

# Episode #331 – Can I Reduce Income Taxes on My Social Security Benefits?

Hello and welcome to another episode of Money Script Monday. My name's Sean Brady and today's topic is, "Can I Reduce Income Taxes on My Social Security Benefits?"

First, we should go over how social security benefits are taxed. Generally, the more income you have, the more income tax you will pay on Social Security benefits. If your income is low, none of your Social Security benefits will be taxed. But people with moderate to high incomes can have up to 50% or up to 85% of their benefits taxed. Income deferred in nonqualified deferred annuities, or IRAs, or even income distributed tax-free from Roth IRAs when a qualified distribution occurs, can keep your income low. Lower income can reduce or eliminate the taxes on your Social Security benefits.

Now let's explore the 0%, up to 50%, and up to 85% levels. If your income is less than \$32,000 for joint filers, \$25,000 for single, you have not reached the threshold. None of your Social Security benefits will be taxed as ordinary income. When income falls between \$32,000 and \$44,000 for joint filers, \$25,000 to \$34,000 for single, up to 50% of your Social Security benefits may be taxed as ordinary income. If you're above \$44,000 for joint filers \$34,000 for single, up to 85% of your Social Security benefits may be taxed as ordinary income.

If you're married filing separately, then you have a threshold of zero dollars if you lived together at all during the year. If you lived apart from your spouse for the entire year, the single filers threshold will apply to you. For more information on this, for more details, refer to Social Security Worksheet found on IRS form 1040. Those instructions are available on [irs.gov](https://www.irs.gov).

What makes up the income to reach the threshold? The income is called combined income. For purposes of reaching the threshold, most income is included, but only half of your Social Security benefit for the year. Surprisingly, even municipal bond interest is counted, even though it would be otherwise tax exempt. Income still deferred inside a nonqualified deferred annuity, IRA, or retirement arrangement is not included, nor are Roth IRA qualified distributions.

Let's get into a before and after example of what this looks like. In Example 1, we have Mr. and Mrs. Smith. They file a joint income tax return and they received the following combined income: \$27,500 of other income, \$10,000 of bond interest, and \$2,500, which is one half of their social security benefits. That combined total is \$40,000. Now, \$40,000 is \$8,000 over the \$32,000 threshold. This means that the Smiths pay income tax on 50% of their Social Security benefits, so, \$2,500 of their \$5,000 benefit is included in taxable income.

What would change if, instead of the municipal bond investment, they had purchased a nonqualified deferred annuity or contributed to a Roth IRA? With a nonqualified deferred annuity, the \$10,000 interest on the annuity would not count as taxable income until withdrawn. Alternatively, with a Roth IRA, even if the Smiths withdrew the \$10,000 of Roth IRA income, the amount would be income-tax-free, assuming the Roth IRA distribution was a qualified distribution.

In Example 2, the Smiths would not have reached the "up to 50%" threshold and none of their Social Security benefits would have been taxed. The impact of this technique is even greater when you can minimize up to 85% inclusion at higher income tax rates.

The bottom line is nonqualified deferred annuities, traditional IRAs, and Roth IRAs might give you flexibility to reduce income, thus keeping the income tax on Social Security benefits down. I encourage you to work with your financial and tax advisors today to compare your income to the social

security income thresholds to determine whether you owe income tax on your social security benefits and discover ways to minimize the tax burden. That concludes today's presentation, I hope you found it of value, and we'll see you again next time on Money Script Monday.