T. Rowe Price

What to know about Social Security benefits and your taxes

Make Your Plan

Key Insights

- People in the 10%, 12%, and 22% federal tax brackets could be affected by high marginal tax rates caused by taxation of Social Security benefits.
- Planning ahead for required minimum distributions can help you minimize or avoid high tax rates.
- High marginal tax rates tend to affect people with relatively large annual Social Security benefits. But it's not a good reason to lower your payments by claiming Social Security early.

Roger Young, CFP®
Thought Leadership Director

Federal income taxes are fairly straightforward for most people during their working years because their income is primarily derived from a paycheck. Income taxes in retirement may get more complicated, however. This is because retirees are often receiving income from multiple sources with different tax characteristics, including Social Security.

A calculation of your overall income dictates how much of your Social Security benefit is taxable. This calculated income (sometimes called "provisional" or "combined" income) is essentially half of your Social Security benefit plus other income, such as retirement plan distributions and any interest earned on municipal bonds.

Your Social Security benefits aren't taxable up to a certain threshold of provisional income. Once above that threshold, however, there's a graded scale of taxation:

- If your provisional income is $25,000 to $34,000 for single filers ($32,000 to $44,000 for joint filers), then up to 50% of your benefits are taxable.
- If your provisional income is more than $34,000 ($44,000 for joint filers), then up to 85% of your benefits are taxable.

In some cases, those in the 22% federal tax bracket could end up paying a marginal tax rate as high as 40.7% because additional retirement income causes more of their Social Security income to become taxable.

(See Figure 1, Social Security income can raise your marginal tax rate.)

Social Security income can raise your marginal tax rate

(Fig. 1) Taxes on Social Security benefits can result in marginal rates of 40.7%.

Ordinary Marginal Tax Rate (A)	Additional Social Security Benefits Taxed (B)	Potential Total Marginal Rate (A x (1+B))
10%	50%	15%
10%	85%	18.5%
12%	50%	18%
12%	85%	22.2%
22%	85%	40.7%

Note: Not all people in these brackets will have the higher marginal rate.

Who could be affected

People in the 10%, 12%, and 22% federal tax brackets could be affected by the high marginal rate, especially those with above-average Social Security benefits. If you're part of this group, consider working with a tax professional to fine-tune your retirement expenses, income, and tax projections. Doing so could help you determine whether additional planning or adjustments may be necessary.

Suppose you and your spouse collect $72,000 a year in combined annual Social Security benefits and your only other income is $70,000 of distributions from individual retirement accounts (IRAs). This makes your provisional income $106,000. At that level, you haven't quite reached the 85% cap on taxability of Social Security.[1] Now suppose you take an additional $1,000 from your IRA. You might expect to pay $220 more in taxes since you'll be in the 22% bracket. However, since that $1,000 results in $850 more of your Social Security benefits being subject to tax, your tax bill increases by $407 (22% of $1,850). Your marginal tax rate is really 40.7% at this point, but at higher income levels, it eventually goes back down to 22%. If there are steps you can take to minimize the income taxed at this level, they are worth considering.

Actions you can take

Since required minimum distributions (RMDs) may put you into this high marginal rate situation, it's important to plan before reaching age 73. One strategy to consider is converting Traditional IRA assets to a Roth IRA. Converting at a relatively low tax rate early in retirement could reduce future RMDs that would push you into a higher bracket and trigger the 40.7% marginal rate described above.

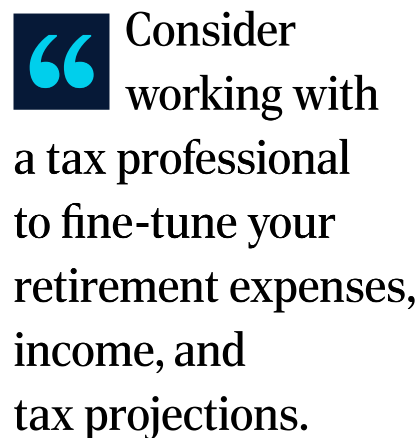
Having some financial flexibility can also help you limit your highly taxed income. If you think you could be subject to high marginal rates, you may want to fund additional spending needs with income sources that generate little or no taxable income. This could include drawing on your cash reserves or a Roth account or selling off investments with small gains.

If you're approaching the point where the maximum 85% of your Social Security benefits are taxable, you could take more taxable distributions once you pass the 85% cap. That would free up cash to use next year so that you can avoid the high marginal rate in that year.

Considering taxes

For many people, it's best to delay claiming Social Security until full retirement age or later. Waiting as long as possible to claim benefits reduces the chances of outliving your money while also maximizing survivor benefits (if you're the higher earner). While Social Security is part of a broader retirement income plan, taxes should be a secondary consideration. Remember that at least 15% of your Social Security income is exempt from federal income taxes no matter what. Don't be tempted to claim Social Security early just because you may be affected by higher marginal rates.

Like many financial aspects of retirement, taxes on Social Security benefits can be confusing. Fortunately, a little planning can prevent it from being a major problem.



[1] The taxable portion of Social Security benefits is calculated as follows: 50% of combined income between $32,000 and $44,000 = $6,000. 85% of combined income over $44,000 = 85% x ($106,000 - $44,000) = $52,700. $6,000 + $52,700 = $58,700 of Social Security benefits included in taxable income. That is less than 85% of $72,000 ($61,200), so additional income would increase the taxable portion (until the point where $61,200 is taxed).

INVEST WITH CONFIDENCE®

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are those of the authors as of December 2024 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation concerning investments, investment strategies, or account types, advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Please consider your own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. **Actual future outcomes may differ materially from any estimates or forward-looking statements provided.**

Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc., distributor. T. Rowe Price Associates, Inc., investment adviser. T. Rowe Price Investment Services, Inc., and T. Rowe Price Associates, Inc., are affiliated companies.

© 2024 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.

ID0007692
202412-4092891