PARAGON
Financial Partners

Podcast Episode 18 – Is My Social Security Income Taxable? | March 31, 2017

Introduction:
Welcome to the Paragon Financial Partners podcast, where we discuss the markets, our strategies and how to live better today while planning for tomorrow.

Elean:
Hello, and welcome to the Paragon podcast. I'm Elean Mendoza, and I'm here with Evan Shorten, the firm's founder and principal.

Evan:
Hello, I'm Evan Shorten and I want to thank you all for tuning in. We hope this podcast continues to be educational and provides you with some useful information. To listen to our previous episodes, you can visit us at paragonfinancialpartners.com/media or you can subscribe to our podcast via iTunes or Stitcher Radio.

Elean:
Today we continue with our social security mini-series, where we cover some of the most common questions surrounding social security benefits. Last time we talked about how working and earning income affects your social security benefits. If you did not have a chance to listen to that episode, we highly recommend you do so, as it clarifies a lot of misconceptions people have with regards to working while receiving benefits. Today, we discuss how social security benefits are taxed. This is the question we get asked often, and we have also found that many people assume social security benefits are not subject to taxation. The answer to the question of how social security benefits are taxed is unsurprisingly a common one, "It depends." And it depends on your combined income. Combined income is an important term with regards to social security benefit taxation as the social security administration takes a slightly different view as to what gets counted in your combined income.

Evan:
Yes it depends on your combined income, and when it comes to the taxation of social security benefits, the Social Security Administration calculates your combined income as your modified adjusted gross income, plus one-half of your combined social security benefits, plus any tax-exempt interest you receive. I know that sounds like a mouthful so I'm going to break that down before I continue with the explanation.

The first component of combined income is your modified adjusted gross income, also referred to as your MAGI, M-A-G-I. Your MAGI is your adjusted gross income, which can be found on line 37 of your IRS Form 1040, with adjustments added back in. Those adjustments may include how much of an IRA contribution is deducted, foreign income, student loan deductions, and tax-exempt interest. Additionally, the combined income component is not limited to earned income, but also includes income from pensions and retirement accounts. The second component is fairly straightforward – one half of your combined social security benefits. The third component, which we mentioned in the MAGI definition, is the tax-exempt interest you receive.

Elean:
This might come as a surprise to our listeners, so it's important to emphasize tax-exempt interest. The income you earn from tax-free bonds is taken into consideration when determining your combined income with respects to taxation of your social security benefits.

Evan:
Yes, while the income from a tax-free-bond may be exempt, it may still affect how much tax you will owe on your social security benefit. So now that we defined how the Social Security Administration determines your combined income, let's talk about how much you could potentially be liable for in taxes. If the combined income is between $25,000 to $34,000 for those filing an individual tax return or in between $32,000 to $44,000 for those filing a joint tax return, up to 50% of your social security benefits may be taxed. If your combined income exceeds $34,000 as an individual tax filer or $44,000 if married filing jointly, up to 85% of your benefits may be taxed. Finally, if you are married filing separately, 85% of your benefits will be taxable no matter how much other income you have.

Elean:
Those income ranges seem unusually low to me. I know when I learned that I was blown away because that's not a lot of money to live off of, even in retirement. To have up to 85% of your social security benefit taxed away for making a combined income of over $44,000 seems wrong.

Evan:
Well, just remember the tax is not up to 85%, but up to 85% of the benefit is taxed; and yes, the income thresholds are pretty low. They were established in 1983 and have not been adjusted for inflation. Essentially, those who managed to save up a sizable income providing nest egg are sure to pay higher tax rates on their social security benefits. Given the low-income thresholds, it's important to consider the possibility of delaying social security benefits until age 70 to give you a chance to boost your social security benefit and to defer some of the taxation on your benefits. Additionally, this is another reason as to why it's important to sit down with your financial advisor or tax advisor.

Elean:
So we hope this episode didn't shock you too much with respect to how your social security benefits get taxed. Hopefully we've provided some new insights and things for you to consider. If you have any questions or would like to reach out to us, you can do so by emailing us at info@paragonfinancialpartners.com or by shooting us a comment on our Facebook page. We hope you enjoyed this podcast and please subscribe via iTunes or Stitcher Radio. Thank you for listening.

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