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TAXATION OF SOCIAL SECURITY BENEFITS
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As a firm specializing in assisting retirees and their families, Oast & Hook is frequently asked by its clients how their Social Security benefits are taxed. That depends on their other income. In the worst case scenario, 85% of the benefits would be taxed. (This doesn't mean you pay 85% of your benefits back to the government in taxes − merely that you would include 85% of these benefits in your income subject to your regular tax rates.)

To determine how much of your benefits are taxed, you must first determine your other income, including certain items otherwise excluded for tax purposes (for example, tax-exempt interest). Add to that the income of your spouse, if you file jointly. To this add half of the Social Security benefits you and your spouse received during the year. The figure you come up with is your total income plus half of your benefits. Now apply the following rules:

1. If your income plus half your benefits is not above $32,000 ($25,000 for single taxpayers), then none of your benefits are taxed.

2. For married couples, if your income plus half your benefits exceeds $32,000 but is below $44,000, then you will be taxed on: (1) one half of the excess over $32,000, or (2) one half of the benefits, whichever is lower. For single taxpayers, if your income plus half your benefits exceeds $25,000 but is below $34,000, then you will be taxed on: (1) one half of the excess over $25,000, or (2) one half of the benefits, whichever is lower.

Example (1): Sam and Denise have $20,000 in taxable dividends, $2,400 of tax-exempt interest, and combined Social Security benefits of $21,000. Thus, their income plus half their benefits is $32,900 ($20,000 plus $2,400 plus one half of $21,000). They must include $450 of the benefits in gross income (one half of $32,900 less $32,000). If their combined Social Security benefits were $5,000, and their income plus half their benefits were $40,000, then they would include $2,500 of the benefits in income. (In this example, one half of $40,000 less $32,000 equals $4,000, but one half of the $5,000 of benefits or $2,500 is lower, so the lower figure is used.)

Example (2): Sam has $20,000 in taxable dividends, $2,400 of tax-exempt interest, and Social Security benefits of $9,000. Thus, his income plus half his benefits is $26,900 ($20,000 plus $2,400 plus one half of $9,000). Sam must include $950 of the benefits in his gross income (one half of $26,900 less $25,000). (If his Social Security benefits were $3,000, and his income plus half his benefits were $30,000, then he would include $1,500 of the benefits in income: one half of $30,000 less $25,000 equals $2,500, but one half of the $3,000 of benefits or $1,500 is lower, and the lower figure is used.)

3. If your income plus half your benefits exceeds $44,000 ($34,000 for single taxpayers), then the computation in many cases grows far more complex. Generally, however, unless your income plus half your benefits is fairly close to $44,000 ($34,000 for single taxpayers), if you fall into this category, 85% of your Social Security benefits will be taxed.

If you aren't paying tax on your Social Security benefits now because your income is below the above floor, or if you are paying tax on only one half of those benefits, an unplanned increase in your income can have a triple tax cost. You'll have to pay tax (of course) on the additional income, you'll also have to pay tax on (or on more of) your Social Security benefits (since the higher your income the more of your Social Security benefits that are taxed), and you may get pushed into a higher marginal tax bracket. This situation might arise, for example, if you receive a large distribution from a retirement plan, such as an individual retirement account ("IRA") during the year or if you have large capital gains. Careful planning might be able to avoid this stiff tax result. For example, it may be possible to:

1. Spread the additional income over more than one year,
2. Reduce taxable income by changing investment strategies to make use of deferred annuities,
3. Convert traditional IRAs to Roth IRAs to eliminate required minimum distributions,
4. Delay taking Social Security, perhaps as late as age 70, which will also increase benefits, or
5. Liquidate assets other than an IRA, such as stock showing only a small gain or stock whose gain can be offset by a capital loss on other shares.

If you should need a large amount of cash for a specific purpose, then Oast & Hook recommends that you contact us before liquidating any assets, so we can help you determine just what your additional tax cost will be. If you know your Social Security benefits will be taxed, then you can voluntarily arrange to have the tax withheld from the payments by filing a Form W-4V. Otherwise, you may have to make estimated tax payments.

Andrew Hook is an elder law attorney with Oast & Hook, and he practices in the areas of estate planning, estate and trust administration, special needs planning, asset protection planning, long-term care planning, and Veterans' benefits. Mr. Hook is certified as an Elder Law Attorney (CELA) by The National Elder Law Foundation (NELF).

Ask Allie

O&H: Allie, we've seen the Simon's Cat videos. Please tell us about their creator.

Allie: Sure! Simon Tofield is the creator of Simon's Cat, a series of films, books, and a comic book about a demanding feline (nothing like me!). Mr. Tofield is a TV commercial animator and director, and he made a test film about his kitten. This two minute film ("Feed the Cat") became a sensation on YouTube. Mr. Tofield produced a sequel to the first film, and eventually Simon's Cat had its own YouTube channel. The plot lines are based on the adventures of Mr. Tofield's four real-life cats. (He says his cats are not as badly behaved as the fictional ones.) He has since authored three Simon's Cat books and animated 16 cat movies. There is now official Simon's Cat merchandise available. The film series has received several awards, including Best Comedy at the 2008 British Animation Awards. Mr. Tofield is a spokesman for Stray Cat Rescue, attending fundraisers and spreading the word about the charity whenever he can. He says he would like to open his own shelter someday. What a great story − I love the Simon's Cat videos! I think I'll go watch a few . . . See you next week!

Announcement

Join CB&H Wealth Management Services and Oast & Hook for an informative joint seminar that will give you a comprehensive look at both the estate planning and the financial planning elements of retirement. Advisors from both perspectives will provide you with sound advice, insight, and a sharper tool-set as you plan for retirement. During this seminar, we will explore in greater depth the following topics: Why Comprehensive Planning is Critically Important (Andrew Hook), Investment Planning (Jeffrey Gump), Risk Management / Insurance Planning (Kevin Shea), Life Care and Health Insurance Planning (Letha McDowell), and Disability and Estate Planning (Sandra Smith).

This joint seminar will be from 10:00 a.m. to noon on Wednesday, April 25th, at SpringHill Suites, Chesapeake Greenbrier, 1446 Crossways Boulevard, Chesapeake, Virginia. For more information or to register for this seminar please call Jennifer Pagano at 757-967-9704 or e-mail her at pagano@oasthook.com.

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