x**	0.50
	Option B Total	**=**	**$** ________
	Option C.		
	Start with total Social Security Benefits		**$** ________
	Multiply by 85% to arrive at the	**x**	0.85
	Option C Total	**=**	**$** ________
	Your Social Security benefits subject to taxes is the lesser of the three options		**$** ________

Scenario 4 - Married Filers with Income Greater Than $44,000

Steps

1.	*Start with 50% of your total annual SS benefit*		$ ________
2.	*Sum your additional wages for the year*	+	$ ________
3.	*Add the two together to arrive at Total Combined Income (Must be greater than $44,000)*	=	$ ________
4.	*Subtract $44,000*	–	$ 44,000
		=	$ ________
5.	*Multiply by 85% to arrive at the*	x	0.85
	Base Amount	=	$ ________
6.	*Calculate three possible options and choose the smallest:*		
	Option A.		
	Start with the Base Amount (Line 5)		$ ________
	Add $6,000	+	$ 6,000
	Option A Total	=	$ ________
	Option B.		
	Start with Total Combined Income (Line 3)		$ ________
	Subtract $32,000	–	$ 32,000
	Subtotal	=	$ ________
	Multiply by 50%	x	0.50
	Option B Total	=	$ ________
	Option C.		
	Start with total Social Security Benefits		$ ________
	Multiply by 85% to arrive at the	x	0.85
	Option C Total	=	$ ________
	Your Social Security benefits subject to taxes is the lesser of the three options		$ ________

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