Introduction

This lesson will help you assist taxpayers who have Social Security and equivalent railroad retirement benefits. These benefits may or may not be taxable.


See Publication 575, Pension and Annuity Income, and Publication 915, Social Security and Equivalent Railroad Retirement Benefits, for additional information on the topics discussed in this lesson.

Objectives

At the end of this lesson, using your resource materials, you will be able to:

• Determine the taxable portion of Social Security and railroad retirement benefits
• Determine the most advantageous method of reporting lump sum Social Security benefits
• Report Social Security and railroad retirement benefits on the tax return

What are Social Security and railroad retirement benefits?

Social Security Benefits

Social security benefits are payments made under Title II of the Social Security Act. They include Old-Age, Survivor, and Disability Insurance (OASDI) benefits.

Social security benefits include monthly retirement, survivor, and disability benefits. They do not include Supplemental Security Income (SSI). Certain government retirees who receive a pension from work are not covered by Social Security.

Some portion of the Social Security benefits received may be taxable. Generally, if Social Security benefits are the only source of income, then the benefits are not taxable. In this instance, taxpayers may not be required to file a return. However, if the taxpayers are Married Filing Separately and lived with their spouse at any time during the tax year, 85% of the benefits will be taxable.
Railroad Retirement Benefits (RRBs)

Railroad Retirement Benefits (RRBs) are benefits paid to railroad employees working in jobs that are covered by the Railroad Retirement Act (RRA). The RRA benefits have two components: tier 1 (Social Security equivalent benefits) and tier 2 (treated as a qualified employee plan). The tier 2 benefits are reported on Form RRB 1099-R. These funds are discussed in the previous lesson on Retirement Income.

How are these benefits reported to the taxpayer?

Form SSA-1099

Social security benefits are reported on Form SSA-1099. Box 5 shows the amount of net benefits. Taxpayers who did not receive Form SSA-1099, or have misplaced it, may be able to get an instant printout of benefits from their personal “my Social Security” account on the Social Security Administration website at SSA.gov. Or taxpayers may call toll-free to request a benefit statement to be sent by mail. Effective October 1, 2014, Social Security stopped providing benefit verification letters in their offices.

Form RRB-1099

Tier 1 railroad retirement benefits are equal to the Social Security benefit that a railroad employee or beneficiary would have been entitled to receive under the Social Security system. These benefits are called “Social Security equivalent benefits” and, for tax purposes, are treated like Social Security benefits. They are shown on the BLUE Form RRB-1099. Box 5 shows the net Social Security equivalent benefits for tier 1.

example

Jacob is a retired railroad switchyard operator. Using the intake and interview sheet, the volunteer determined Jacob received Railroad Retirement Benefits. He received Form RRB-1099 and Form RRB-1099-R. The amount from Form RRB-1099 will be added to any amount of Social Security benefits that he may have received from other employment.

When are Social Security benefits and tier 1 RRBs taxable?

Part of the following benefits received by the taxpayer may be taxable:

• Social security benefits

• Railroad retirement benefits, tier 1 (Social Security equivalent portion)

To correctly calculate the taxable portion, you need to know the amount in box 5 of Form SSA-1099 or Form RRB-1099. The taxable amount, if any, of a taxpayer’s Social Security benefits depends upon filing status and other reportable income. Generally, if Social Security (or Social Security equivalent) benefits were the taxpayer’s only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return.

A portion of the benefits is taxable if total income (including tax-exempt interest), plus one-half of the benefits received, is more than certain base income amounts, which vary based upon the taxpayer’s filing status. A portion of the benefits is also taxable if the taxpayers are Married Filing Separately and lived with their spouse at any time during the year.

If the taxpayer files a joint return, enter the amounts from each Form SSA-1099 and the software will compute the portion that is taxable, if any.
How do I report Social Security or railroad tier 1 benefits?

**Tax Software Hint:** The tax software will perform all the calculations to determine the taxable amount based on other information on the return. Be sure to enter all income, including tax-exempt interest, in order for the software to correctly calculate taxability of benefits. If the taxpayer is itemizing deductions, include Medicare premiums (Part B and D) from Forms SSA-1099 and RRB-1099 so that it flows to Schedule A. Additionally, be sure to enter any federal income tax withholding. Go to the Volunteer Resource Guide, Income tab, for software entries.

**EXERCISES**

Answers follow the lesson summary.

**Question 1:** Hank comes to your site to get some help with his tax return. He is upset because his neighbor told him that he would have to pay tax on all of his Social Security benefits this year. After talking to Hank, you learn that his wife died several years ago. This tax year, he sold all of his stock and moved into senior housing. The sale of the stock created $31,896 of taxable income for Hank. His neighbor told him, with that much income, the entire $11,724 of his Social Security benefits would be taxable. What is the maximum taxable amount of Hank’s benefits?

A. $31,896  
B. $20,172  
C. $11,724  
D. $9,965

**What are lump-sum benefit payments?**

Some taxpayers may have received a lump-sum benefit payment. This payment could be for the current tax year and for prior tax years. Box 3 of the taxpayer’s Form SSA-1099 or Form RRB-1099 will include the lump-sum payment. The form will also show the year, or years, of the payment. The additional information will be shown in Description of Amount in box 3 on Form SSA-1099 or in boxes 7–9 on Form RRB-1099.

When figuring the taxable portion of Social Security benefits, two options are available for lump-sum benefit payments:

- **The first option** allows the taxpayer to report the whole payment the year it was received. When the taxpayer chooses this option, complete the Social Security Benefits Worksheet as usual by including the entire lump-sum payment on line 1.

- **The second option** is to treat the payment as received in the earlier year or years. This is done by figuring whether any part of these benefits is taxable, based on the earlier year’s income. Any part that is taxable is then added to any taxable benefits for the current year and included on Form 1040, line 20b. The taxpayer can elect this method if it lowers the taxable benefits.

Do not confuse this type of lump-sum benefit payment with the lump-sum death benefit that both the SSA and RRB pay to many of their beneficiaries. No part of the lump-sum death benefit is subject to tax.
Will the lump-sum election method lower taxable benefits?

Figuring the taxable benefits under the lump-sum election method is in scope for the VITA/TCE programs. If the taxpayer chooses the second option, only the current year income will be adjusted. You do not file amended returns for the earlier years.

Under the lump-sum election method, refigure the taxable part of all the benefits for the earlier year (including the lump-sum payment) using that year’s income and filing status; then subtract any taxable benefits for that year that were previously reported. The remainder is the taxable part of the lump-sum payment. Add it to the taxable part of the benefits for the current year (figured without the lump-sum for the earlier year).

In order to compute the taxable benefits, you will need copies of the taxpayer’s prior year returns.

For additional information on the lump-sum election, see Publication 915.

**example**

In 2014, Jane applied for Social Security disability benefits but was told she was ineligible. She appealed the decision and won. In 2015, she received a lump-sum payment of $6,000, of which $2,000 was for 2014 and $4,000 was for 2015. Jane also received $5000 in Social Security benefits in 2015, so her 2015 Form SSA-1099 shows benefits paid of $11,000.

Jane had other taxable income in both 2014 and 2015. She should figure her taxable benefits under the lump-sum election method to see if it is lower.

**TIP**

When a lawyer is hired to file the appeal, Form 1099-SSA will show the amount paid to the lawyer. A miscellaneous itemized deduction is allowed for the legal fees to the extent that the benefits are taxable. As an example: If, based on the taxpayer’s filing status and income level, 40% of the lump-sum benefit is taxable, then 40% of the legal fees can be deducted on Schedule A.

**CAUTION**

Because the earlier year’s taxable benefits are included in the current year’s income, no adjustment is made to the earlier year’s return. Do not file an amended return for the earlier year.

**CAUTION**

Once a taxpayer elects this method of figuring the taxable part of a lump-sum payment, the election can only be revoked with the consent of the IRS.

**Tax Software Hint:** The tax software will figure all the calculations after you enter the prior year tax return information. Go to the Volunteer Resource Guide, Income tab, Form 1099-R for software entries.
Summary

This lesson explained how to determine whether income from taxpayers’ Social Security benefits and railroad retirement benefits is taxable.

Generally, if Social Security benefits were the taxpayer’s only source of income, the benefits are not taxable and the taxpayer does not need to file a federal income tax return. If the taxpayer received Social Security benefits and other income, the Social Security Benefits Worksheet found in the Form 1040 Instructions is completed by the software to calculate the taxable portion.

When figuring the taxable portion of Social Security benefits, two options are available for lump-sum benefit payments. The taxpayer may report the whole payment in the year it was received or treat the payment as received in the applicable earlier year or years.

If you are unable to complete the entire exercise, complete as much as you can. Come back later to finish the exercise after you cover all the technical topics in later lessons.

TAX LAW APPLICATION USING THE WORKBOOK

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study in Publication 4491-W.

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.

EXERCISE ANSWERS

Answer 1: D. $9,965 or 85% of the net benefits, is the maximum amount that could ever be taxable.