Franklin&Company
Accountants

MAY 2014 UPDATE

Taxing Social Security Benefits

Some taxpayers must include up to 85% of their Social Security benefits in taxable income, while others find that their benefits are not taxable at all. If Social Security is your only source of income, your benefits probably won't be taxable. In fact, you may not even need to file a federal income tax return. If you get income from other sources, however, you may have to pay taxes on at least a portion of your Social Security benefits. Your income and filing status will also affect whether you must pay taxes on your Social Security benefits.

A quick way to find out if any of your benefits may be taxable is to add half of your Social Security benefits to all your other income, including any tax-exempt interest. Next, compare this total to the following base amounts. If your total is more than the base amount for your filing status, then some of your benefits may be taxable. The three base amounts are:

- $25,000 for single, head of household, qualifying widow or widower with a dependent child, or married individuals filing separately and who did not live with their spouse at any time during the year.
- $32,000 for married couples filing jointly.
- $0 for married persons filing separately who lived together at any time during the year.

To avoid tax time surprises, Social Security recipients can request that federal income tax be withheld from their benefit payments. Withholding is voluntary and can be initiated by completing IRS Form W-4V ("Voluntary Withholding Request"), requesting to have 7%, 10%, 15%, or 25% (those are the only choices) withheld for federal income tax, and submitting the form to the local Social Security Administration office. Voluntary withholding can be stopped by completing a new Form W-4V.

Taxing a Child's Investment Income

Some children who receive investment income are required to file a tax return and pay tax on at least a portion of that income (and possibly at the parents' marginal tax rate). This is often referred to as the kiddie tax. The kiddie tax cannot be computed accurately until the parents' income is known. Thus, the child's return may have to be extended until the parents' return has been completed. Additionally, if the parents' return is amended or adjusted upon IRS audit, the child's return could require correction (assuming the changes to the parental return affect the tax bracket). If a child cannot file his or her own tax return for any reason, such as age, the child's parent or guardian is responsible for filing a return on the child's behalf.

There are tax rules that affect how parents report a child's investment income. Investment income normally includes interest, dividends, capital gains, and other unearned income, such as from a trust. Some parents can include their child's investment income on their tax return. Other children may have to file their own tax return. Special rules apply if a child's total investment income is more than $2,000. Finally, the parents' tax rate may apply to part of that income instead of the child's tax rate.

Note: Higher income individuals subject to the 3.8% net investment income tax (3.8% NIIT) may benefit from shifting income to and having their child claim investment income on the child's tax return. This may be advantageous because the child receives his or her own $200,000 exclusion from the 3.8% NIIT.