

ARE YOUR SOCIAL SECURITY BENEFITS TAXABLE?

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According to a recent AARP survey, Social Security is supported by more than 90% of the population and critical to older Americans' financial health, with four out of five of those polled expecting to rely on Social Security during their later years.¹

Most likely Social Security benefits are a part of your retirement financial plan too. If so, you're not alone — approximately 65 million Americans received Social Security benefits amounting to more than \$1 trillion during 2020.²

Yet many Americans, even those who are already retired and receiving benefits, still struggle with the facts and myths surrounding how the Social Security system works. The example on the right highlights one of the most misunderstood scenarios.

It's easy to understand why people are confused. With federal laws, IRS rules, and dollar amounts constantly changing, it's difficult to keep up with current guidelines. Perhaps the answers to the following four common questions may help shed some light on the current regulations.

WHAT SOCIAL SECURITY BENEFITS ARE TAXABLE?

First of all, it's important to know what the IRS considers as a "benefit." Social Security benefits include monthly retirement, survivor, and disability payments. Supplemental security income payments (which are not taxable) are not included.

If you receive Social Security payments, each January you should get a Benefit Statement (Form SSA-1099) that lists your benefits received the previous year. You can use the information on this form to calculate how much — if any — of your Social Security benefits are subject to taxation. (If for some reason you do not receive this form in the mail, you can find it on www.ssa.gov under the "replacement documents" tab in "My Social Security Account").

HOW DO I CALCULATE THE TAX RATE ON MY SOCIAL SECURITY BENEFITS?

The portion of your benefits that you may need to pay taxes on depends on your income and filing status. Generally, if Social Security is your only source of retirement income, likely you won't have to pay taxes on your benefits. In January 2021, the average Social Security payment was \$1,543 for retired workers. For married couples who both received benefits, the average payment was \$2,596 (below the threshold for taxation of benefits).³

FACT OR MYTH: SOCIAL SECURITY BENEFITS ARE NOT TAXABLE

This is a myth. However, it was a fact — that is, until 1984. At that time, the Social Security overhaul passed by Congress the previous year included a provision that made a portion of the benefit taxable depending on your income level. You pay federal income tax on up to 50% of your benefits if your annual income is \$25,000 to \$34,000 for an individual filer and \$32,000 to \$44,000 for a couple filing jointly. Above those thresholds, up to 85% of benefits are taxable.¹

To determine if your Social Security benefits are taxable, refer to your Benefit Statement (Form SSA-1099) and follow these IRS guidelines⁴:

- To calculate your total income, take one half of the Social Security money you were paid during the previous year and add it to the Adjusted Gross Income line from your tax return plus any non-taxable interest you may have. Note: qualified Roth IRA distributions do not count for this calculation.
- If you are filing your taxes as single, head of household, qualifying widow or widower with total income between \$25,000 and \$34,000, fifty percent of your benefits may be taxable. If your total income is more than \$34,000, up to 85% of your benefits may be taxed.
- If you are married filing separately and lived apart from your spouse for the entire tax year, 50% of your benefits may be taxable if your total income is between \$25,000 and \$34,000. If your total income is more than \$34,000, or if you lived with your spouse at any time during the previous year, up to 85% of your benefits may be taxed.
- If you are married filing jointly, take half of your Social Security benefits you were paid during the previous year plus half of your spouse's benefits paid and add those amounts to all other combined income. If that total amount of income is between \$32,000 and \$44,000, fifty percent of your benefits may be taxable. If your total combined income is more than \$44,000, up to 85% of your benefits may be taxed.

CAN I ELECT TO HAVE FEDERAL TAXES WITHHELD FROM MY BENEFIT CHECKS?

If you think you are going to owe taxes on your Social Security benefits, you can elect to have federal taxes withheld from your benefit checks by filling out IRS Form W-4V. You can choose to have 7%, 10%, 12%, or 22% of your monthly benefit automatically withheld for taxes. Or, you can make quarterly estimated tax payments directly to the IRS. Of these two options, it's much easier and more convenient to have it withheld from your monthly benefit amount.³

ARE THERE STATE TAXES ON SOCIAL SECURITY INCOME?

That depends — state income tax rules vary from state to state. There are some states that don't have an income tax, and most states don't tax Social Security benefits at the state level even if benefits are taxed at the federal level. Check with your tax professional regarding specific rules that apply to your state of residence, income level, and filing status.

STILL HAVE QUESTIONS?

Regardless of whether you're already retired and collecting Social Security benefits or are just starting to plan for this important milestone, it's important to get all your questions answered so you can make informed decisions. Contact Commerce Trust Company today — we will answer your questions, evaluate or update your retirement plan, and discuss other income and cash flow options that can help supplement your benefits.

- ¹ Andy Markowitz, AARP, “10 Social Security Myths That Refuse to Die,” <https://www.aarp.org/retirement/social-security/info-2020/10-myths-explained.html#>, updated September 20, 2020.
- ² Rachel Hartman, “8 Myths About Social Security,” <https://money.usnews.com/money/retirement/social-security/articles/myths-about-social-security>, U.S News & World Report, July 8, 2020.
- ³ Emily Brandon, <https://money.usnews.com/money/retirement/social-security/articles/when-you-need-to-pay-taxes-on-social-security>, “When You Need to Pay Taxes on Social Security, March 15, 2021.
- ⁴ Source: [irs.gov](https://www.irs.gov/newsroom/dont-forget-social-security-benefits-may-be-taxable), “Don’t forget, Social Security benefits may be taxable,” <https://www.irs.gov/newsroom/dont-forget-social-security-benefits-may-be-taxable>, Tax Tip 2020, Updated June 25, 2020.

The opinions and other information in the commentary are provided as of June 29, 2021. This summary is intended to provide general information only, and may be of value to the reader and audience.

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David is a financial planner with Commerce Trust Company. He is a member of the financial advisory services team, a dedicated financial planning practice within Commerce Trust that provides objective financial advice to clients. Following a thorough assessment of a client's unique situation and thoughts regarding wealth, David develops holistic and coordinated plans to help clients meet their short-term and long-term goals as well as take full advantage of various planning, tax, and investment strategies along the way. His areas of focus includes planning for financial independence, retirement, divorce, executive compensation, estate preservation, and business succession. David joined Commerce in 1995 and has held positions in private banking, credit analysis, commercial business development, and retail sales. David received his bachelor of science degree in business administration from Southeast Missouri State University. He holds both the CERTIFIED FINANCIAL PLANNER[™] and Certified Divorce Financial Analyst[™] designations. Additionally, David is a member of the Financial Planning Association and the Institute for Divorce Financial Analysts.



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