

Overview: Taxable Social Security Benefit Exemption

Policy Issue & Context

The personal income level of a Social Security (SS) beneficiary determines how much of his or her or SS benefits are taxed. This taxable amount may become part of a Vermonter's adjusted gross income at the federal level, which flows through to Vermont's income tax structure as taxable income.

Although a certain percentage of SS benefits are exempt from taxation, many Vermonters must pay taxes on these benefits. In FY19, the Tax Department projects that nearly 90,000 Vermonters (roughly \$55,000 filers) will pay more than \$30M in taxes on social security benefits.

Taxable SS benefits are determined by combined income, which is briefly defined as: adjusted gross income + nontaxable interest + ½ of social security benefits. Table 1 below shows the level of taxable social security benefits by combined income and filing status:

Table 1: Taxation of Social Security Benefits by Income and Filing Status		
<u>Single/Separate/Widow/HoH</u> Combined Income	<u>Married Joint</u> Combined Income	Percentage of Social Security Benefits that are Taxed
Less than \$25K	Less than \$32K	0%
\$25K-\$34K	\$32K - \$44K	Up to 50%
Greater than \$34K	Greater than \$44K	Up to 85%

For more on the taxability of SS benefits, see:

- The Social Security Administration's ["Income Taxes and Your Social Security Benefits,"](#) and
- The Vermont Legislative Joint Fiscal Office's [October 2016 Issue Brief](#) on this issue.

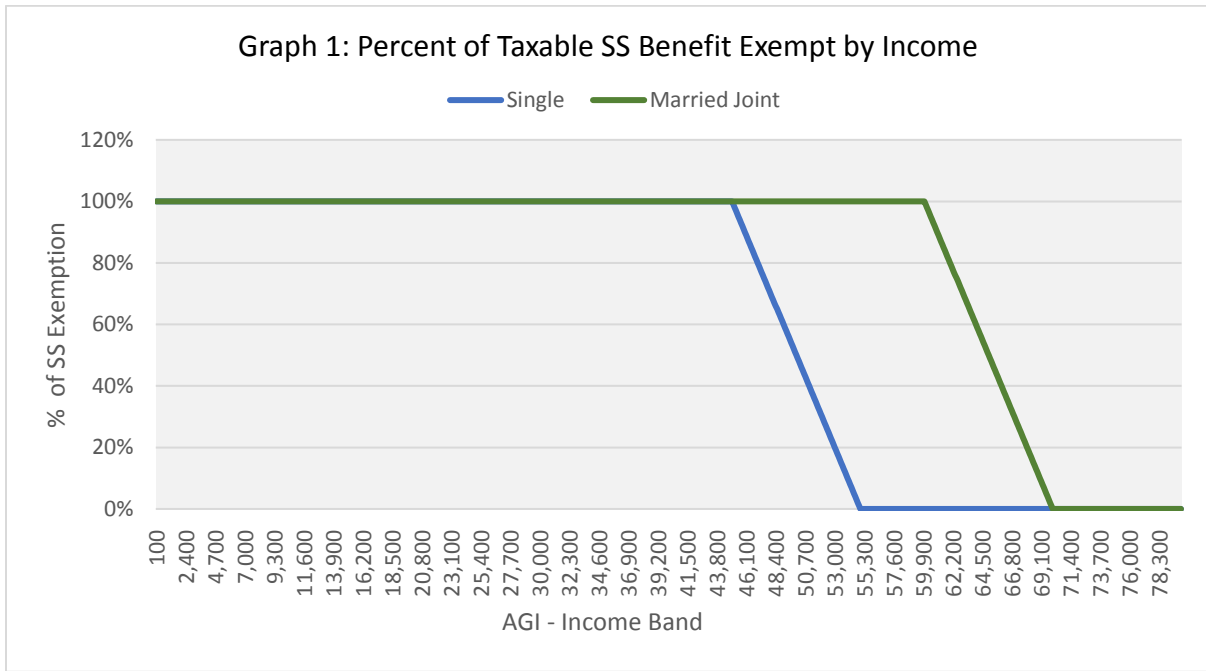
Social Security Exemption Proposal

The proposed personal income tax exemption of SS benefits reduces tax liabilities mainly for lower-middle- and middle-income Vermonters who are disabled or 65-plus-years-old. It does this by excluding from taxable income all or part of taxable SS benefits reported on Federal Form 1040. The exemption does not exclude other types of income.

For single, separate, and widow filers earning Adjusted Gross Income (AGI) up to \$45K, the Vermont exemption would apply in full and then phase out smoothly between \$45K-\$55K. It would not apply to filers with AGI greater than or equal to \$55K. For married joint filers, the exemption would apply in full up to \$60K, would phase out between \$60K-\$70K, and would not apply to filers with AGI greater than or equal to \$70K.

Table 2 on the following page illustrates how the exemption would be applied by filing status and income group. Graph 2 shows the percentage of a taxable SS benefit that would be exempt from Vermont taxable income based on income level.

Table 2: Exemption by Filing Status and Income		
Filing Status	AGI	Benefit?
Single/Separate/Widows/HoH	\$0-\$45K	Full Exemption
	\$45K-\$55K	Phaseout Range
	Amounts >= \$55K	No Exemption
Married Joint Filers	\$0-\$60K	Full Exemption
	\$60K-\$70K	Phaseout Range
	Amounts >= \$70K	No Exemption



Phase-In and Revenue Estimates

The proposed policy would be phased in over a three-year period, from Tax Years 2018-2020, which is Fiscal Years 2019-2021. The phase-in would cap the exemption at 33% of its full value in FY19, 67% of its value in FY20, and move to the full value in FY21. We will explore several examples to illustrate how this phase-in approach works.

The projected cost of this proposal in foregone revenue grows from \$1.9M in FY19 to \$6.1M in FY21. The cost estimate grows for two key reasons: 1) the exemption is being phased in over this period, and 2) Vermont's 65-plus-year-old population has been growing at an average rate of 3.5% since 2010 and is expected to continue growing at a similar rate over this period.

Table 3: Social Security Exemption Revenue Estimates			
Tax Year	FY19	FY20	FY21
Phase-In Percent	33%	67%	100%
Revenue Estimate	-\$1.9M	-\$4M	-\$6.1M

**Note on revenue estimates: The revenue estimates in Table 3 were calculated in early January using the Chainbridge Microsimulation Model and applying a demographic growth factor. These estimates were based on the Tax Department and Joint Fiscal Office’s best interpretation of the federal Tax Cuts and Jobs Act (TCJA) at that time. The population projections used in this model were based on the most up-to-date projections from Legislative Economist Tom Kavet. Since these costs were estimated, the State has learned more about how the federal government will implement the TCJA and has updated its microsimulation model. While these estimates are not anticipated to change much, if at all, they should be revisited during the session, as the State continues to refine its estimate of the TCJA and/or if the State proceeds with any tax reforms.*

Examples of Social Security Exemptions

The following two examples illustrate how the exemption is phased in over three fiscal years and how the exemption would be claimed: 1) by a single filer who receives the full exemption amount, and 2) a married joint filer in the phase-out range.

Example 1: Single Filer – No Phaseout

Example 1 is a single filer earning \$40K in AGI, with an annual SS benefit of \$16K, and a taxable SS benefit of \$10K. The taxable portion of the benefit is currently reported on Federal Form 1040, Line 20b, and this is the line from which Vermont’s income tax form would draw.

Since this filer’s income is less than the \$45K phaseout threshold for single filers, this filer can claim the full \$10K of taxable SS benefits as an exemption. In FY19, that \$10K exemption is capped at 33%, which would translate to \$3,300 for this filer. In FY20, the exemption is capped at 67%, or \$6,700 for this filer. And, in FY21 and beyond, the exemption can be claimed by this filer in full at \$10K.

Here’s another way of considering this:

Example 1: Single Filer – No Phaseout		
AGI	\$40,000	Income is below phaseout threshold
Annual SS Benefit	\$16,000	Amount on Form 1040, Line 20a
Taxable SS Benefit	\$10,000	Amount on Form 1040, Line 20b
Vermont Exemption in Full	\$10,000	Full amount of exemption; no phaseout

For simplicity, let’s say this single filer had the same AGI and taxable SS benefits in FY19-FY21. Here’s how the phase-in would affect this taxpayer’s \$10K exemption in those years.

Phase-In of \$10K Exemption			
If claimed in Fiscal Year:	FY19	FY20	FY21
Then, Exemption Capped Using:	33%	67%	100%
And the Exemption would be:	\$3,300	\$6,700	\$10,000

If, for example, this filer’s income and taxable benefit shifted so that the full exemption became \$11K in FY20, then the FY20 exemption would be \$7,370, or 67% of \$11K.

Example 2: Joint Filer with a Phaseout

Example 2 is a joint filer with an AGI of \$65K, an annual SS benefit of \$32K, and a taxable SS benefit of \$20K. The exemption for joint filers phases out between \$60K-\$70K, so this filer’s exemption would be in that phaseout range.

The phased-out exemption is calculated as follows:

1. Subtract the filer’s AGI from the phaseout ceiling → $\$70K - \$65K = \$5K$
2. Divide the difference between AGI and the ceiling by \$10K → $\$5K / \$10K = 50\%$
3. Multiply the taxable SS benefit by the phaseout percentage → $\$20K * 50\% = \$10K$

Once the phased-out exemption value is calculated, the exemption amount would be applied and phased-in using the same method as Example 1. So, the \$10K exemption in Example 2 would translate to a \$3,300 exemption in FY19 (33%*\$10K), \$6,700 in FY20 (67%*\$10K), and the full \$10K in FY21.

Another was to consider the phaseout is:

Example 2: Joint Filer with Phaseout		
AGI	\$65,000	AGI in the \$60K-\$70K Phaseout Range
Annual SS Benefit	\$32,000	Amount on Form 1040, Line 20a
Taxable SS Benefit	\$20,000	Amount on Form 1040, Line 20b
Phaseout % = (Phaseout Ceiling - AGI)/\$10K → $(\$70K - \$65K) / \$10K = 50\%$		
Exemption = Phase-Out % * Taxable SS Benefit → $50\% * \$20K = \$10K$		
Vermont Exemption in Full	\$10,000	Full exemption after phaseout

Tax Impact?

In FY19, we project that roughly 40,000 Vermonters would experience a tax decrease (26,000 filers) from this exemption. Of those filers, 54% are expected to be married joint, 43% single, and the remaining 3% would be other filing statuses (e.g. married separate, widows, etc).

Based on 2014 data, the average impact of the exemption applied in full is broken out below by income bracket and the two main filing statuses.

Model 1- Avg. Impact by Income Bracket in 2014 Dollars		
AGI Bracket	Single	Married Filing Joint
-Infinity-\$10K	-	-
\$10K-\$20K	-\$30	-
\$20K-\$30K	-\$94	-\$41
\$30K-\$40K	-\$219	-\$143
\$40K-\$50K	-\$304	-\$294
\$50K-\$60K	-\$118	-\$418
\$60K-\$70K	\$0	-\$252
\$70K-\$80K	\$0	\$0
\$80K-\$90K	\$0	\$0
\$90K-\$100K	\$0	\$0
\$100K-Infinity	\$0	\$0

Appendix

IRS Form 1040 - Page 1
Taxable Social Security Benefit Worksheet
Vermont IN-111 - Page 1

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20
Your first name and initial Last name
If a joint return, spouse's first name and initial Last name
Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).
Foreign country name Foreign province/state/county Foreign postal code

See separate instructions.
Your social security number
Spouse's social security number
Make sure the SSN(s) above and on line 6c are correct.
Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund.
You Spouse

Filing Status
1 Single
2 Married filing jointly (even if only one had income)
3 Married filing separately. Enter spouse's SSN above and full name here.
4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here.
5 Qualifying widow(er) (see instructions)

Exemptions
6a Yourself. If someone can claim you as a dependent, do not check box 6a.
b Spouse
c Dependents:
(1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4) if child under age 17 qualifying for child tax credit (see instructions)
d Total number of exemptions claimed

Boxes checked on 6a and 6b
No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above
Add numbers on lines above

Income
7 Wages, salaries, tips, etc. Attach Form(s) W-2
8a Taxable interest. Attach Schedule B if required
b Tax-exempt interest. Do not include on line 8a
8b
9a Ordinary dividends. Attach Schedule B if required
b Qualified dividends
9b
10 Taxable refunds, credits, or offsets of state and local income taxes
11 Alimony received
12 Business income or (loss). Attach Schedule C or C-EZ
13 Capital gain or (loss). Attach Schedule D if required. If not required, check here
14 Other gains or (losses). Attach Form 4797
15a IRA distributions
15a Taxable amount
15b
16a Pensions and annuities
16a Taxable amount
16b
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E
18 Farm income or (loss). Attach Schedule F
19 Unemployment compensation
20a Social security benefits
20a Taxable amount
20b
21 Other income. List type and amount
22 Combine the amounts in the far right column for lines 7 through 21. This is your total income

Adjusted Gross Income
23 Educator expenses
24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ
25 Health savings account deduction. Attach Form 8889
26 Moving expenses. Attach Form 3903
27 Deductible part of self-employment tax. Attach Schedule SE
28 Self-employed SEP, SIMPLE, and qualified plans
29 Self-employed health insurance deduction
30 Penalty on early withdrawal of savings
31a Alimony paid b Recipient's SSN
31a
32 IRA deduction
32
33 Student loan interest deduction
33
34 Reserved for future use
34
35 Domestic production activities deduction. Attach Form 8903
35
36 Add lines 23 through 35
36
37 Subtract line 36 from line 22. This is your adjusted gross income

Social Security Benefits Worksheet—Lines 20a and 20b

Keep for Your Records



Before you begin:

- ✓ Complete Form 1040, lines 21 and 23 through 32, if they apply to you.
- ✓ Figure any write-in adjustments to be entered on the dotted line next to line 36 (see the instructions for line 36).
- ✓ If you are married filing separately and you lived apart from your spouse for all of 2017, enter “D” to the right of the word “benefits” on line 20a. If you don’t, you may get a math error notice from the IRS.
- ✓ Be sure you have read the **Exception** in the line 20a and 20b instructions to see if you can use this worksheet instead of a publication to find out if any of your benefits are taxable.

<p>1. Enter the total amount from box 5 of all your Forms SSA-1099 and Forms RRB-1099. Also, enter this amount on Form 1040, line 20a 1. _____</p>		
2. Multiply line 1 by 50% (0.50)	2.	_____
3. Combine the amounts from Form 1040, lines 7, 8a, 9a, 10 through 14, 15b, 16b, 17 through 19, and 21	3.	_____
4. Enter the amount, if any, from Form 1040, line 8b	4.	_____
5. Combine lines 2, 3, and 4	5.	_____
6. Enter the total of the amounts from Form 1040, lines 23 through 32, plus any write-in adjustments you entered on the dotted line next to line 36	6.	_____
7. Is the amount on line 6 less than the amount on line 5?		
<input type="checkbox"/> No. None of your social security benefits are taxable. Enter -0- on Form 1040, line 20b.		
<input type="checkbox"/> Yes. Subtract line 6 from line 5	7.	_____
8. If you are:		
<ul style="list-style-type: none"> • Married filing jointly, enter \$32,000 • Single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2017, enter \$25,000 • Married filing separately and you lived with your spouse at any time in 2017, skip lines 8 through 15; multiply line 7 by 85% (0.85) and enter the result on line 16. Then, go to line 17 	}	8. _____
9. Is the amount on line 8 less than the amount on line 7?		
<input type="checkbox"/> No. None of your social security benefits are taxable. Enter -0- on Form 1040, line 20b. If you are married filing separately and you lived apart from your spouse for all of 2017, be sure you entered “D” to the right of the word “benefits” on line 20a.		
<input type="checkbox"/> Yes. Subtract line 8 from line 7	9.	_____
10. Enter: \$12,000 if married filing jointly; \$9,000 if single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for all of 2017	10.	_____
11. Subtract line 10 from line 9. If zero or less, enter -0-	11.	_____
12. Enter the smaller of line 9 or line 10	12.	_____
13. Enter one-half of line 12	13.	_____
14. Enter the smaller of line 2 or line 13	14.	_____
15. Multiply line 11 by 85% (0.85). If line 11 is zero, enter -0-	15.	_____
16. Add lines 14 and 15	16.	_____
17. Multiply line 1 by 85% (0.85)	17.	_____
18. Taxable social security benefits. Enter the smaller of line 16 or line 17. Also enter this amount on Form 1040, line 20b	18.	_____

TIP *If any of your benefits are taxable for 2017 and they include a lump-sum benefit payment that was for an earlier year, you may be able to reduce the taxable amount. See Lump-Sum Election in Pub. 915 for details.*



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2017 VERMONT Income Tax Return FORM IN-111

1 Taxpayer Information: Taxpayer's Last Name, First Name, Initial, Taxpayer's Social Security Number, Spouse's or CU Partner's Last Name, First Name, Initial, Spouse's or CU Partner's Social Security Number, Mailing Address, Taxpayer's Driver's License Number, State, City, State, ZIP Code, Spouse's/CU's Driver's License Number, State, Check here if this is an AMENDED return, Check if taxpayer died during 2017, Check if Spouse or CU Partner died during 2017, Check here if using RECOMPUTED Federal Return information, 1. VT School District Code, 2. 911 street address on 12/31/2017 - Number, street/road name (Do not use "PO Box," "same," or Town name)

2 FILING STATUS: 3. Single, 4. Head of Household, 5. Married Filing Jointly, 6. CU Partner Filing Jointly, 7. Qualifying Widow(er) with dependent children, 8a. Married Filing Separately, 8b. CU Filing Separately, Enter Spouse or CU Partner full name, Enter Spouse or CU Partner Social Security Number, 9. Exemptions Claimed (federal Form 1040-Line 6d; 1040A-Line 6d; 1040EZ/1040NR-EZ-enter 0, 1, or 2) 9.

3 Taxable Income: 10. Adjusted Gross Income (Federal Form 1040-Line 37; 1040A-Line 21; 1040EZ-Line 4) 10. .00, 11. Federal Taxable Income (Federal Form 1040-Line 43; 1040A-Line 27; 1040EZ-Line 6) If the federal amount is -0-, see instructions. 11. .00, ADDITIONS: 12a. Income from Non-Vermont State and Local Obligations (Schedule IN-112, Part I, Line 3) 12a. .00, 12b. Bonus Depreciation Allowed under Federal law for 2017 12b. .00, 12c. Addback of Itemized Deductions (Schedule IN-155, Line 11) 12c. .00, 13. Federal Taxable Income with Additions (Add Lines 11, 12a, 12b, and 12c). 13. .00, SUBTRACTIONS: 14a. Interest Income from U.S. Obligations 14a. .00, 14b. Capital Gains Exclusion (Schedule IN-153, Line 21) 14b. .00, 14c. Adjustment for Prior Years' Bonus Depreciation 14c. .00, 14d. Taxable refunds of state and local income taxes (Federal Form 1040-Line10) 14d. .00, 14e. Add Lines 14a, 14b, 14c, and 14d 14e. .00, 15. Vermont Taxable Income (Subtract Line 14e from Line 13. If Line 14e is more than Line 13, enter -0-). 15. .00

4 VT Income Tax: 16. Vermont Income Tax from Tax Table or Tax Rate Schedule on Line 15 amount (If Line 10 is greater than \$150,000, see instructions) 16. .00, 17. Additions to Vermont Income Tax (Schedule IN-112, Part II, Line 7) 17. .00, 18. Vermont Income Tax with Additions (Add Lines 16 & 17) 18. .00, 19. Subtractions from Vermont Income Tax (Schedule IN-112, Part II, Line 15) 19. .00, 20. Vermont Income Tax (Subtract Line 19 from Line 18. If Line 19 is more than Line 18, enter -0-) 20. .00, 21. Income Adjustment (Schedule IN-113, Line 39 OR 100.00%) 21. % , 22. Adjusted Vermont Income Tax (Multiply Line 20 by Line 21) 22. .00

Enclose Form(s) W-2 and Form(s) 1099-R, if tax was withheld