Chapter 1: Elder Issues

Note. Corrections were made to this workbook through January of 2023. No subsequent modifications were made. For terms used in this chapter, see the **Acronyms and Abbreviations** section following the index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

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The counsel needed by elderly taxpayers often involves issues only indirectly related to tax. This chapter aims to prepare tax practitioners to guide clients through the maze of decisions associated with social security, Medicare, aging-in-place, funding long-term care, and making qualified charitable distributions.

SOCIAL SECURITY BENEFITS

Tax practitioners can assist their elderly clients better understand options as they make important decisions that could affect the rest of their lives. The scope of the decisions facing elderly taxpayers usually extends beyond tax issues into the realm of benefits to which only elderly taxpayers are generally entitled. In a 2021 report, for example, the Social Security Administration (SSA) stated that social security benefits represent approximately 30% of a retiree's income.[1] To address these important decisions, a series of suggested steps follow.

STEP 1: COLLECT INFORMATION

To qualify for social security retirement insurance benefits, an individual generally must have 40 credits of coverage, or 10 years. Each credit is earned by receiving wages or earning self-employment (SE) income equal to or greater than the amount needed in that year to earn a quarter of coverage.[2] For 2022, the amount of earnings needed to earn one quarter of coverage is $1,510.[3] The maximum number of quarters of coverage available in one year is four; therefore, an employee earning at least $6,040 in 2022 receives credit for four quarters of coverage.

Social Security Statement[4]

Individuals should begin by obtaining benefit records directly from ssa.gov. Social security statements are available to view online by opening a *my Social Security account*. Individuals can access information about their estimated future benefits and review their current earnings history, as well as elect to commence benefits.

For persons aged 60 or older who do not have a *my Social Security account*, SSA annually mails social security statements three months before the worker's birthday.

A sample page 1 of a social security statement follows.

1. *Social Security Fact Sheet*. SSA. [www.ssa.gov/news/press/factsheets/basicfact-alt.pdf] Accessed on Dec. 22, 2021.
2. 20 CFR §404.143(a); *Retirement Benefits: Social Security Credits*. SSA. [www.ssa.gov/planners/credits.html#&a0=1] Accessed on Apr. 1, 2022.
3. *Quarter of Coverage*. SSA. [best.ssa.gov/OACT/COLA/QC.html] Accessed on Feb. 15, 2022.
4. *Get Your Social Security Statement.* SSA. [www.ssa.gov/myaccount/statement.html] Accessed on Dec. 22, 2021.

Your Social Security Statement

WANDA WORKER

June 1, 2022

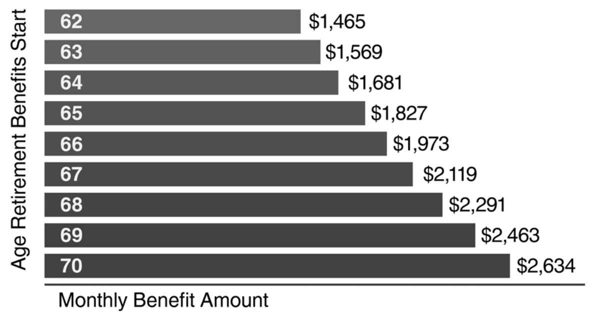
Retirement Benefits

You have earned enough credits to qualify for retirement benefits. To qualify for benefits, you earn "credits" through your work — up to four each year.

Your full retirement age is **67**, based on your date of birth: April 5, 1962. As shown in the chart, you can start your benefits at any time between ages **62** and **70**. **For each month you wait to start your benefits, your monthly benefit will be higher—for the rest of your life.**

These personalized estimates are based on your earnings to date and assume you continue to earn $54,489 per year until you start your benefits. Learn more at *ssa.gov/benefits/retirement/learn.html*.

Personalized Monthly Retirement Benefit Estimates (Depending on the Age You Start)



Disability Benefits

You have earned enough credits to qualify for disability benefits. If you became disabled right now, your monthly payment would be about **$2,083 a month**. Learn more at *ssa.gov/disability*.

Survivors Benefits

You have earned enough credits for your eligible family members to receive survivors benefits. If you die this year, members of your family who may qualify for monthly benefits include:

Minor child:	**$1,562**
Spouse, if caring for a disabled child or child younger than age 16:	**$1,562**
Spouse, if benefits start at full retirement age:	**$2,083**
Total family benefits cannot be more than:	**$3,802**

Your spouse or minor child may be eligible for an additional one-time death benefit of **$255**. Learn more at *ssa.gov/survivors*.

Medicare

You have enough credits to qualify for Medicare at age 65. Medicare is the federal health insurance program for people:

- age 65 and older,
- under 65 with certain disabilities, and
- of any age with End-Stage Renal Disease (ESRD) (permanent kidney failure requiring dialysis or a kidney transplant).

Even if you do not retire at age 65, you may need to sign up for Medicare within 3 months of your 65th birthday to **avoid a lifetime late enrollment penalty**. Special rules may apply if you are covered by certain group health plans through work.

For more information about Medicare, visit *medicare.gov* or *ssa.gov/medicare* or call **1-800-MEDICARE** (**1-800-633-4227**) (TTY **1-877-486-2048**).

We base benefit estimates on current law, which Congress has revised before and may revise again to address needed changes. Learn more about Social Security's future at *ssa.gov/ThereForMe*.

Estimating Social Security Benefits

The SSA offers a variety of online benefit calculators to estimate the amount of an individual's potential benefit using different retirement dates and levels of future earnings. These calculators estimate disability and survivor benefit amounts as well as retirement benefits amounts. The calculators are available at **uofi.tax/22b1x7** [www.ssa.gov/benefits/calculators].

1. The **Quick Calculator** gives a simple, rough estimate based on the individual's date of birth and current year's earnings. The individual must be 22 or older for this calculator to work correctly.
2. The **Online Calculator** requires users to input their date of birth and complete earnings history to obtain a benefit estimate. The user may project future earnings until their anticipated retirement date.
3. The **Detailed Calculator** provides the most precise amount. It must be downloaded and installed on the user's computer.

These calculators are not linked to the user's specific social security record but instead use the earnings amounts entered.

The **Retirement Estimator**, available at **uofi.tax/22b1x1** [www.ssa.gov/retire/estimator.html], uses social security earnings records and projected future earnings to estimate the individual's retirement benefits. The actual benefit amount cannot be provided until the individual applies for benefits.

Observation. Their SSA statement may convince a client to continue working. This change of mind might happen if they had fewer than 40 quarters during which they paid social security taxes from their wages. By working until they reach the 40-quarter threshold, they overcome this limitation and become entitled to social security benefits.

Self-Employed Taxpayers

To receive social security benefits, self-employed individuals must generally work at least 10 years to earn the 40 credits of coverage needed.[5] In 2022, individuals earn one credit for each $1,510 of earnings, up to a maximum of four credits. To earn four credits in 2022, self-employed taxpayers need $6,540 (($1,510 × 4) ÷ 92.35%) in net SE income.

Self-employed taxpayers face an additional decision when their business's net profit reported for 2022 on Schedule C, *Profit or Loss From Business*, is less than $6,540 or operates at a loss,[6] as they are not able to receive all four credits. There is an optional method for self-employed taxpayers to reach four credits.[7] The optional method increases the amount subject to SE tax to four times the amount required to earn a credit for a quarter of coverage, subject to the following conditions.[8]

- SE income in 2022 is less than $6,540.
- Nonfarm SE income is less than 72.189% of **gross** nonfarm income.[9]
- **Net** SE earnings in two of the immediately preceding three years were at least $400.
- The nonfarm optional method can be used no more than five times during an individual's life.

5. *Quarter Of Coverage.* SSA. [ssa.gov/oact/cola/QC.html] Accessed on May 5, 2022.
6. *If You Are Self-Employed,* p. 2. Jan. 2022. SSA. [www.ssa.gov/pubs/EN-05-10022.pdf] Accessed on May 5, 2022.
7. *Topic No. 554 Self-Employment Tax*. Feb. 18, 2022. IRS. [www.irs.gov/taxtopics/tc554] Accessed on Mar. 18, 2022.
8. *If You Are Self-Employed,* p. 2. Jan. 2022. SSA. [www.ssa.gov/pubs/EN-05-10022.pdf] Accessed on May 5, 2022.
9. This seemingly arbitrary percentage is the result of dividing ⅔ by 0.9235. This establishes parity between the nonfarm optional method and the farm optional method, which limits income for social security credit purposes to ⅔ of gross (farm) income.

The optional method of reporting farm income can be used an unlimited number of times.[10]

The amount used to calculate SE tax appears on Line 6 on Schedule SE, *Self-Employment Tax*. This amount of SE tax includes only **92.35%** of net SE income or the optional amount in SE tax calculation.

Caution. Certain elections may reduce the SE income to less than the $6,540 threshold, resulting in an adverse outcome if the taxpayer wishes to qualify for social security coverage for the year. For example, a decision to use IRC §179 expensing can reduce SE earnings to less than $6,540. A self-employed taxpayer may accidentally forego earning four quarters of coverage for social security purposes without carefully weighing these factors.

STEP 2: COMPUTING BENEFITS

The **primary insurance amount** (PIA) is a person's benefit if they begin receiving benefits at their full retirement age (FRA). At FRA, the benefit is neither reduced for early retirement nor increased for delayed retirement.[11]

Average Indexed Monthly Earnings[12]

Computing social security retirement benefits uses average indexed monthly earnings (AIME) as the foundation for subsequent calculations. Annual earnings before the individual attained age 60 are indexed for inflation. If they worked more than 35 years, the highest 35 years of indexed earnings are used in the calculation. If they worked fewer than 35 years in covered employment, then all years are included in the calculation.[13] The national average wage indexing series for 2011 to 2020, the last year available, follows.[14]

Year	Index
2011	$42,979.61
2012	44,321.67
2013	44,888.16
2014	46,481.52
2015	48,098.63
2016	48,642.15
2017	50,321.89
2018	52,145.80
2019	54,099.99
2020	55,628.60

The index adjusts the earnings only to the year in which the individual turned age 60 generally, which is called the **indexing year.** Any earnings after age 60 are not indexed. The average is calculated by adding together the indexed earnings and then dividing the sum by the total number of months in the benefit computation years. This is generally 420 months (35 years × 12 months), although a period during which social security disability benefits were received may reduce the number of months. If fewer than 35 years of earnings are counted, $0 is assumed for the balance, and the total is still divided by 420 months. Finally, the amount is rounded down to the next lower whole dollar amount unless it is already an integer multiple of $1.[15]

10. *If You Are Self-Employed*. Jan. 2022. SSA. [www.ssa.gov/pubs/EN-05-10022.pdf] Accessed on Jun. 9, 2022.

11. *Primary Insurance Amount.* SSA. [www.ssa.gov/oact/cola/piaformula.html] Accessed on Mar. 18, 2022.

12. *Social Security Benefit Amounts.* SSA. [www.ssa.gov/oact/cola/Benefits.html] Accessed on Jun. 9, 2022.

13. Ibid.

14. *National Average Wage Index*. SSA. [www.ssa.gov/oact/cola/AWI.html#Series] Accessed on May 18, 2022.

15. *Social Security Handbook: Chapter 7 Figuring the Cash Benefit Rate*. SSA. [www.ssa.gov/OP_Home/handbook/handbook.07/handbook-toc07.html] Accessed on Jun. 9, 2022. See §§700 – 706.

The PIA is the sum of three separate percentages applied to portions of the AIME.[16] The percentages of the PIA formula are fixed by law, and the dollar amounts in the formula are adjusted annually for changes in the national average wage index. These dollar amounts, called **bend points,** govern which portions of the AIME are subject to which percentage.[17]

The bend points in the 2022 PIA formula are $1,024 and $6,172, and they apply to individuals who first become eligible for retirement benefits in 2022.[18] For most individuals, the bend points are fixed in the year they turn 62, not the year they retire. However, the bend point may be fixed earlier for individuals who become disabled or die before age 62.[19] The PIA for 2022 is calculated as follows.

1. 90% of the individual's AIME up to the first bend point ($1,024 for 2022), **plus**
2. 32% of the individual's AIME greater than the first bend point ($1,024 for 2022) but less than or equal to the second bend point ($6,172 for 2022), **plus**
3. 15% of the individual's AIME greater than the second bend point ($6,172 for 2022).
4. This amount is then rounded down to the next lower integer multiple of $0.10 unless the sum itself is an integer multiple of $0.10.[20]

Example 1. Cedric retires in 2022 at age 62. His AIME is $6,500. His PIA is calculated as follows.

AIME up to first bend point	$1,024.00	
Percentage of AIME included	× 90%	
AIME included in PIA	$ 921.60	$ 921.60
AIME between first and second bend points ($6,172.00 − $1,024.00)	$5,148.00	
Percentage of AIME included	× 32%	
AIME included in PIA	$1,647.36	1,647.36
AIME above second bend point ($6,500.00 − $6,172.00)	$ 328.00	
Percentage of AIME included	× 15%	
AIME included in PIA	$ 49.20	49.20
Total PIA (calculated)		$2,618.16
Rounded down to nearest $0.10 per regulations		$2,618.10

16. Up to 35 years of a worker's earnings are indexed to reflect the change in general wage levels that occurred during their years of employment. The indexing series for the years 1951−2020 is available from the SSA on the web page *National Average Wage Index* [www.socialsecurity.gov/OACT/COLA/AWI.html] Accessed on Nov. 16, 2021; *Primary Insurance Amount.* SSA [www.ssa.gov/oact/cola/piaformula.html] Accessed on Nov. 15, 2021.

17. *Social Security Benefit Amounts.* SSA. [www.socialsecurity.gov/OACT/COLA/Benefits.html#aime] Accessed on Nov. 15, 2021.

18. *Social Security Primary Insurance Amount*. SSA. [www.ssa.gov/OACT/COLA/piaformula.html] Accessed on Feb. 15, 2022.

19. 20 CFR §404.212(b).

20. 20 CFR §404.212(c).

Practitioner Planning Tip

Maximizing social security benefits usually means maximizing AIME. The higher the AIME, the higher the benefit. To maximize AIME, the client needs to earn as much money as possible and work for at least 35 years. If earned income is maximized, the AIME is based on a higher wage. If the client has earnings for at least 35 years,[21] then there are no years with $0 earnings to factor in. Clients may be advised to work longer if earnings are higher in later years. This could result in a higher AIME because some lower-earning years would no longer count in the AIME calculation. At the very least, clients should strive to reach an AIME of $6,172 to take full advantage of the 90% and 32% bend points. Achieving this result may require working longer, starting a business, or, for existing self-employed taxpayers, maximizing net profit to maximize AIME. This mindset may represent a quantum change for taxpayers and tax practitioners alike, as the common goal for many years has been to minimize taxes, which may later result in costing taxpayers valuable benefits when they retire.

STEP 3: WHEN TO CLAIM BENEFITS

After determining that an individual is eligible for benefits based on the previous discussions regarding the 40 quarters and the PIA, the next consideration is the best time to collect benefits.

Maximizing social security benefits may appear to be an objective of planning, but an advisor should be aware of the differing needs of each client.

- An individual may need **additional income** at age 62, so starting to receive social security benefits early may fulfill a key objective. In many cases, this means not receiving additional income that the individual would receive if they had waited until FRA to file for benefits instead.
- Other persons may prefer to wait until their FRA or even age 70 to receive social security benefits. They may not have immediate income needs and prefer to let monthly benefit payments grow for as long as possible to maximize their **lifetime income** from social security. If they anticipate living a long time, they are better off continuing to work and receiving a larger social security payment starting later.
- **Maximizing monthly income** is closely related to the previous objective.
- Because social security offers spousal benefits, a person may wish to provide the **largest possible income** to their **spouse**.
- Some individuals may want to arrange their income to **minimize** their **federal tax liability**, even if it means restricting their income.
- Other individuals may want to **minimize** their **dependence on social security**, perhaps out of a concern for its stability.

This list is not exhaustive. Every individual has their own constraints and objectives, and each has their own best approach to accomplishing their goals.

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21. 20 CFR §404.211(e)(1). This regulation does not restrict the calculation of the AIME to those years in which the individual earn four credits for quarters of coverage. Thus, years in which an individual earned less than the amount to earn four quarters of coverage could be included in the calculation of AIME, provided those years are among the individual's 35 highest-earning years.

Taking Benefits Before FRA

Some individuals want to start receiving social security retirement benefits as early as age 62 for a variety of reasons. Taking these benefits before FRA comes with a set of consequences of which tax practitioners should make sure their clients are aware. These can have an immediate impact on their social security benefits and, in some cases, affect the rest of the individual's life. Three consequences of this decision are discussed next.

Benefits Received Before FRA.[22] The primary consequence of taking retirement benefits before FRA is that the benefits are reduced for the rest of the person's life. The following table shows how retirement benefits are reduced depending on the year in which the individual was born. Because individuals born more recently have FRAs that are reached at older ages, they receive retirement benefits for a longer time before reaching FRA. Consequently, the retirement benefits of persons born more recently are reduced more when viewed as a percentage.

Primary and Spousal Benefits at Age 62
(Benefits Based on a $1,000 Primary Insurance Amount)

Year of Birth [a]	Normal (or Full) Retirement Age	Number of Reduction Months [b]	Primary Amount	Primary Percent Reduction [c]	Spouse Amount	Spouse Percent Reduction [d]
1937 or earlier	65	36	$800	20.00%	$375	25.00%
1938	65 and 2 months	38	791	20.83%	370	25.83%
1939	65 and 4 months	40	783	21.67%	366	26.67%
1940	65 and 6 months	42	775	22.50%	362	27.50%
1941	65 and 8 months	44	766	23.33%	358	28.33%
1942	65 and 10 months	46	758	24.17%	354	29.17%
1943-1954	66	48	750	25.00%	350	30.00%
1955	66 and 2 months	50	741	25.83%	345	30.83%
1956	66 and 4 months	52	733	26.67%	341	31.67%
1957	66 and 6 months	54	725	27.50%	337	32.50%
1958	66 and 8 months	56	716	28.33%	333	33.33%
1959	66 and 10 months	58	708	29.17%	329	34.17%
1960 and later	67	60	700	30.00%	325	35.00%

[a] If you are born on January 1, use the prior year of birth.
[b] Applies only if you are born on the 2nd of the month; otherwise the number of reduction months is one less than the number shown.
[c] Reduction applied to primary insurance amount ($1,000 in this example). The percentage reduction is 5/9 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.
[d] Reduction applied to $500, which is 50% of the primary insurance amount in this example. The percentage reduction is 25/36 of 1% per month for the first 36 months and 5/12 of 1% for each additional month.

Earnings Limitations When Receiving Retirement Benefits.[23] A second consequence of receiving benefits before FRA is that continuing to work may reduce retirement benefits. This applies to both wages and SE income. The reduction can occur regardless of whether the earned income is subject to social security tax.[24] Consequently, an individual who reaches age 62 can file for social security benefits regardless of whether they continue to work.

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22. *Benefit Reduction for Early Retirement*. SSA. [www.ssa.gov/oact/quickcalc/earlyretire.html] Accessed on Mar. 2, 2022.

23. 20 CFR §404.415(a); *Retirement Benefits*. SSA. [www.ssa.gov/benefits/retirement/planner/whileworking.html] Accessed on Mar. 18, 2022. Separate rules governing the reduction of social security benefits due to work performed outside the United States are not considered in the text.

24. 42 USC §409. Virtually all forms of compensation for personal services are included in this reference to earned income, even if the income is exempt from social security tax. Ordinary business income reported by an S corporation in box 1 of Schedule K-1 (Form 1120-S) is not included in earned income.

For individuals below the FRA, wages count toward their social security earnings limits. Wages are included in earnings when they are earned rather than when they are paid. For example, accumulated sick or vacation pay that is earned in one year, but not paid until the following year, is counted as earnings for the year it is earned. An employee's contributions to a pension or retirement plan do count toward the earnings limit if the contribution amount is included in their gross wages.[25]

For a self-employed person, only the net earnings from their SE activities count toward the earnings limits. Income from SE activities generally counts toward the earnings limit when the individual receives it rather than when they earn it. However, income earned before the self-employed person becomes entitled to social security but not paid until after the individual becomes entitled to benefits is not counted toward the earnings limit.[26]

Retirement Earnings Test. In years before the calendar year when the individual reaches FRA, their social security benefit is reduced by $1 for every $2 that their earned income exceeds the exempt amount threshold. In 2021, the first $18,960 of an individual's earned income was not subject to this **retirement earnings test** (RET); in 2022, this threshold increased to $19,560.[27] But for annual wages and SE income more than this threshold, their benefit is reduced by half the amount of earnings in excess of the threshold amount. The Code of Federal Regulations refers to **half** the amount of earned income exceeding this threshold as **excess earnings** until the end of the calendar year before the individual reaches FRA.[28] Each dollar of excess earnings reduces social security benefits by $1 until the end of the calendar year before the individual reaches FRA.[29]

During the months in that calendar year before the month during which an individual reaches FRA, excess earnings are **one-third** the amount by which earnings exceed the threshold.[30] Thus, their social security benefit is reduced by $1 for every $3 that wages and SE income exceeds another, higher threshold amount. The threshold amount for individuals reaching FRA during 2022 is $4,330 monthly ($51,960 annual exempt amount ÷ 12 months). Every $3 of earned income over this amount reduces a recipient's social security benefit by $1. However, the RET is no longer applied to start the month they reach FRA.

The following table shows exempt amounts for 2015 through 2022, inclusive.[31]

Year	Lower Amount (Before Year of FRA)	Higher Amount (Year of FRA)
2015	$15,720	$41,880
2016	15,720	41,880
2017	16,920	44,880
2018	17,040	45,360
2019	17,640	46,920
2020	18,240	48,600
2021	18,960	50,520
2022	19,560	51,960

25. *Social Security: How Work Affects Your Benefits.* 2021. SSA. [www.socialsecurity.gov/pubs/EN-05-10069.pdf] Accessed on Oct. 7, 2021.

26. Ibid.

27. *Exempt Amounts Under The Earnings Test.* SSA. [www.ssa.gov/oact/cola/rtea.html] Accessed on Mar. 16, 2022*; Fact Sheet: 2022 Social Security Changes,* p. 1. SSA. [www.ssa.gov/news/press/factsheets/colafacts2022.pdf] Accessed on Mar. 16, 2022.

28. 20 CFR §404.430(b).

29. 20 CFR §404.434(b).

30. 20 CFR §404.434(c).

31. *Exempt Amounts Under The Earnings Test*. SSA. [www.ssa.gov/oact/cola/rtea.html] Accessed on Mar. 21, 2022.

When the RET reduces social security benefits, the reduction in social security benefits is not spread equally among the year's benefit payments. Instead, the benefit payments are reduced as early in the year as possible, assuming the recipient follows the official procedures.[32]

An individual can use a simplified version of the official procedure. Each year an individual who anticipates a reduction in social security benefits advises the agency about their projected earnings.[33] If the projected earnings exceed the year's exempt amount for the RET, the SSA reduces the social security benefit the individual receives.[34] Social security law does not reduce the benefit proportionately throughout the year; it eliminates the benefit until the full reduction is taken and then reinstates the benefit.[35] This method depends on an individual accurately predicting their earnings for the year. An individual under the FRA who expects to earn more than the yearly exempt amount should file a report of their **expected earnings** with the SSA to prevent an overpayment of benefits due to an early retiree.

Example 2. On October 15, 2021, Harold retired from his job of 30 years on his 63rd birthday and filed for social security. He was never married. On December 15, 2021, Harold realized he was bored and accepted a job starting in January 2022, driving a school bus part-time for the local school district. He expects to earn $29,560 during 2022, which is $10,000 greater than the exempt amount of $19,560.[36] His excess earnings are $5,000 (50% × ($29,560 – $19,560)) for January through December 2022. Harold was born in 1958 and therefore attains FRA in June 2025 because FRA for persons born in 1958 is 66 years, 8 months. Because his earnings from working are so consistent, Harold files an expected earnings report in September 2022.

Consequently, his social security benefits are reduced by $5,000 in 2023, even though his earnings from working for the school district are not subject to social security tax. If his monthly benefit during 2022 had been $2,000 without the RET, Harold would receive no social security benefit for January and February 2023 and only $1,000 for March. Benefit payments for April through December would revert to $2,000. The RET reduces his social security income by $5,000 over the entire year. He should expect to receive $2,000 per month from April through December, resulting in a total 2023 social security benefit received of $19,000.

Example 3. Hadlee filed for social security benefits in January 2022 and started to receive a social security benefit of $600 per month in February.[37] She reaches her FRA of 66 years, 4 months in November 2022, when she retires from her job. She earned $52,980 from January through October 2022.

During this period, the SSA has overpaid her benefit by $340 (($52,980 − $51,960 limit) ÷ 3). The SSA corrects this by withholding Hadlee's first check of the year. In January 2023, the SSA pays Hadlee the remaining $260 ($600 withheld in January 2022 − $340 required deduction).

The recovery of the overpayment may be delayed, though. Without an accurate projection of earnings, the SSA withholds two types of benefit payments, those benefit payments due to the failure to file a report of earnings and those required to be withheld because of excess earnings.[38] The SSA accepts a Form W-2, *Wage and Tax Statement*, and Schedule SE from a tax return as annual reports of earnings. A penalty could result if the individual attempts to hide earnings from the SSA.[39] The SSA is aware that individuals may try to disguise SE income as rent or dividends in an attempt to avoid having it classified as excess earnings.[40]

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32. 20 CFR §404.434(a).

33. 20 CFR §404.452; *How Work Affects Your Benefits*, p. 6. Jan. 2022. SSA. [www.ssa.gov/pubs/EN-05-10069.pdf] Accessed on Mar. 18, 2022.

34. 20 CFR §404.456.

35. 20 CFR §404.434(a); *1806. Payment of Partial Benefit.* Jan. 17, 2003. SSA. [www.ssa.gov/OP_Home/handbook/handbook.18/handbook-1806.html] Accessed on Mar. 18, 2022. See §§1806.1 and 1806.3.

36. *Exempt Amounts Under The Earnings Test.* SSA. [www.ssa.gov/oact/cola/rtea.html] Accessed on Mar. 18, 2022.

37. Example adapted from *How Work Affects Your Benefits*, p. 2. SSA. [www.ssa.gov/pubs/EN-05-10069.pdf] Accessed on Apr. 1, 2022.

38. *1819. Delay in Filing Annual Report*. SSA. [www.ssa.gov/OP_Home/handbook/handbook.18/handbook-1819.html] Accessed on Sep. 29, 2021. See §1819.2 within this page of the Social Security Handbook.

39. Ibid; 20 CFR §404.453(a).

40. *1813. Does the recipient of income determine whether the earnings count under the earnings test?* Jan. 17, 2003. SSA. [ssa.gov/OP_Home/handbook/handbook.18/handbook-1813.html] Accessed on May 5, 2022.

Example 4. Use the same facts as **Example 2.** If Harold had not advised the SSA of his earned income, the reckoning would have come no later than the following year when the SSA receives his Form W-2 and compares it to the projection earnings he provided.

Special Rule for Year of Retirement.[41] A special rule applies to earnings for one year, usually the first year in which a person receives social security benefits. The rule ensures that individuals retiring in the current year are not unduly ineligible for retirement benefits. Because the earnings test in the year of retirement is applied on a month-by-month basis, not an annual basis, the year is referred to as a **grace year.**[42]

Example 5. Don, age 64, retires on May 31, 2022.[43] Until this date, he earned $6,000 per month, resulting in earned income of $30,000 for the year. Don has no plans to work during the last seven months of 2022. Because Don is under his FRA, he would not be eligible for any retirement benefits without the special rule, as his earnings exceed the annual exemption amount ($19,560).

Fortunately, the special rule comes into play in Don's case. Because Don does not earn more than $^1/_{12}$ of the annual exempt amount in any month after May, Don satisfies the special rule requirement and receives the full social security benefit due him.

Thus, under this rule, a retiree who starts receiving benefits in a month other than January can get a full social security check for any whole month they are retired. During this year, their annual income can be more than the yearly earnings limit.

The individual must also have a **nonservice month** during the grace year, which is a month during which the individual:[44]

- Does not have substantial SE services,
- Does not earn more than $^1/_{12}$ of the monthly exempt amount for that month as an employee, and
- Does not earn wages not subject to social security outside of the United States for more than six days in any month.

During 2022, a person under their FRA for the entire year is considered retired if their monthly earnings are $1,630 or less ($19,560 annual limit ÷ 12 months).[45]

If individuals reach their FRA during the year, they can earn more during their nonservice months and still qualify for social security benefits. For example, a person who reaches their FRA in 2022 is considered retired in any month that their earnings are $4,330 or less ($51,960 annual limit ÷ 12 months).[46] Because the month-by-month analysis is only available for the year of retirement, the **annual** exempt amount comparison is again used to test the retiree's earnings. The month-by-month test is no longer available.

Example 6. Ruth retired at age 62 on October 31, 2021. She worked full time and earned $45,000 through October. In November, she takes a part-time job that pays her $500 per month. Her grace year is 2021.

Although Ruth's earnings for the year substantially exceed the 2021 annual limit of $18,960, there is no reduction in her social security benefit for November or December. This is because Ruth's earnings for these months are less than $1,630, which is the monthly limit for someone younger than their FRA. Ruth's earnings are tested beginning in 2022 on an annual basis, as the month-by-month test is only available in 2021, the year of her retirement. As long as her earnings in 2022 do not exceed the exempt amount ($19,560 because she is under her FRA), Ruth receives the full social security benefit.

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41. 20 CFR §404.435.
42. 20 CFR §404.435(b).
43. Example adapted from 20 CFR §404.435, example 1.
44. 20 CFR §404.435(a)(7).
45. 20 CFR §404.435(a)(7)(ii).
46. 20 CFR §§404.435(a)(7)(ii), (c), (d) and 404.446(a).

SE Activities in Year of Retirement. A self-employed individual can still receive full benefits in the year of retirement if they have not met the threshold of **substantial services** in SE activities.[47] The threshold is based on both hours worked and earnings. The SSA determines substantial services from SE activities based on the number of hours worked and may disregard losses incurred. Whenever an individual works fewer than 15 hours in a month, the SSA considers their services not substantial. If the individual works more than 45 hours in that SE activity, the SSA generally considers their hours substantial.

If a self-employed individual works between 15 and 45 hours in a month, that could be considered a grace month. Facts and circumstances govern whether the individual is considered to have provided substantial services from SE activities.[48] The SSA might consider an individual in a highly-skilled occupation to have provided substantial services, while only working 15 hours in a month.[49] In contrast, an individual providing SE services in a relatively low-skilled profession might be considered to have met the requirement for a nonservice month with 45 hours of work.[50]

> **Example 7.** Dr. Wight is a world-famous veterinarian. He retires at the age of 63 in June 2022 after operating his practice as an S corporation for 35 years. By late July, Dr. Wight is bored and decides to work as an independent contractor for other veterinary practices. He starts work during the last week of July, working only two eight-hour days, which he dutifully records in his journal. Dr. Wight is paid $1,200 for these two days. Mr. Thirsk, who worked for Dr. Wight cleaning cages for 10 years, comes to work at the same veterinary practices cleaning cages as an independent contractor for 8.5 hours per day for five days during the same week. By coincidence, he also turned 63 in June 2022 and earned $1,670 during July. By the time they retired in June, both Dr. Wight and Mr. Thirsk had earned wages more than the annual exemption amount of $19,560. If not for the special year rule, their social security benefits would have been reduced.
>
> The SSA likely would conclude that Dr. Wight's earnings during July are substantial because of his skills, even though his earnings were less than the monthly exemption amount for 2022 of $1,630. In contrast, Mr. Thirsk worked almost 45 hours in a low-skilled profession. The SSA likely does not consider him to provide substantial services, even though he earned more than the exemption amount.
>
> In summary, Dr. Wight would not be entitled to a grace year because of the nature of services he rendered. Even though he worked more hours, Mr. Thirsk would be entitled to a grace year, thereby avoiding the reduction in social security benefits during 2022 that normally would occur because he was under the FRA and earned more than the exemption amount. In contrast, Dr. Wight should expect reduced social security benefits due to the RET.

Taking Benefits Before FRA Affects Benefits Earned by Family Members.[51] A third consequence of receiving benefits before FRA is that a family member's social security benefits may be reduced. If a spouse and/or child receive benefits based on the worker's record, excess earnings reduce the worker's benefit payment, also decreasing the amount payable to family members. Spousal benefits are covered later.

47. 20 CFR §§404.435(c) and (d).

48. 20 CFR §404.406(a).

49. 20 CFR §404.447(a)(1) does not define the term "highly skilled occupation" although it may be understood to be a profession requiring significant training and a period of apprenticeship or internship under an established professional.

50. 20 CFR §404.447(a)(1); *Social Security Handbook: 1807. Grace Year and Non-Service Month Defined*. Aug. 8, 2011. SSA. [www.ssa.gov/OP_Home/handbook/handbook.18/handbook-1807.html] Accessed on Jun. 9, 2022.

51. *1804. How Excess Earnings are Charged Against Benefits*. Apr. 19, 2010. SSA. [www.ssa.gov/OP_Home/handbook/handbook.18/handbook-1804.html] Accessed on Mar. 21, 2022.

Example 8. Perry, age 63, is entitled to social security retirement benefits of $1,200 per month before a reduction for excess earnings. His wife, Paula, who is also 63, receives half of Perry's retirement benefit, or $600 per month before a reduction for excess earnings.

Perry's earnings in 2022 are $20,560, which is $1,000 over the earnings limit. Therefore, his benefit is reduced by $500 ($1 for every $2 over the limit). Paula's spousal benefit is reduced by $250 (½ of $500).

In addition, any excess earnings of the spouse affect the spouse's benefits but not the primary worker's benefits.

Example 9. Use the same facts as **Example 8,** except Paula also works. Her 2021 earnings are $19,360, which is $400 over the earnings limit. Therefore, her 2022 spousal benefit is reduced by $200 ($1 for every $2 over the limit). After reductions, her monthly spousal benefit is $150 ($600 unadjusted spousal benefit − $250 reduction for Perry's excess earnings − $200 reduction for Paula's excess earnings).

Paula's earnings do not affect Perry's social security retirement benefits because he is not drawing benefits based on her earnings record.

Taking Benefits Upon Reaching FRA

FRA is based on the year an individual was born and gradually increases from age 65 to 67 for individuals born after 1959. Employees who delay filing for benefits beyond their FRA are eligible for increased benefits.[52] The following chart shows FRA based on the year of a taxpayer's birth.[53]

Year of Birth	FRA
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943–1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

The year of birth column is based on the principle that establishes an individual's age on the "first moment of the day preceding the anniversary" of their birth.[54] For example, an individual born on January 1, 1956, uses 1955 as their year of birth and therefore has an FRA of 66 years, 2 months. A person born the next day, January 2, 1956, has an FRA of 66 years, 4 months.

52. 20 CFR §404.313(a).

53. *Retirement Planner: Full Retirement Age*. SSA. [www.socialsecurity.gov/planners/retire/retirechart.html] Accessed on Nov. 22, 2021.

54. *Program Operations Manual System (POMS) GN 00302.400*. Oct. 6, 1994. SSA. [secure.ssa.gov/apps10/poms.nsf/lnx/0200302400] Accessed on Mar. 22. 2022.

Special Rule for Year of FRA. Once an individual reaches FRA, the social security earnings test no longer applies.[55] Before 2000, earned income could reduce the social security benefits of taxpayers under age 70. After 2000, an individual who reaches FRA no longer has their social security benefit reduced regardless of their earnings.

Adjustment of Reduction Factor at FRA.[56] An individual can recover any reductions of benefits incurred before reaching FRA through increases in benefits after FRA. Social security law identifies this as the **adjustment of reduction factor.** Through this factor, a retiree can recover the amount by which the SSA reduced their benefits before FRA. When a beneficiary reaches their FRA, any benefits that had been withheld because of the RET are gradually restored through a permanent increase in the monthly benefit for the retired worker.[57] The retiree need not file any application for the increase in benefit amount. Instead, the post-FRA benefit is recalculated automatically.

Taking Benefits at Delayed Retirement Age[58]

Congress provided an incentive to delay receiving social security benefits until age 70. For individuals who attain FRA in 2009 or later, their benefits increase by 2/3% each month. This results in a **delayed retirement credit** and an annual increase in benefits of 8%. This amount is not compounded but is multiplied by the number of months the individual delays filing for retirement benefits. Congress set the rate of increase in the 1980s when interest rates were much higher than in 2021. As a result, individuals can increase their monthly social security benefits by approximately 25-30% by delaying filing for social security benefits from FRA until age 70. The range is established by the number of months during which the delayed retirement benefits accumulate, with workers born in 1960 or later having the oldest FRA and, therefore, the shortest time for delayed retirement credits to accumulate.

Example 10. (The figures presented are from an actual SSA report, used with permission). Tom Terrific turns age 62 in 2022. The SSA estimates his monthly social security retirement benefit at age 62 to be $2,009. If he were to delay benefits until age 70, SSA estimates his benefits to be $3,549. If Tom were to take early benefits, by the time he reaches age 70 he would have received $192,864 ($2,009 × 12 months × 8 years). At age 70, his benefit projection is $1,540 more than his early retirement benefit ($3,549 – $2,009). Tom must wait 125 months before his waiting proves more beneficial financially than taking early benefits ($192,864 ÷ $1,540 = 125 months or 10.43 years), which places him at roughly age 80½. Tom's father died at age 74, and his mother died at age 82. Tom has a difficult decision to make.

Observation. This example does not consider the benefits Tom may forfeit if he continues working and files for benefits before FRA (age 67 for someone born in 1960 and after, as illustrated previously). Further, if Tom were to wait until FRA to claim benefits, SSA has estimated his benefit at $2,862 per month. When compared to waiting until age 70, the difference per month is $687 ($3,549 – $2,862). Between FRA and delayed retirement, Tom would have received $103,032 ($2,862 × 12 months × 3 years). Delaying receipt of his benefits from FRA to age 70 extends the breakeven period by 150 months or 12.5 years before delaying benefits proves more beneficial financially ($103,032 ÷ $687 = 150 months (rounded) or 12.5 years). This places him at age 82½ before his delaying of benefits begins to exceed taking benefits at FRA.

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55. *Senior Citizens' Freedom to Work Act of 2000*, PL 106-182, §2.

56. *728. Adjustment of Reduction Factor at FRA*. Sep. 23, 2016. SSA. [www.ssa.gov/OP_Home/handbook/handbook.07/handbook-0728.html] Accessed on Sep. 30, 2021.

57. *Modeling Behavioral Responses to Eliminating the Retirement Earnings Test*. Olsen, Anya, and Romig, Kathleen. 2013. SSA. [www.ssa.gov/policy/docs/ssb/v73n1/v73n1p39.html] Accessed on Oct. 7, 2021.

58. *Social Security Amendments of 1983*, PL 98-21, §114.

Other Factors to Consider

Spousal Benefits.[59] When an individual applies for retirement benefits, their spouse may be eligible for **spousal benefits** based on the individual's covered earnings. A spouse may be eligible for a benefit based on their working spouse's earnings when the worker files for retirement benefits. The spouse must be at least 62 years old or have a qualifying child in their care. A qualifying child is under age 16 or receives social security disability benefits. The amount of the spousal benefit can be as much as half of the worker's PIA depending on the age of the spouse when the worker's spouse retires. Benefits are reduced if the spouse begins receiving benefits prior to their FRA **unless** the spouse is caring for a qualifying child.

File and Suspend.[60] Under the file and suspend strategy, an individual who reached their FRA could apply for social security retirement benefits and then request to have the payments suspended. This entitled the individual's spouse and other family members to receive benefits based on the individual's earnings record while the individual continued to earn delayed social security retirement benefits at the rate of 8% per year up to age 70. The Bipartisan Budget Act of 2015 (BBA) changed the rule so that if an individual suspends the receipt of benefits, no one can claim benefits based on their earnings record except for a divorced spouse.

This provision is effective for benefits payable beginning six months after the enactment of the BBA. This means that an individual who has been using the file and suspend strategy is **grandfathered** and therefore can continue to do so. However, as of April 30, 2016 (six months after enactment), any new request to suspend benefit payments will stop all benefit payments — including spousal and other family benefits — until the individual who suspended the benefits has their benefits reinstated. An individual can still voluntarily suspend their retirement benefits. This is an option for someone who began receiving benefits early and wants to halt their benefits temporarily to earn delayed retirement credits. However, such an individual will no longer be able to request a lump-sum payment of all of their retroactive benefits if they decide they want their benefits reinstated.

Deemed Filing. The BBA eliminated the file and suspend strategy by extending the **deemed filing** concept.[61] If a married person files for social security benefits, they are deemed to file for both their own retirement benefit and their spousal benefit. The SSA pays only the larger of the two benefits.

The deemed filing concept applies if the person filing for benefits is **eligible** for more than one benefit. A married person cannot be deemed to file for a spousal benefit unless their spouse has already filed for their own benefit. Eligibility for a spousal benefit is determined only in the month that a person files for benefits.[62]

> **Example 11.** Callie applies for social security retirement benefits on her 62nd birthday in January 2016. Her husband, Larry, is still working and does not plan to file for social security benefits until his 70th birthday in 2025. Callie is not deemed to apply for a spousal benefit because Larry has to file for his own retirement benefit before Callie is eligible for a spousal benefit.

The deemed filing rule does not apply to **survivor benefits.** A surviving spouse can file for survivor benefits without being deemed to file for their own retirement benefit. As a result, a surviving spouse can receive some benefits from social security while their own retirement benefits continue to grow. Such a person is **not** deemed to have filed for their own retirement benefit if they file for a spousal benefit.[63]

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59. *Benefits for Spouses.* Sep. 25, 2013. SSA. [www.ssa.gov/oact/quickcalc/spouse.html] Accessed on Nov. 12, 2021.

60. *Retirement Planner: Suspending Retirement Benefit Payments.* SSA. [www.ssa.gov/planners/retire/suspend.html] Accessed on May 9, 2022.

61. *Bipartisan Budget Act of 2015,* PL 114-74, §831.

62. *Program Operations Manual System (POMS): GN 00204.004 Considering Possible Entitlement to Retirement Insurance Benefits (RIB) when a Claimant Files an Application for Spouse's Benefits.* Jan. 3, 2017. SSA. [secure.ssa.gov/poms.nsf/lnx/0200204004] Accessed on Oct. 7, 2021.

63. *Program Operations Manual System (POMS): GN 00204.020 Scope of the Application.* Jul. 13, 2020. SSA. [secure.ssa.gov/poms.nsf/lnx/0200204020] Accessed on Mar. 22, 2022.

The same rule for deemed filing applies if the surviving spouse has a disabled adult child who is entitled to **child's benefits.** These federally funded benefits are awarded to children with a parent who is entitled to social security benefits based on the parent's retirement, disability, or death.[64] The child must be younger than 18 unless they are still a full-time high school student, in which case they can be 18 or 19 years old. A child can receive benefits when 18 or older if they have a disability that starts before they turn age 22.[65] A person caring for a child under 16 or a disabled adult child is not deemed to have filed for their own retirement benefit if they file for a **spousal** benefit.

Prior to the BBA's enactment, deemed filing ended at an individual's FRA. Under the BBA, deemed filing is extended to age 70.[66] Before the BBA, an individual could defer their own benefit at their FRA to continue to earn delayed retirement credits (8% per year up to age 70) and collect only the spousal benefit instead. Under the BBA, this option is no longer available. Because social security pays only the larger of the individual's own retirement benefit or their spousal benefit, the requirement to take both benefits means that the individual loses the smaller of the two benefits.[67]

The changes to the deemed filing provisions are effective for individuals who reach age 62 after December 31, 2015.[68] Individuals who were age 62 before that date can still file a **restricted application** for a spousal benefit only when they attain their FRA.

> **Example 12.** Use the same facts as **Example 11,** except Larry's 66th birthday is April 1, 2016. Because he attained his FRA on that date, he can apply for a spousal benefit without being deemed to file for his own retirement benefit.

Withholding Federal Income Tax.[69] Before the government enacted the Social Security Amendments of 1983, social security income was not taxable.[70] The legislation's enactment created the need to withhold federal income tax. Form W-4V, *Voluntary Withholding Request,* allows benefit recipients to have the federal government withhold a portion of their social security income. In addition to social security benefits, taxpayers can use Form W-4V to voluntarily withhold from unemployment compensation, Tier 1 railroad retirement benefits, Commodity Credit Corporation loans, certain crop disaster payments, or title II of the Disaster Assistance Act of 1988. Taxpayers can file the form again to stop withholding.

Practitioner Planning Tip

Form W-4V is relatively short, with few fields to complete, apart from showing the individual's name, address, social security number, and claim or identification number. It gives the individual the option to start or stop withholding from social security or similar government program. If the individual chooses to start federal income tax withholding from their social security, they only have options of 7%, 10%, 12%, and 22% from which to choose. This portion of the form follows.

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64. 42 USC 402(d); *Social Security Child's Insurance Benefits*. SSA. [www.benefits.gov/benefit/4380] Accessed on Nov. 16, 2021.

65. 42 USC §402(d)(1)(B); *Social Security Child's Insurance Benefits*. SSA. [www.benefits.gov/benefit/4380] Accessed on Mar. 22, 2022.

66. *Bipartisan Budget Act of 2015*, PL 114-74, §831(b).

67. *New Budget Deal Is Cutting Your Social Security Benefits and It's a Good Thing.* Hopkins, Jamie. Oct. 29, 2015. Forbes. [www.forbes.com/sites/jamiehopkins/2015/10/29/new-budget-deal-is-cutting-your-social-security-benefits-and-its-a-good-thing/] Accessed on Nov. 15, 2021.

68. *Bipartisan Budget Act of 2015*, PL 114-74, §831(a) adding 42 USC 402(r)(3).

69. Form W-4V, *Voluntary Withholding Request*, p.1. Feb. 2018. IRS. [www.irs.gov/pub/irs-pdf/fw4v.pdf] Accessed on Mar. 18, 2022.

70. *Social Security Amendments of 1983.* PL 98-21. *Debunking Some Internet Myths — Part 2*. SSA. [www.ssa.gov/history/InternetMyths2.html] Accessed on Mar. 18, 2022.

Form **W-4V**
(Rev. February 2018)
Department of the Treasury
Internal Revenue Service

Voluntary Withholding Request
(For unemployment compensation and certain Federal Government and other payments.)
▶ Give this form to your payer. Do not send it to the IRS.

OMB No. 1545-0074

1 Your first name and middle initial	Last name			**2** Your social security number
3 Home address (number and street or rural route)	City or town	State	ZIP code	
4 Claim or identification number (if any) you use with your payer				

5 ☐ I want federal income tax withheld from my unemployment compensation at a rate of 10% of each payment.

6 I want federal income tax withheld from (a) my social security benefits, (b) my social security equivalent Tier 1 railroad retirement benefits, (c) my Commodity Credit Corporation loans, (d) certain crop disaster payments under the Agricultural Act of 1949 or under Title II of the Disaster Assistance Act of 1988, or (e) dividends and other distributions from Alaska Native Corporations to its shareholders, at the rate of (check one):

7% ☐ **10%** ☐ **12%** ☐ **22%** ☐

7 ☐ I want you to stop withholding federal income tax from my payment(s).

Your signature ▶ **Date ▶**

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 22891V Form **W-4V** (Rev. 2-2018)

STEP 4: AMOUNT TO INCLUDE IN GROSS INCOME[71]

Social security benefits may be partially included in a taxpayer's gross income. The IRS counts them in the taxpayer's combined income[72] to determine if benefits are potentially taxable.

Gross Income vs. Combined Income[73]

Only a portion of social security benefits is included in gross income. This portion ranges from 0% to 85% and depends on other income. The required calculation with other income requires the computation of "combined income," a term that the SSA uses in only a few places. The combined income amount is the sum of:[74]

- Adjusted gross income (AGI) without social security,
- **Nontaxable** interest, and
- Half of the social security benefits.

A taxpayer's combined income generally corresponds to line 8 of Worksheet 1, *Figuring Your Taxable Benefits,* in IRS Pub. 915, *Social Security and Equivalent Railroad Retirement Benefits,* for 2021 (shown later).

If the combined income is less than a base amount, no tax is imposed on the social security benefits. The base amount depends on filing status.[75]

- Married filing jointly (MFJ): $32,000
- Single, head of household (HoH), qualifying widow (QW), or married filing separately (MFS) living apart from a spouse: $25,000
- MFS living with spouse at any time during the year: $0

71. IRC §86.
72. *Retirement Benefits*. SSA. [www.ssa.gov/benefits/retirement/planner/taxes.html] Accessed on Mar. 18, 2022.
73. IRC §86(b)(2).
74. IRC §§86(a) and (b).
75. IRC §86(c)(1).

The following table shows the percentage of social security benefits subject to income tax based on **combined income.**[76]

S, HoH, or QW	MFJ	MFS Living Apart for Entire Year	MFS Living Together at Any Time During Year	Social Security Benefits
≤ $25,000	≤ $32,000	≤ $25,000	N/A	Not taxable
$25,001–$34,000	$32,001–$44,000	$25,001–$34,000	N/A	Up to **50%** is taxable
> $34,000	> $44,000	> $34,000	> $0	Up to **85%** is taxable

Many details in IRC §86 affect the calculation of the portion of social security benefits that is taxable. Most of the details are beyond the scope of this discussion. However, some general principles guide the estimation of the taxable amount that can be readily seen.

Combined Income for Individuals Not Filing Married Returns. To calculate combined income, social security recipients add AGI, nontaxable interest income, plus half of the total social security benefits for the year. If the taxpayer uses single, HoH, or QW filing status, and their combined income is less than $25,000,[77] no social security benefits are taxable. The Code refers to this threshold as the **base amount.**[78] If the combined income falls between $25,000 and $34,000, up to 50% of the benefits may be taxable. If combined income exceeds $34,000, up to 85% of the benefits may be taxable.[79]

MFJ Couples. The combined income limits are slightly different for MFJ couples. As a general rule, those having less than $32,000[80] in combined income do not have to pay taxes on their benefits. Up to 50% of benefits may be taxable for MFJ couples with a combined income between $32,000 and $44,000. In comparison, those whose combined income exceeds $44,000[81] may be taxed on up to 85% of the value of their social security benefits. The maximum amount of any social security recipient's benefits that can be taxed is limited to 85%.

MFS Couples. Married couples who file separate tax returns and live together for **any** part of the year should expect to pay taxes on their social security benefits. Regardless of their income, 85% of all social security benefits are taxable for MFS couples who live together for any part of the year.[82]

In contrast, the rules differ for married individuals living in separate residences from their spouse **at all times** during the year and using MFS filing status. The rules affecting taxation of their social security benefits are the same as those described earlier for individuals not filing married returns. A 2002 tax court case highlighted the importance of living in separate residences, not just separate quarters within the same residence.[83]

The IRS publishes the following worksheet for determining taxable benefits under social security or railroad retirement benefits.[84]

76. IRC §86(c).

77. IRC §86(c)(1)(A).

78. IRC §86(c)(1).

79. IRC §86(c)(2)(A).

80. IRC §86(c)(1)(B).

81. IRC §86(c)(2)(B).

82. IRC §§86(c)(1)(C)(i) and (ii).

83. *McAdams v. Comm'r*, 118 TC 373 (2002).

84. IRS Pub. 915, *Social Security and Equivalent Railroad Retirement Benefits*, p. 16 (2022).

Worksheet 1. **Figuring Your Taxable Benefits** *Keep for Your Records*

Before you begin:

- If you are married filing separately and you **lived apart** from your spouse for all of 2021, enter "D" to the right of the word "benefits" on Form 1040 or 1040-SR, line 6a.
- Don't use this worksheet if you repaid benefits in 2021 and your total repayments (box 4 of Forms SSA-1099 and RRB-1099) were more than your gross benefits for 2021 (box 3 of Forms SSA-1099 and RRB-1099). None of your benefits are taxable for 2021. For more information, see *Repayments More Than Gross Benefits*.
- If you are filing Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989, don't include the amount from line 2b of Form 1040 or 1040-SR on line 3 of this worksheet. Instead, include the amount from Schedule B (Form 1040), line 2.

1. Enter the total amount from ***box 5*** of **ALL** your **Forms SSA-1099** and **RRB-1099**. Also enter this amount on Form 1040 or 1040-SR, line 6a . . . . . . **1.** ______

2. Multiply line 1 by 50% (0.50) . . . . . . **2.** ______

3. Combine the amounts from: Form 1040 or 1040-SR, lines 1, 2b, 3b, 4b, 5b, 7, and 8 . . . . . . **3.** ______

4. Enter the amount, if any, from Form 1040 or 1040-SR, line 2a . . . . . . **4.** ______

5. Enter the total of any exclusions/adjustments for:
- Adoption benefits (Form 8839, line 28),
- Foreign earned income or housing (Form 2555, lines 45 and 50), and
- Certain income of bona fide residents of American Samoa (Form 4563, line 15) or Puerto Rico . . . . . . **5.** ______

6. Combine lines 2, 3, 4, and 5 . . . . . . **6.** ______

7. Enter the total of the amounts from Schedule 1 (Form 1040), lines 11 through 20, and 23 and 25 . . . . . . **7.** ______

8. Is the amount on line 7 less than the amount on line 6?

No. STOP None of your social security benefits are taxable. Enter -0- on Form 1040 or 1040-SR, line 6b.

Yes. Subtract line 7 from line 6 . . . . . . **8.** ______

9. If you are:
- 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 2021, enter $25,000 . . . . . . **9.** ______

Note. If you are married filing separately and you lived with your spouse at any time in 2021, skip lines 9 through 16, multiply line 8 by 85% (0.85), and enter the result on line 17. Then, go to line 18.

10. Is the amount on line 9 less than the amount on line 8?

No. STOP None of your benefits are taxable. Enter -0- on Form 1040 or 1040-SR, line 6b. If you are married filing separately and you **lived apart** from your spouse for all of 2021, be sure you entered "D" to the right of the word "benefits" on Form 1040 or 1040-SR, line 6a.

Yes. Subtract line 9 from line 8 . . . . . . **10.** ______

11. 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 2021 . . . . . . **11.** ______

12. Subtract line 11 from line 10. If zero or less, enter -0- . . . . . . **12.** ______

13. Enter the **smaller** of line 10 or line 11 . . . . . . **13.** ______

14. Multiply line 13 by 50% (0.50) . . . . . . **14.** ______

15. Enter the **smaller** of line 2 or line 14 . . . . . . **15.** ______

16. Multiply line 12 by 85% (0.85). If line 12 is zero, enter -0- . . . . . . **16.** ______

17. Add lines 15 and 16 . . . . . . **17.** ______

18. Multiply line 1 by 85% (0.85) . . . . . . **18.** ______

19. **Taxable benefits.** Enter the **smaller** of line 17 or line 18. Also enter this amount on Form 1040 or 1040-SR, line 6b . . . . . . **19.** ______

TIP *If you received a lump-sum payment in 2021 that was for an earlier year, also complete Worksheet 2 or 3 and Worksheet 4 to see if you can report a lower taxable benefit.*

Inclusion of Lump-Sum Settlements.[85] Taxpayers may receive a lump-sum payment of benefits received during the year, which represents more than one year of benefits. In general, the gross amount of lump-sum benefit is includable as part of the combined income for the year. However, taxpayers may be able to figure the taxable part of a lump-sum payment for an earlier year separately, using the income for the earlier year **as if the benefits received in the current year were received in an earlier tax year.** Normally, the Form SSA-1099, *Social Security Benefit Statement,* reports which years the lump-sum payments cover. Taxpayers may utilize the lump-sum election (LSE) if it lowers the amount of taxable benefits.

Note. Use of the LSE does not require amending of previous returns for which benefits are allocated.

85. IRC §86(e).

Example 13. Rachel is 66 and single.[86] In 2020, she applied for social security disability benefits but was denied. She appealed the decision and won. In 2021, she received a $9,000 lump-sum payment ($3,000 for 2020 and $6,000 for 2021). Rachel also received $6,000 in social security benefits in 2021, so her total benefits were $15,000. Rachel's other income for 2020 and 2021 is as follows.

Income	2020	2021
Wages	$18,000	$ 3,500
Interest income	2,000	3,000
Dividend income	1,000	1,000
Fully-taxable pension		18,000
Total	$21,000	$25,500

Rachel completes Worksheet 1 from IRS Pub. 915 to find the amount of her taxable benefits for 2021 under the **regular method.** She completes Worksheet 2, *Figure Your Additional Taxable Benefits (From a Lump-Sum Payment for a Year After 1993),* to calculate the taxable amount of the 2020 lump-sum payment under the LSE method. Additionally, Rachel completes Worksheet 4, *Figure Your Taxable Benefits Under the Lump-Sum Election Method,* to determine if the LSE method lowers her taxable benefits.

Rachel compares the amounts from Worksheet 4, line 21 ($3,250), and Worksheet 1, line 19 ($4,000). Because the amount on Worksheet 4 is smaller, she chooses to use the LSE method. To do this, she prints "LSE" to the left of Form 1040, *U.S. Individual Income Tax Return,* line 6a. She then enters $15,000 on Form 1040 and her taxable benefits of $3,250 on line 6b. Rachel's completed Worksheets 1, 2, and 4 follow.

86. Example adapted from IRS Pub. 915, *Social Security and Equivalent Railroad Retirement Benefits,* pp. 11–14 (2021).

For Example 13

Worksheet 1. **Figuring Your Taxable Benefits** *Keep for Your Records*

Before you begin:
- If you are married filing separately and you **lived apart** from your spouse for all of 2021, enter "D" to the right of the word "benefits" on Form 1040 or 1040-SR, line 6a.
- Don't use this worksheet if you repaid benefits in 2021 and your total repayments (box 4 of Forms SSA-1099 and RRB-1099) were more than your gross benefits for 2021 (box 3 of Forms SSA-1099 and RRB-1099). None of your benefits are taxable for 2021. For more information, see *Repayments More Than Gross Benefits*.
- If you are filing Form 8815, Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989, don't include the amount from line 2b of Form 1040 or 1040-SR on line 3 of this worksheet. Instead, include the amount from Schedule B (Form 1040), line 2.

1. Enter the total amount from ***box 5*** of **ALL** your **Forms SSA-1099** and **RRB-1099**. Also enter this amount on Form 1040 or 1040-SR, line 6a	**1.** 15,000		
2. Multiply line 1 by 50% (0.50)		**2.**	7,500
3. Combine the amounts from: Form 1040 or 1040-SR, lines 1, 2b, 3b, 4b, 5b, 7, and 8		**3.**	25,500
4. Enter the amount, if any, from Form 1040 or 1040-SR, line 2a		**4.**	0
5. Enter the total of any exclusions/adjustments for: • Adoption benefits (Form 8839, line 28), • Foreign earned income or housing (Form 2555, lines 45 and 50), and • Certain income of bona fide residents of American Samoa (Form 4563, line 15) or Puerto Rico		**5.**	0
6. Combine lines 2, 3, 4, and 5		**6.**	33,000
7. Enter the total of the amounts from Schedule 1 (Form 1040), lines 11 through 20, and 23 and 25		**7.**	0
8. Is the amount on line 7 less than the amount on line 6? **No.** STOP None of your social security benefits are taxable. Enter -0- on Form 1040 or 1040-SR, line 6b. **Yes.** Subtract line 7 from line 6		**8.**	33,000
9. If you are: • 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 2021, enter $25,000		**9.**	25,000
Note. If you are married filing separately and you lived with your spouse at any time in 2021, skip lines 9 through 16, multiply line 8 by 85% (0.85), and enter the result on line 17. Then, go to line 18.			
10. Is the amount on line 9 less than the amount on line 8? **No.** STOP None of your benefits are taxable. Enter -0- on Form 1040 or 1040-SR, line 6b. If you are married filing separately and you **lived apart** from your spouse for all of 2021, be sure you entered "D" to the right of the word "benefits" on Form 1040 or 1040-SR, line 6a. **Yes.** Subtract line 9 from line 8		**10.**	8,000
11. 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 2021		**11.**	9,000
12. Subtract line 11 from line 10. If zero or less, enter -0-		**12.**	0
13. Enter the **smaller** of line 10 or line 11		**13.**	8,000
14. Multiply line 13 by 50% (0.50)		**14.**	4,000
15. Enter the **smaller** of line 2 or line 14		**15.**	4,000
16. Multiply line 12 by 85% (0.85). If line 12 is zero, enter -0-		**16.**	0
17. Add lines 15 and 16		**17.**	4,000
18. Multiply line 1 by 85% (0.85)		**18.**	12,750
19. **Taxable benefits.** Enter the **smaller** of line 17 or line 18. Also enter this amount on Form 1040 or 1040-SR, line 6b		**19.**	4,000

TIP *If you received a lump-sum payment in 2021 that was for an earlier year, also complete Worksheet 2 or 3 and Worksheet 4 to see if you can report a lower taxable benefit.*

For Example 13

Worksheet 2. **Figure Your Additional Taxable Benefits (From a Lump-Sum Payment for a Year After 1993)**

Keep for Your Records

Enter earlier year **2020**

1.	Enter the total amount from ***box 5*** of **ALL** your **Forms SSA-1099** and **RRB-1099** for the earlier year, plus the lump-sum payment for the earlier year received after that year . . . 1. **3,000** **Note.** If line 1 is zero or less, skip lines 2 through 20 and enter -0- on line 21. Otherwise, go to line 2.		
2.	Multiply line 1 by 50% (0.50)	2.	1,500
3.	Enter your adjusted gross income for the earlier year	3.	21,000
4.	Enter the total of any exclusions/adjustments you claimed in the earlier year for: • Adoption benefits (Form 8839) • Qualified U.S. savings bond interest (Form 8815) • Student loan interest (for 2020, 2019, and 2018, Schedule 1 (Form 1040); for years before 2018, Form 1040 or Form 1040A, page 1) • Tuition and fees (for 2020, 2019, and 2018, Schedule 1 (Form 1040); for years before 2018, Form 1040 or Form 1040A, page 1) • Domestic production activities (for 2005 through 2017) (Form 1040, page 1) • Foreign earned income or housing (Form 2555 or Form 2555-EZ) • Certain income of bona fide residents of American Samoa (Form 4563) or Puerto Rico	4.	0
5.	Enter any tax-exempt interest received in the earlier year	5.	0
6.	Add lines 2 through 5	6.	22,500
7.	Enter your taxable benefits for the earlier year that you previously reported	7.	0
8.	Subtract line 7 from line 6	8.	22,500
9.	If, for the earlier year, you were: • Married filing jointly, enter $32,000 • Single, head of household, qualifying widow(er), married filing separately and you **lived apart** from your spouse for all of the earlier year, enter $25,000	9.	25,000
	Note. If you were married filing separately and you lived with your spouse at any time during the earlier year, skip lines 9 through 16, multiply line 8 by 85% (0.85), and enter the result on line 17. Then, go to line 18.		
10.	Is the amount on line 8 more than the amount on line 9? **No.** Skip lines 10 through 20 and enter -0- on line 21. **Yes.** Subtract line 9 from line 8	10.	
11.	Enter $12,000 if married filing jointly for the earlier year; $9,000 if single, head of household, qualifying widow(er), or married filing separately and you **lived apart** from your spouse for all of the earlier year	11.	
12.	Subtract line 11 from line 10. If zero or less, enter -0-	12.	
13.	Enter the **smaller** of line 10 or line 11	13.	
14.	Multiply line 13 by 50% (0.50)	14.	
15.	Enter the **smaller** of line 2 or line 14	15.	
16.	Multiply line 12 by 85% (0.85). If line 12 is zero, enter -0-	16.	
17.	Add lines 15 and 16	17.	
18.	Multiply line 1 by 85% (0.85)	18.	
19.	**Refigured taxable benefits.** Enter the **smaller** of line 17 or line 18	19.	
20.	Enter your taxable benefits for the earlier year (or as refigured due to a previous lump-sum payment for the year)	20.	
21.	**Additional taxable benefits.** Subtract line 20 from line 19. Also enter this amount on Worksheet 4, line 20	21.	0

CAUTION

Don't file an amended return for this earlier year. Complete a separate Worksheet 2 or Worksheet 3 for each earlier year for which you received a lump-sum payment in 2021.

For Example 13

Worksheet 4. **Figure Your Taxable Benefits Under the Lump-Sum Election Method (Use With Worksheet 2 or 3)**

Keep for Your Records

Complete Worksheet 1 and Worksheets 2 and 3 as appropriate before completing this worksheet.

1.	Enter the total amount from ***box 5*** of **ALL** your **Forms SSA-1099** and **RRB-1099** for 2021, minus the lump-sum payment for years before 2021 . . . **1.** 12,000 **Note.** If line 1 is zero or less, skip lines 2 through 18, enter -0- on line 19, and go to line 20. Otherwise, go to line 2.		
2.	Multiply line 1 by 50% (0.50)	**2.**	6,000
3.	Enter the amount from Worksheet 1, line 3	**3.**	25,500
4.	Enter the amount from Worksheet 1, line 4	**4.**	0
5.	Enter the amount from Worksheet 1, line 5	**5.**	0
6.	Combine lines 2, 3, 4, and 5	**6.**	31,500
7.	Enter the amount from Worksheet 1, line 7	**7.**	0
8.	Subtract line 7 from line 6	**8.**	31,500
9.	Enter the amount from Worksheet 1, line 9. But if you are married filing separately and lived with your spouse at any time during 2021, skip lines 9 through 16, multiply line 8 by 85% (0.85), and enter the result on line 17. Then, go to line 18	**9.**	25,000
10.	Is the amount on line 8 more than the amount on line 9? **No.** Skip lines 10 through 18, enter -0- on line 19, and go to line 20. **Yes.** Subtract line 9 from line 8	**10.**	6,500
11.	Enter the amount from Worksheet 1, line 11	**11.**	9,000
12.	Subtract line 11 from line 10. If zero or less, enter -0-	**12.**	0
13.	Enter the **smaller** of line 10 or line 11	**13.**	6,500
14.	Multiply line 13 by 50% (0.50)	**14.**	3,250
15.	Enter the **smaller** of line 2 or line 14	**15.**	3,250
16.	Multiply line 12 by 85% (0.85). If line 12 is zero, enter -0-	**16.**	0
17.	Add lines 15 and 16	**17.**	3,250
18.	Multiply line 1 by 85% (0.85)	**18.**	10,200
19.	Enter the **smaller** of line 17 or line 18	**19.**	3,250
20.	Enter the total of the amounts from Worksheet 2, line 21, and Worksheet 3, line 14, for all earlier years for which the lump-sum payment was received	**20.**	0
21.	**Taxable benefits under lump-sum election method.** Add lines 19 and 20	**21.**	3,250

Next. Is line 21 above smaller than Worksheet 1, line 19?

No. Don't use this method to figure your taxable benefits. Follow the instructions on Worksheet 1 to report your benefits.

Yes. You can elect to report your taxable benefits under this method. **To elect this method:**

1. Enter "LSE" to the left of Form 1040 or 1040-SR, line 6a.
2. If line 21 above is zero, follow the instructions in line 10 for "No" on Worksheet 1. Otherwise:
   a. Enter the amount from Worksheet 1, line 1, on Form 1040 or 1040-SR, line 6a.
   b. Enter the amount from line 21 above on Form 1040 or 1040-SR, line 6b.
   c. If you are married filing separately and you **lived apart** from your spouse for all of 2021, enter "D" to the right of the word "benefits" on Form 1040 or 1040-SR, line 6a.

Note. The objective of the LSE is to optimize the allocation of the social security benefit. The choice is between the following.

- Allocating it to the year for which it was intended, or
- Allocating it to the year in which it was received.

In this example, Rachel includes $750 less social security benefits in her 2021 income ($4,000 – $3,250) by allocating it to its intended year.

Other Issues

Survivor's Benefits.[87] Social security provides benefits for the family members of a participant. If a participant passes away, for example, the age at which the survivor is eligible to draw benefits based on the earnings record of their deceased spouse depends on their age and disability status and if they care for children. A divorced spouse may also be eligible if the marriage lasted 10 years or longer.

A survivor who remarries after reaching 60 years of age continues to be eligible for benefits. However, if they are younger than 60 years, they retain their survivor's benefits **only** in the following circumstances.[88]

- They remarried after reaching age 50, and
- They were disabled when they remarried.

Surviving spouses may receive benefits at age 60; however, their benefits may be higher if they wait until their own FRA to file for social security benefits based on their deceased spouse's earnings record. A disability or the presence of children creates eligibility for social security benefits at an earlier age, as described next.

Disability.[89] The surviving spouse of a deceased benefit recipient can receive benefits as early as age 50 if they have a disability that meets all three of the following requirements.

1. The disability starts within seven years of the recipient's death or seven years after the survivor is last entitled to:
   - Mother's or father's benefits, or
   - Survivor benefits based upon a disability, whichever happened last.
2. The disability persists for five full consecutive months unless the survivor is eligible for supplemental security income or federally administered state supplementary payments.
3. The survivor has not received 36 months of disability payments for which alcoholism or drug addiction is a contributing factor.

Disability is defined using the basic definition of being unable to perform any substantial gainful activity because of either a physical or mental impairment. The impairment must be expected to last longer than one year or result in the survivor's death. [90]

Child-In-Care Provisions.[91] If a survivor cares for a deceased person's child, the survivor may be eligible for social security benefits under the child-in-care provisions. The child must either be under age 16 or disabled. A child in the care of a survivor lives with the survivor and does not meet **any** of the following **disqualifications.**

- They are 16 years old or older, **and**
  - Are not disabled,
  - Have a physical disability **not** requiring performance of personal services such as dressing, feeding, and managing money, or
  - Have a mental disability **not** requiring the survivor's active supervision or decision-making about the child's needs.
- They are in active military service.

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87. *Planning for Your Survivors.* SSA. [www.ssa.gov/benefits/survivors/onyourown.html] Accessed on Nov. 15, 2021.

88. 20 CFR §404.335(e)(3).

89. 20 CFR §404.335(c).

90. 20 CFR §404.1505(a).

91. 20 CFR §404.339.

REDUCTIONS OF SOCIAL SECURITY BENEFITS

Federal law limits social security benefits when retirees have another noncovered (i.e., not arising from social security wages) pension. This situation occurs if the pension provides benefits while social security benefits are received. The noncovered pension payments might have arisen from a governmental pension, or they might have arisen from a private pension provided by a nonprofit organization paying wages that are not subject to social security tax. One provision covers retirees, and the other covers their spouses and survivors.

Windfall Elimination Provision (WEP)[92] — Covers Retirees

WEP curtails social security benefits paid to retirees who also receive payments from another pension that arose from wages not covered by social security. This provision addresses a situation in which an individual who works for a state or local government for most of their career but retires early enough to get a retirement job for at least a few years. Thus, this individual receives both a pension from working for the state or local government and a social security benefit. Congress enacted the law in 1983 to eliminate a perceived advantage that certain retirees had when they had earned both social security benefits and pension benefits from a government agency or a nonprofit that were not covered by social security.[93]

WEP only applies to the first tier of AIME, affecting only the first $1,024 of AIME in 2022. For this reason, WEP has a greater effect on workers who have earned lower wages during their working lives.[94] These workers have a higher percentage of their income in the first tier compared with a high-income earner. However, the reduction due to WEP cannot exceed half of the noncovered pension.[95]

The regulations governing WEP apply the reduction to social security benefits even when an individual opts for a lump sum payment. The SSA's Program Operations Manual System (POMS) contains the following definition of a pension.[96]

> *A pension is a periodic or **lump sum** payment from an employer's retirement or disability plan based in whole or in part on non-covered earnings. The payment can be from a defined benefit (DB) or defined contribution (DC) plan (e.g., 401(k), 403(b), or 457).* [Emphasis added]

WEP no longer reduces social security payments when one of the following occurs.[97]

- The individual is no longer entitled to a pension payment or the proration of a lump sum payment based on a specific period ends.
- The individual dies.
- The individual attained 30 years of substantial earnings for social security purposes, thereby qualifying for the WEP exception.

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92. *The Social Security Act of 1935,* PL 74-271, §§215(a)(7) and (d)(3); 42 USC §§415(a)(7) and (d)(3); 20 CFR §§404.213 and 404.243; The term "windfall elimination provision" is colloquial and does not appear in the text of the legislation.

93. *Social Security Amendments of 1983.* PL 98-21; Also see the associated conference report at Social Security Amendments of 1983, pp. 120-121. U.S. Congress, Committee of Conference [www.finance.senate.gov/imo/media/doc/Conf-98-47.pdf] Accessed on Oct. 5, 2021.

94. *Social Security: The Windfall Elimination Provision (WEP),* p. 8. Sep. 14, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/RS/98-35] Accessed on Oct. 5, 2021.

95. 20 CFR §215(d)(3)(B)(ii).

96. *Program Operations Manual System (POMS). RS 00605.360 Windfall Elimination Provision.* Jun. 15, 2021. SSA. [secure.ssa.gov/apps10/poms.nsf/lnx/0300605360] Accessed on Nov. 24, 2021.

97. Ibid.

If an individual has fewer than 30 years of substantial earnings, their social security benefits are reduced by substituting the following percentages for 90% in the amount of income under the first bend point included in the PIA.[98]

Years of Substantial Earnings	Applicable Percentage
30 or more	90%
29	85%
28	80%
27	75%
26	70%
25	65%
24	60%
23	55%
22	50%
21	45%
20 or less	40%

The following table shows how the substantial earnings threshold has increased since the inception of social security.[99]

Year	Substantial Earnings	Year	Substantial Earnings
1937–54	$ 900	1993	$10,725
1955–58	1,050	1994	11,250
1959–65	1,200	1995	11,325
1966–67	1,650	1996	11,625
1968–71	1,950	1997	12,150
1972	2,250	1998	12,675
1973	2,700	1999	13,425
1974	3,300	2000	14,175
1975	3,525	2001	14,925
1976	3,825	2002	15,750
1977	4,125	2003	16,125
1978	4,425	2004	16,275
1979	4,725	2005	16,725
1980	5,100	2006	17,475
1981	5,550	2007	18,150
1982	6,075	2008	18,975
1983	6,675	2009–11	19,800
1984	7,050	2012	20,475
1985	7,425	2013	21,075
1986	7,875	2014	21,750
1987	8,175	2015–16	22,050
1988	8,400	2017	23,625
1989	8,925	2018	23,850
1990	9,525	2019	24,675
1991	9,900	2020	25,575
1992	10,350	2021	26,550

98. 42 USC §§415(a)(7)(B) and (D).

99. *Windfall Elimination Provision*. Jan. 2022. SSA. [www.ssa.gov/pubs/EN-05-10045.pdf] Accessed on Mar. 22, 2022.

Example 14. Harvey worked for his state government from age 30 until he was 55, long enough to earn a pension.[100] He worked in private industry from age 20 until he was 30, and then again from age 56 until turning age 66 in 2021. Thus, he had 20 years of substantial coverage for social security in addition to the state pension he had earned. For his wages subject to social security during those 20 years, Harvey's AIME came to $1,500. If Harvey did not have his government pension, he would have been eligible for a monthly benefit of $1,058. However, WEP reduces his social security benefit to $560, a reduction of $498 ($1,058 – $560).

Example 15. Use the same facts as **Example 14.** Harvey worked in private employment, covered by social security, from age 16 through age 55. During those years, he accumulated at least 30 years of substantial earnings. Retiring at age 55, Harvey found himself bored and took a position teaching classes at a state university. The university employment is not covered employment, and even though he is entitled to a government pension upon his retirement, the fact that he had at least 30 years of substantial earnings means that he does not lose social security benefits because he has a government pension.

Government Pension Offset (GPO) Provision[101] — Covers Spouses of Retirees

The GPO provision reduces the social security benefits paid to spouses and widow(er)s if the retiree receives a pension from a government on which the retiree did not pay social security tax. Unlike WEP, it does not affect the retiree whose social security benefit is based on earnings record. This provision is intended to establish equity between pensions benefits earned for public service or government work and those earned in the private sector, as justified with the following language in an SSA document describing the GPO.

The Government Pension Offset ensures that we calculate the benefits of government employees who don't pay Social Security taxes the same as workers in the private sector who pay Social Security taxes.

The GPO reduces the social security benefits paid to a spouse or a survivor of a government pension enrollee by two-thirds of the government pension benefit.

Example 16. Barry worked in the private sector for 45 years and was entitled to a $2,000 monthly social security benefit the year he died.[102] As a result, his widow, Gertrude, is entitled to a $2,000 survivor's social security benefit after Barry's death. However, Gertrude worked for their state government for 20 years and is entitled to a state pension benefit of $900 per month. The GPO reduces the social security benefit to which she is entitled by $600 ($^2/_3$ × $900). After considering the GPO, Gertrude receives an adjusted social security benefit of $1,400, so her total pension income is $2,300 ($900 + $1,400).

MEDICARE INCOME-RELATED MONTHLY ADJUSTMENT AMOUNT

Medicare is health insurance for individuals who are 65 years or older (or individuals with disabilities, or certain diseases).[103] The SSA uses filing status to determine Medicare premiums and bases the premiums on AGI, which is modified by adding tax-exempt income.[104] Because tax returns are not available immediately, income differences resulting from different filing statuses can also affect Medicare premium amounts two years later. The table on the following page shows the difference that filing status makes at different modified AGI (MAGI) levels.[105]

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100. Example adapted from *Social Security: The Windfall Elimination Provision (WEP).* p. 3. Sep. 14, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/RS/98-35] Accessed on Oct. 5, 2021.

101. *Government Pension Offset*. May 2019. SSA. [www.ssa.gov/pubs/EN-05-10007.pdf] Accessed on Oct. 4, 2021.

102. Example adapted from *Social Security: The Government Pension Offset (GPO),* p. 4. Feb. 8, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/RL/RL32453] Accessed on Oct. 5, 2021.

103. *Getting Started with Medicare.* Medicare.gov. [medicare.gov/basics/get-started-with-medicare] Accessed on Aug. 11, 2022.

104. *Premiums: Rules for Higher-Income Beneficiaries.* SSA. [www.ssa.gov/benefits/medicare/medicare-premiums.html] Accessed on Aug. 11, 2022.

105. *2022 Medicare Parts A & B Premiums and Deductibles/2022 Medicare Part D Income-Related Monthly Adjustment Amounts*. Nov. 15, 2021. Centers for Medicare & Medicaid Services. [www.cms.gov/newsroom/fact-sheets/2022-medicare-parts-b-premiums-and-deductibles2022-medicare-part-d-income-related-monthly-adjustment] Accessed on Nov. 15, 2021.

2020 MAGI (Single)		2020 MAGI (MFJ)		2020 MAGI (MFS)		2022 Monthly Medicare Part B Premium
Over	But Not Over	Over	But Not Over	Over	But Not Over	
$ 0	$ 91,000	$ 0	$182,000	$ 0	$ 91,000	$170.10
91,000	114,000	182,000	228,000	N/A		$238.10
114,000	142,000	228,000	284,000	N/A		$340.20
142,000	170,000	284,000	340,000	N/A		$442.30
170,000	499,999	340,000	749,999	91,000	408,999	$544.30
499,999		749,999		408,999		$578.30

Of the six rows of data in this chart, the second, third, and fourth contain no data for MFS taxpayers. Consequently, a $1 increase in MAGI above $91,000 (first row) promotes an MFS taxpayer from the first row to the fourth row with a Medicare premium more than three times higher. In this extreme case, a taxpayer's monthly premium increases from $170.10 to $544.30 in 2022. There are no intermediate brackets for MFS taxpayers, as there are for all other filing statuses.

Example 17. Herb and Jennifer both turned 65 in 2021 and signed up for Medicare. The Medicare premiums they pay in 2022 are at issue. In 2020, Herb earned wages of $50,000, and Jennifer earned wages of $87,000. She also earned $5,000 in tax-exempt income. For 2019, their MAGI for the Medicare premium calculation is $142,000 ($50,000 Herb's wages + $87,000 Jennifer's wages + $5,000 tax-exempt income) if they filed as MFJ.

However, they filed MFS returns. Herb has MAGI of $50,000 for Medicare Part B purposes, and Jennifer now has MAGI for Medicare premium purposes of $92,000 ($87,000 wages + $5,000 tax-exempt income). For 2022, Herb's monthly Medicare Part B premium is $170.10, whereas Jennifer has a 2022 Medicare Part B premium of $544.30 **per month.** Filing a 2020 tax return using MFJ filing status would result in substantially smaller Medicare Part B premiums that they pay in 2022.

APPEALING A MEDICARE PREMIUM INCREASE[106]

Tax practitioners may serve in the additional role of advisor to clients when they are contemplating the sale of property or assets or make qualified plan withdrawals which may cause a short-term increase in their income. Beyond the tax impact of these decisions, practitioners should caution taxpayers as to the potential for Medicare premium increases. The SSA uses historical data from previously filed tax returns (e.g., the SSA uses 2019 information on file to calculate 2021 premiums).

Taxpayers may appeal the SSA decision on Form SSA-44, *Medicare Income-Related Monthly Adjustment Amount — Life-Changing Event*, if any of the following situations arise that might result in decreasing income.

- Marriage, divorce, or death of a spouse
- Taxpayer or spouse stopped working or reduced the number of hours worked
- Taxpayer or spouse lost income-producing property because of a disaster or other event beyond their control
- Taxpayer or spouse pension plan payments were altered or terminated
- Taxpayer or spouse received a settlement from an employer or former employer because of the employer's closure, bankruptcy, or reorganization

Example 18. Edward M. Smith lost his income-producing property due to a tornado in November 2021. As a result, he expects his 2022 AGI to be substantially reduced. He completes the following first two pages of Form SSA-44.

106. *Premiums: Rules for Higher-Income Beneficiaries*. SSA. [www.ssa.gov/benefits/medicare/medicare-premiums.html] Accessed on Mar. 28, 2022.

For Example 18

Form **SSA-44** (12-2021)
Discontinue Prior Editions
Social Security Administration

Page 1 of 8
OMB No. 0960-0784

Medicare Income-Related Monthly Adjustment Amount - Life-Changing Event

If you had a major life-changing event and your income has gone down, you may use this form to request a reduction in your income-related monthly adjustment amount. See page 5 for detailed information and line-by-line instructions. If you prefer to schedule an interview with your local Social Security office, call 1-800-772-1213 (TTY 1-800-325-0778).

Name	Social Security Number
Edward M. Smith	111-22-3333

You may use this form if you received a notice that your monthly Medicare Part B (medical insurance) or prescription drug coverage premiums include an income-related monthly adjustment amount (IRMAA) and you experienced a life-changing event that may reduce your IRMAA. To decide your IRMAA, we asked the Internal Revenue Service (IRS) about your adjusted gross income plus certain tax-exempt income which we call "modified adjusted gross income" or MAGI from the Federal income tax return you filed for tax year 2020. If that was not available, we asked for your tax return information for 2019. We took this information and used the table below to decide your income-related monthly adjustment amount.

The table below shows the income-related monthly adjustment amounts for Medicare premiums based on your tax filing status and income. If your MAGI was lower than $91,000.01 (or lower than $182,000.01 if you filed your taxes with the filing status of married, filing jointly) in your most recent filed tax return, you do not have to pay any income-related monthly adjustment amount. If you do not have to pay an income-related monthly adjustment amount, you should not fill out this form even if you experienced a life-changing event.

If you filed your taxes as:	*And your MAGI was:*	*Your Part B monthly adjustment is:*	*Your prescription drug coverage monthly adjustment is:*
-Single, -Head of household, -Qualifying widow(er) with dependent child, or -Married filing separately (and you did not live with your spouse in tax year)*	$ 91,000.01 - $114,000.00 $114,000.01 - $142,000.00 $142,000.01 - $170,000.00 $170,000.01 - $499,999.99 More than $499,999.99	$ 68.00 $170.10 $272.20 $374.20 $408.20	$ 12.40 $ 32.10 $ 51.70 $ 71.30 $ 77.90
-Married, filing jointly	$182,000.01 - $228,000.00 $228,000.01 - $284,000.00 $284,000.01 - $340,000.00 $340,000.01 - $749,999.99 More than $750,000.00	$ 68.00 $170.10 $272.20 $374.20 $408.20	$ 12.40 $ 32.10 $ 51.70 $ 71.30 $ 77.90
-Married, filing separately (and you lived with your spouse during part of that tax year)*	$91,000.01 - $408,999.99 More than $409,000.00	$374.20 $408.20	$ 71.30 $ 77.90

* Let us know if your tax filing status for the tax year was Married, filing separately, but you lived apart from your spouse at all times during that tax year.

For Example 18

Form **SSA-44** (12-2021) Page 2 of 8

STEP 1: Type of Life-Changing Event

Check **ONE** life-changing event and fill in the date that the event occurred (mm/dd/yyyy). If you had more than one life-changing event, please call Social Security at 1-800-772-1213 (TTY 1-800-325-0778).

- [ ] Marriage
- [ ] Divorce/Annulment
- [ ] Death of Your Spouse
- [ ] Work Stoppage
- [ ] Work Reduction
- [x] Loss of Income-Producing Property
- [ ] Loss of Pension Income
- [ ] Employer Settlement Payment

Date of life-changing event: 11/28/2021
mm/dd/yyyy

STEP 2: Reduction in Income

Fill in the tax year in which your income was reduced by the life-changing event (see instructions on page 6), the amount of your adjusted gross income (AGI, as used on line 11 of IRS form 1040) and tax-exempt interest income (as used on line 2a of IRS form 1040), and your tax filing status.

Tax Year	Adjusted Gross Income	Tax-Exempt Interest
2021	$ 200000.00	$ 100.00

Tax Filing Status for this Tax Year (choose **ONE**):

- [ ] Single
- [ ] Head of Household
- [ ] Qualifying Widow(er) with Dependent Child
- [x] Married, Filing Jointly
- [ ] Married, Filing Separately

STEP 3: Modified Adjusted Gross Income

Will your modified adjusted gross income be lower next year than the year in Step 2?

- [ ] No - Skip to STEP 4
- [x] Yes - Complete the blocks below for next year

Tax Year	Estimated Adjusted Gross Income	Estimated Tax-Exempt Interest
2022	$ 100000.00	$ 100.00

Expected Tax Filing Status for this Tax Year (choose **ONE**):

- [ ] Single
- [ ] Head of Household
- [ ] Qualifying Widow(er) with Dependent Child
- [x] Married, Filing Jointly
- [ ] Married, Filing Separately

Practitioner Planning Tip

Taxpayers approaching retirement may experience large increases in income that last only one year. The spike in income might result from the following motivations.

- Large withdrawals from qualified plans or individual retirement arrangements (IRAs) generate ordinary income.
- Rebalancing of an investment portfolio, which is a valuable financial tactic, but one that can generate significant capital gain income when appreciated stock is sold.

Tax practitioners are encouraged to inform clients of potential Medicare premium increases. Even a one-year spike in income can trigger the income-related monthly adjustment amount (IRMAA), potentially creating significant increases in Medicare premiums for one year.

These unwelcome surprises can be avoided with a plan. Tax practitioners can work with their clients to build a multiple-year plan, the execution of which generates sufficient cash to repay debt. This plan's objective might be to eliminate mortgage debt or credit card debt without triggering the IRMAA increase in Medicare premiums.

RETIREMENT PLANS AND ELDERLY TAXPAYERS

CONTRIBUTIONS TO RETIREMENT PLANS

Before the enactment of the Setting Every Community Up for Retirement Enhancement (SECURE) Act, taxpayers could not make qualified retirement contributions to their IRAs for any year in which they turned 70½ or after.[107] The SECURE Act repealed this restriction without putting another age limit in place.[108] Since January 1, 2020, elderly taxpayers can contribute to their IRAs for as long as they have earned income.

> **Note.** The term qualified retirement plan (QRP) in this chapter includes all types of qualified return plans, either IRAs or employer-sponsored plans.

Some taxpayers can deduct their IRA contributions as adjustments to their gross income, as described later in the section on active participation in qualified plans.[109] The adjustment appears in part II of Schedule 1, *Additional Income and Adjustments to Income*, of Form 1040. As a result, taxpayers making IRA contributions benefit from an immediate tax adjustment arising from their IRA contributions.

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107. IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*, p. 10 (2015).

108. *Further Consolidated Appropriations Act of 2020*, PL 166-94, §107(a), repealing IRC §219(d).

109. IRC §219(g).

Active Participation in Qualified Plans

As active participants in employer retirement plans, some employees have limited deductibility for their IRA contributions. Depending on their MAGI for IRA purposes, they may be ineligible for the adjustment to their gross income because of the IRA deduction.[110]

For 2021 and 2022, the following table shows phaseout ranges of MAGI that apply for **traditional IRA contributions.**[111]

Filing Status	2021 MAGI Phaseout Ranges	2022 MAGI Phaseout Ranges
Single, HoH	$ 66,000– 76,000	$ 68,000– 78,000
MFJ (contributing spouse is covered by workplace retirement plan)	105,000–125,000	109,000–129,000
MFJ (contributing spouse is not covered by workplace retirement plan and other spouse is covered by workplace retirement plan)	198,000–208,000	204,000–214,000
MFS	0– 10,000	0– 10,000

For example, if they are an active participant in a qualified plan, a single taxpayer with MAGI exceeding $78,000 is permitted no adjustment to 2022 gross income for their IRA contributions. This rule particularly affects taxpayers using MFS filing status and living in the same residence, as their deductions for IRA contributions phase out at only $10,000.[112]

Practitioner Planning Tip

When advising elderly taxpayers looking for deductions for IRA contributions, tax practitioners should remind them of the low ceiling for IRA deductions if MFS filing status seems beneficial.

Concerning these phaseout ranges, the following general rules apply.

- Taxpayers with AGI amounts below the ranges shown are entitled to deduct the full amount of their IRA contributions up to the $6,000 per-taxpayer maximum for 2021[113] and 2022[114] (plus the additional $1,000 that the taxpayer may contribute starting at age 50),[115] subject to the earned income limitation.
- Taxpayers with AGI amounts within the phaseout range are entitled to a reduced IRA deduction.[116]
- Taxpayers with AGI amounts above their phaseout range cannot deduct any of the amounts contributed.[117]
- For MFJ filers, when neither spouse is covered under a workplace retirement plan, there is no applicable phaseout range (and the spouses can deduct 100% of their contributions up to the maximum allowable amounts for each spouse).[118]

110. Treas. Reg. §1.219-2(d).
111. IRS Notices 2020-79, 2020-46 IRB 1014 and 2021-61, 2021-47 IRB 738.
112. IRC §§219(g)(3)(B)(iii) and (4).
113. IRS Notice 2020-79, 2020-46 IRB 1014.
114. IRS Notice 2021-61, 2021-47 IRB 738.
115. IRC §219(b)(5)(B)(ii).
116. IRC §219(g)(2).
117. Ibid.
118. IRC §§219(c)(2), (f)(2), and (g)(1).

Even if the taxpayer cannot deduct an IRA contribution, they may still contribute. Such nondeductible contribution amounts provide the taxpayer with **basis** in their IRA.

Example 19. Bruce is a 64-year-old single filer and is an active participant in a qualified plan. His AGI for 2022 is $82,400. He makes the maximum $7,000 IRA contribution. Because Bruce's AGI is above the phaseout range for his filing status, he cannot deduct any portion of the $7,000. Bruce's $7,000 nondeductible contribution provides him with $7,000 of basis in his IRA, which provides a delayed benefit in future years when a portion of each IRA distribution is not subject to income tax.

Tracking Basis

To avoid paying tax twice on the same income, taxpayers have a strong incentive to track basis in their IRAs. Taxpayers meet this responsibility in two steps. First, they determine whether an IRA contribution is deductible or not by evaluating answers to the following two questions.

- Are they active participants in their employer's retirement plans?
- How does their income compare to the MAGI phaseout range explained above? If it is greater than the upper limit, no IRA deduction is allowed if they are active participants.

As a second step, they must report the nondeductible contribution on Form 8606, *Nondeductible IRAs.*

Example 20. Conway and Carla filed a joint return for 2021. Both spouses were 65 years old at the end of the year. Conway, an architect, earned a salary of $68,000 in 2021 and is covered by his employer's retirement plan. Carla, a civil engineer, earned a salary of $57,500 working part-time and is also an active participant in her employer's retirement plan. In October 2021, each spouse contributed $7,000 to their respective traditional IRAs for the 2021 tax year. Conway paid $2,000 in deductible student loan interest in 2021.

Conway and Carla's tax preparer, Sandra, determines that they are not able to deduct their IRA contributions because each is covered by their employer's retirement plans and because their MAGI exceeds the upper limit of the phaseout range. To make this determination, Sandra confirms that both Conway and Carla are active participants in their employers' retirement plans by checking their 2020 Forms W-2 and confirming from a current paystub that some amounts are being withheld from their pay. She then prepares the following worksheet from IRS Pub 590-A, *Contributions to Individual Retirement Arrangements (IRAs),* to calculate their MAGI for 2021.

Worksheet 1-1. **Figuring Your Modified AGI** *Keep for Your Records*

Use this worksheet to figure your modified AGI for traditional IRA purposes.

1.	Enter your adjusted gross income (AGI) from Form 1040, 1040-SR, or Form 1040-NR, line 11, figured without taking into account the amount from Schedule 1 (Form 1040), line 20	1.	**123,500**
2.	Enter any student loan interest deduction from Schedule 1 (Form 1040), line 21	2.	**2,000**
3.	Enter any foreign earned income exclusion and/or housing exclusion from Form 2555, line 45	3.	
4.	Enter any foreign housing deduction from Form 2555, line 50	4.	
5.	Enter any excludable savings bond interest from Form 8815, line 14	5.	
6.	Enter any excluded employer-provided adoption benefits from Form 8839, line 28	6.	
7.	Add lines 1 through 6. This is your **Modified AGI** for traditional IRA purposes	7.	**125,500**

Because their joint MAGI of $125,500 exceeds the upper limit of the 2021 phaseout range for couples filing MFJ of $125,000, they cannot take a deduction for their IRA. Conway has no basis in his IRAs, having never made a nondeductible contribution to his IRA in the past.

Sandra is aware that Conway already has nondeductible contributions of $1,000 from 2011 and $1,530 from 2012 (for a total of $2,530 in nondeductible contributions that must be carried forward to 2021 and shown on the Form 8606). The first page of Conway's 2021 Form 8606 follows.

For Example 20

Form **8606**
Department of the Treasury
Internal Revenue Service (99)

Nondeductible IRAs

▶ Go to *www.irs.gov/Form8606* for instructions and the latest information.
▶ Attach to 2021 Form 1040, 1040-SR, or 1040-NR.

OMB No. 1545-0074
2021
Attachment Sequence No. 48

Name. If married, file a separate form for each spouse required to file 2021 Form 8606. See instructions.	Your social security number
Conway Clayton	123-45-6789

Fill in Your Address Only if You Are Filing This Form by Itself and Not With Your Tax Return

Home address (number and street, or P.O. box if mail is not delivered to your home)		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below (see instructions).		
Foreign country name	Foreign province/state/county	Foreign postal code

Part I **Nondeductible Contributions to Traditional IRAs and Distributions From Traditional, SEP, and SIMPLE IRAs**
Complete this part only if one or more of the following apply.

- You made nondeductible contributions to a traditional IRA for 2021.
- You took distributions from a traditional, SEP, or SIMPLE IRA in 2021 **and** you made nondeductible contributions to a traditional IRA in 2021 or an earlier year. For this purpose, a distribution does not include a rollover (other than a repayment of a qualified disaster distribution (see 2021 Forms 8915-D and 8915-F)), qualified charitable distribution, one-time distribution to fund an HSA, conversion, recharacterization, or return of certain contributions.
- You converted part, but not all, of your traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2021 **and** you made nondeductible contributions to a traditional IRA in 2021 or an earlier year.

1	Enter your nondeductible contributions to traditional IRAs for 2021, including those made for 2021 from January 1, 2022, through April 18, 2022. See instructions			1	7,000
2	Enter your total basis in traditional IRAs. See instructions			2	
3	Add lines 1 and 2			3	7,000
	In 2021, did you take a distribution from traditional, SEP, or SIMPLE IRAs, or make a Roth IRA conversion? No ▶ Enter the amount from line 3 on line 14. Do not complete the rest of Part I. Yes ▶ Go to line 4.				
4	Enter those contributions included on line 1 that were made from January 1, 2022, through April 18, 2022			4	
5	Subtract line 4 from line 3			5	
6	Enter the value of **all** your traditional, SEP, and SIMPLE IRAs as of December 31, 2021, plus any outstanding rollovers. Subtract any repayments of qualified disaster distributions (see 2021 Forms 8915-D and 8915-F)	6			
7	Enter your distributions from traditional, SEP, and SIMPLE IRAs in 2021. **Do not** include rollovers (other than repayments of qualified disaster distributions (see 2021 Forms 8915-D and 8915-F)), qualified charitable distributions, a one-time distribution to fund an HSA, conversions to a Roth IRA, certain returned contributions, or recharacterizations of traditional IRA contributions (see instructions)	7			
8	Enter the net amount you converted from traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2021. Also, enter this amount on line 16	8			
9	Add lines 6, 7, and 8 — 9				
10	Divide line 5 by line 9. Enter the result as a decimal rounded to at least 3 places. If the result is 1.000 or more, enter “1.000”	10	× .		
11	Multiply line 8 by line 10. This is the nontaxable portion of the amount you converted to Roth IRAs. Also, enter this amount on line 17	11			
12	Multiply line 7 by line 10. This is the nontaxable portion of your distributions that you did not convert to a Roth IRA	12			
13	Add lines 11 and 12. This is the nontaxable portion of all your distributions			13	
14	Subtract line 13 from line 3. This is **your total basis in traditional IRAs for 2021 and earlier years**			14	7,000
15a	Subtract line 12 from line 7			15a	
b	Enter the amount on line 15a attributable to qualified disaster distributions from 2021 Forms 8915-D and 8915-F (see instructions). Also, enter this amount on 2021 Form 8915-D, line 23; **or** 2021 Form 8915-F, line 18, as applicable			15b	
c	**Taxable amount.** Subtract line 15b from line 15a. If more than zero, also include this amount on 2021 Form 1040, 1040-SR, **or** 1040-NR, line 4b			15c	
	Note: You may be subject to an additional 10% tax on the amount on line 15c if you were under age 59½ at the time of the distribution. See instructions.				

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 63966F Form **8606** (2021)

Note. Generally, Form 8606 is filed with a taxpayer's return. However, a taxpayer who is not required to file a Form 1040 may still be required to disclose a nondeductible IRA contribution on Form 8606. In this case, the taxpayer's identifying information is indicated on Form 8606, which must be filed with the IRS by the normal tax return due date.[119]

Caution. A Form 8606 is required for each year in which a taxpayer makes a nondeductible contribution. There is a $50 penalty for each required Form 8606 that is not timely filed.[120] In addition, there is a $100 penalty for overstating the nondeductible contribution amount on Form 8606.[121] These penalties may be waived upon a showing of reasonable cause.

DISTRIBUTIONS FROM ELDERLY TAXPAYER'S RETIREMENT PLAN

IRAs and other QRPs were established to encourage U.S. taxpayers to save for retirement. To discourage taxpayers from withdrawing the funds before retirement age, Congress passed tax legislation subjecting most early withdrawals to a 10% additional tax. Taxpayers can generally start to withdraw from their QRPs at age 59½ without penalty, although certain circumstances allow withdrawals at younger ages in specific circumstances.[122]

Early Withdrawal[123]

The Code includes several exceptions to the penalty for early withdrawals made before the individual reaches age 59½. However, the exceptions do not apply universally to all tax-favored retirement plans. Generally, for these purposes, tax-favored retirement plans can be grouped into two categories: qualified plans and IRAs. For example, separation from service is a valid exception for employees at least age 55 who take an early withdrawal from their qualified plan, such as a 401(k), but not for contributors to IRAs.[124] Conversely, IRA owners are able to withdraw up to $10,000 from their IRAs to purchase a home if they qualify for a first-time homebuyer exception.[125] Governmental 457(b) distributions are not subject to the 10% additional tax except for distributions attributable to rollovers from another type of plan or IRA.[126]

Note. For more information about exceptions to the 10% additional tax on IRA and qualified plan withdrawals, see the 2020 *University of Illinois Federal Tax Workbook*, Volume B, Chapter 1: Retirement Plans Distributions. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

119. Instructions for Form 8606.
120. IRC §6693(b)(2).
121. IRC §6693(b)(1).
122. IRC §72(t).
123. IRC §72(t)(2)(A).
124. The exception is also applied to public service employees taking separations from service at age 50.
125. IRC §72(t)(2)(F).
126. *Retirement Topics — Exceptions to Tax on Early Distributions*. Apr. 7, 2022. IRS. [www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-tax-on-early-distributions] Accessed on May 31, 2022.

Penalty-Free Distributions at Age 59½[127]

Once a taxpayer reaches age 59½, distributions from IRAs and QRPs can be received without penalty. However, the distributed funds are generally subject to income tax.

Required Minimum Distributions Start at Age 72

The SECURE Act not only removed the age restrictions on making IRA contributions but it also raised the age at which required minimum distributions (RMDs) from an IRA or QRP must be taken.[128] This RMD age increase only applies to taxpayers born after June 30, 1949. Once a taxpayer reaches age 72, distributions from IRAs and other retirement plans are required. The first distribution is not required until April 1 of the calendar year following the year the taxpayer turns 72. The Code refers to this date as the **required beginning date.**[129]

> **Example 21.** Graham was born on June 25, 1949. Because this date falls prior to the June 30, 1949 date specified in the SECURE Act, his age for required RMDs is 70½. He turns 70½ in December 2019, so his required beginning date is April 1, 2020.
>
> Conversely, Graham's younger brother Henry was born on January 5, 1951, after the specified date in the SECURE Act, so Henry's age for required RMDs is 72. Henry turns 72 in on January 5, 2023 so his required beginning date is April 1, 2023, a full 3 years later than that of his brother Graham, despite their birth dates only being 18 months apart.

An RMD taken after January 1 and on or before April 1 is for the previous year, the one in which the taxpayer reached age 72. Another RMD must be distributed for the subsequent year because the taxpayer reaches age 73.[130]

Taxation of Distributions

Regardless of the taxpayer's age at the time of distribution, withdrawals from a retirement plan are generally subject to income tax.[131] Exceptions arise when a taxpayer has made nondeductible contributions to a retirement plan and has retained documentation to substantiate the claim that tax has already been paid on the funds distributed.[132] Otherwise, distributions are taxed as ordinary income; the distribution represents income for which the tax was deferred until withdrawn.

The retirement plan issuer, which is commonly the trustee, reports the income on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc*. If the trustee cannot determine the taxable amount of the distribution, they may check the form's box 2b, which is labeled "Taxable amount not determined."[133] This box is commonly marked if a trustee has no information to determine the taxable amount of the distribution. In effect, this marking instructs the tax return preparer to perform additional research to determine what amount of the total distribution is subject to income tax. The instructions also direct the organizations completing Form 1099-R to leave box 2a, labeled "Taxable Amount," empty if they are unsure of the taxable amount.[134] An empty box 2a does not mean that none of the distribution is subject to income tax, just an indeterminate amount.

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127. IRC §§401(a)(36)(A), 403(b)(7), 403(b)(11), and 457(d)(1)(A)(i).

128. *Further Consolidated Appropriations Act of 2020*, PL 166-94, §114.

129. IRC §401(a)(9)(C).

130. IRC §401(a)(9)(C)(i).

131. IRC §408(d)(1).

132. IRC §§72(a), 72(b), and 408(l).

133. Instructions for Forms 1099-R and 5498.

134. Ibid.

Practitioner Planning Tip

Practitioners should consider adding questions about nondeductible contributions to IRAs and qualified plans to their client organizers. Clients who respond that they have made nondeductible contributions should provide a Form 8606 filed in a previous year that supports the nondeductible contribution.

When a taxpayer subsequently makes withdrawals from a nondeductible IRA, they should include Form 8606 with their Form 1040 to show the portion of the withdrawal that is not subject to income tax.[135]

Note. Form 8606 contains important information to support future exclusions from income of nondeductible IRA contributions. Without retaining this form, possibly indefinitely, taxpayers may lose track of these contributions and end up paying tax a second time on the IRA contributions they made years earlier.

If taxpayers have made nondeductible contributions to traditional IRAs in past years, the distribution of those amounts is not subject to taxation, either on the taxpayer's return or on their heirs' returns. If a distribution is made from an IRA that consists of deductible and nondeductible contributions, the following formula determines the portion of the distribution that constitutes a nontaxable return of basis.[136]

$$\text{Nontaxable return of basis} = \frac{\text{Total nondeductible contributions} - \text{Amounts previously recovered}}{\text{Total end-of-year IRA balance} + \text{Distribution amount}} \times \text{Distribution amount}$$

Example 22. Barry has one IRA at Main Street Bank, into which the following contributions were made.

Taxation Year	Deductible Contributions	Nondeductible Contributions
2004	$ 3,000	
2005	4,000	
2006	2,000	$ 2,000
2007	2,000	2,000
2008	5,000	
2009	1,000	4,000
2010	1,500	3,500
2011	4,000	1,000
2012	4,000	1,000
2013	3,500	2,000
Total	$30,000	$15,500

135. IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*, p. 16 (2022).

136. IRS Notice 87-16, 1987-1 CB 446.

Barry made no further IRA contributions. On May 31, 2022, Barry receives his first distribution from his IRA of $5,000. At the end of 2022, the remaining balance in his IRA account was $90,000. The amount of the $5,000 distribution that is considered a nontaxable return of basis is calculated as follows.

$$\text{Nontaxable return of basis} = \frac{\text{Total nondeductible contributions} - \text{Amounts previously recovered}}{\text{Total end-of-year IRA balance} + \text{Distribution amount}} \times \text{Distribution amount}$$

$$= \frac{\$15{,}500 - \$0}{\$90{,}000 + \$5{,}000} \times \$5{,}000$$

$$= 0.16316 \times \$5{,}000$$

$$= \$816$$

When a taxpayer with nondeductible contributions has more than one traditional IRA, the following rules apply when determining how much of a withdrawal is taxable.[137]

- All existing traditional IRAs are treated as one account.
- All distributions received during the tax year are added together and treated as one distribution.
- The value of all traditional IRAs as of the end of the tax year in which the distributions are made are added together for a total end-of-year IRA value.

Example 23. Use the same facts as **Example 22,** except that Barry has another IRA account at Anystreet Financial, to which the following contributions have been made in addition to the Main Street Bank IRA.

Taxation Year	Deductible Contributions	Nondeductible Contributions
1999	$1,000	$0
2000	1,000	0
2001	1,000	0
2002	1,000	0
2003	1,000	0
Total	$5,000	$0

At the end of 2021, the Anystreet Financial IRA has a balance of $12,000.

Barry must treat both of his existing IRAs as a single account to calculate the portion of the $5,000 distribution that constitutes a nontaxable return of basis. The following amounts are the combined totals of both accounts that must be used in the calculations.

	Main Street Bank IRA	Anystreet Financial IRA	Total
Deductible contributions	$30,000	$ 5,000	$ 35,000
Nondeductible contributions	15,500	0	15,500
Balance at the end of 2021	90,000	12,000	102,000

137. IRC §408(d)(2).

The nontaxable portion of the $5,000 distribution is calculated as follows.

$$\text{Nontaxable return of basis} = \frac{\text{Total nondeductible contributions} - \text{Amounts previously recovered}}{\text{Total end-of-year IRA balance} + \text{Distribution amount}} \times \text{Distribution amount}$$

$$= \frac{\$15{,}500 - \$0}{\$102{,}000 + \$5{,}000} \times \$5{,}000$$

$$= 0.145 \times \$5{,}000$$

$$= \$725$$

Observation. Nondeductible contributions can be used to "build basis" in an IRA. Under the IRA rules, all IRAs of the taxpayer are aggregated and considered as one account, and all distributions are treated as one distribution.[138] For retiring spouses, a review of each spouse's IRA basis can be made to determine the best strategy for starting withdrawals.

Distributions and the Net Investment Income Tax

The Health Care and Education Reconciliation Act of 2010 excluded distributions from QRPs from the definitions of net investment income (NII)[139] and net investment income tax (NIIT) when it went into effect in 2013.[140] NIIT is equal to 3.8% of the amount that NII exceeds a MAGI threshold based on the taxpayer's filing status. For **NIIT purposes,** the following threshold amounts determine if a taxpayer is subject to NIIT.[141]

Filing Status	NIIT MAGI Threshold Amount
MFJ, QW	$250,000
Single, HoH	200,000
MFS	125,000

The threshold amounts are written into IRC §1411 and are not subject to adjustment with inflation. Thus, it is realistic to believe an increasing number of elderly taxpayers find their NIIT is affected by their pension income. The following example illustrates this effect.

Example 24. Currently age 65 and single, Chet retired three years ago from a local manufacturer with $190,000 of qualified dividends as his only source of income. These dividends are paid on an investment portfolio he has built over the years of work. However, his pension from his former employer started on January 1, 2022, and provides an additional $25,000 of income in 2022. He has decided to wait to start receiving social security benefits until he reaches age 70.

Since retirement, Chet has not paid NIIT because his MAGI for NIIT purposes has been less than the $200,000 threshold. Although the pension itself is not subject to NIIT, it increases his MAGI for NIIT purposes so that it is $15,000 over the threshold. As a result, Chet is liable for $570 in NIIT for 2022 (($190,000 dividends + $25,000 pension – $200,000 threshold) × 3.8%).

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138. IRC §408(d)(2).

139. IRC §1411(c).

140. *Health Care and Education Reconciliation Act of 2010*, PL 111-152, §1402(a)(4).

141. IRC §1411. It is important to note that the MAGI for NIIT purposes is defined differently from the MAGI used to calculate eligibility to deduct IRA contributions, despite the similar names.

Note. For background information about NII and the NIIT, see the 2014 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Affordable Care Act Update. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

CONVERTING RETIREMENT PLANS

Having established retirement plans, taxpayers may later decide that other retirement vehicles better suit their purposes. Congress has passed tax legislation allowing changes in retirement plans. The IRS has published the following convenient chart for planning conversions, which are typically handled as rollovers from one plan to another.[142]

ROLLOVER CHART

Roll From \ Roll To	Roth IRA	Traditional IRA	SIMPLE IRA	SEP-IRA	Governmental 457(b)	Qualified Plan[a] (pre-tax)	403(b) (pre-tax)	Designated Roth Account (401(k), 403(b) or 457(b))
Roth IRA	Yes[b]	No	No	No	No	No	No	No
Traditional IRA	Yes[c]	Yes[b]	Yes[b, g], after two years	Yes[b]	Yes[d]	Yes	Yes	No
SIMPLE IRA	Yes[c], after two years	Yes[b], after two years	Yes[b]	Yes[b], after two years	Yes[d], after two years	Yes, after two years	Yes, after two years	No
SEP-IRA	Yes[c]	Yes[b]	Yes[b, g], after two years	Yes[b]	Yes[d]	Yes	Yes	No
Governmental 457(b)	Yes[c]	Yes	Yes[g], after two years	Yes	Yes	Yes	Yes	Yes[c,e]
Qualified Plan[a] (pre-tax)	Yes[c]	Yes	Yes[g], after two years`	Yes	Yes[d]	Yes	Yes	Yes[c,e]
403(b) (pre-tax)	Yes[c]	Yes	Yes[g], after two years	Yes	Yes[d]	Yes	Yes	Yes[c,e]
Designated Roth Account (401(k), 403(b) or 457(b))	Yes	No	No	No	No	No	No	Yes[f]

[a]Qualified plans include, for example, profit-sharing, 401(k), money purchase, and defined benefit plans.
[b] Only one rollover in any 12-month period.
[c]Must include in income.
[d]Must have separate accounts.
[e]Must be an in-plan rollover.
[f]Any nontaxable amounts distributed must be rolled over by direct trustee-to-trustee transfer.
[g]Applies to rollover contributions after December 18, 2015. For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans.

This chart shows that a wide variety of rollovers are available to taxpayers, including elderly employees. If the taxpayer still works, the possibility of rolling over retirement funds to a qualified plan sponsored by their employer may exist, providing the plan allows for it.

142. *Rollover Chart*. IRS. [www.irs.gov/pub/irs-tege/rollover_chart.pdf] Accessed on Jun. 2, 2022.

Roth Conversions[143]

Roth conversions are among the most popular forms of rollovers, particularly for taxpayers approaching retirement. Elderly taxpayers may be enticed by the prospect of taking distributions in future years from Roth accounts without additional taxation.[144] If an individual's income drops in a particular year, Roth conversions become particularly attractive.

A conversion of a traditional IRA to a Roth IRA is treated as a rollover. If the assets are withdrawn from the traditional IRA and reinvested in a Roth IRA within 60 days, the 10% additional tax on early distributions does not apply. However, part or all of the distribution from the traditional IRA may be included in the taxpayer's gross income and subjected to ordinary income tax.[145] Taxpayers must include in their gross income distributions from traditional IRAs. However, these distributions would have eventually been included in income even if they had not been converted into Roth IRAs. These amounts are included in income for the year that the taxpayer converted them from a traditional IRA to a Roth IRA. The taxpayer does **not** include in gross income any part of a distribution from a traditional IRA that is a return of basis.[146] There are several financial consequences from a taxable Roth conversion of which elderly taxpayers should be aware.

Increased Medicare Part B Premiums. Roth conversions increase a taxpayer's MAGI for Medicare purposes. As a result, taxpayers may experience a one-time increase in their Medicare Part B and Part D premiums. In some cases, such as when the taxpayers choose MFS filing status, the Medicare premium increases can be extreme, as discussed previously.

> **Example 25.** Shannon and Jason are married and file joint tax returns. Their 2020 MAGI was $100,000. Of this amount, $80,000 was from private pensions, and $20,000 was from social security retirement benefits. Both Shannon and Jason have Medicare Part B premiums withheld from their monthly social security benefits. In 2021, each paid a monthly premium of $148.50,[147] and due to the cost of living adjustment, their 2022 monthly premiums are $170.10.
>
> In 2022, Shannon and Jason are considering converting each of their traditional IRAs, having a combined value of $460,000, to Roth IRAs. They have no basis in the IRAs. Before taking any action, they meet with their tax professional, Kate, to discuss their options. They ask her if it might be better to convert the IRAs over two years rather than converting the entire balance in 2022.
>
> Shannon and Jason tell Kate that their estimated 2022 income — without taking a potential IRA conversion into account — is $100,000. They expect their 2023 income to be at the same level.
>
> **Tax Result A.** Shannon and Jason report the entire $460,000 conversion on their 2022 return. Their 2022 MAGI is $560,000 ($460,000 IRA value + $100,000 MAGI), and 2024 Medicare premiums are affected by 2022 MAGI. Even if the **2024** Medicare Part B premiums remain the same as the 2022 rates, Shannon and Jason must each anticipate paying a monthly premium of $544.30. This premium is **$374.20 more** per person per month than the $170.10 they would have paid without the 2022 Roth conversion. The total **additional** Part B premium cost for 2024 is $8,980.80 ($374.20 × 2 people × 12 months).
>
> **Tax Result B.** Shannon and Jason convert half of their traditional IRAs in 2022 and the other half in 2023. Their other income for these years does not change; therefore, Kate projects their MAGI for both 2022 and 2023 to be $330,000 ($230,000 IRA conversion + $100,000 other income).

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143. IRC §408A(c); Treas. Reg. §1.408A-4.

144. IRC §408A(d)(1).

145. Treas. Reg. §1.408-4. See answer to question 7.

146. IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs).*

147. *2021 Medicare Parts A & B Premiums and Deductibles*, Nov. 6, 2020. Centers for Medicare and Medicaid Services. [www.cms.gov/newsroom/fact-sheets/2021-medicare-parts-b-premiums-and-deductibles] Accessed on Jun. 2, 2022.

Assuming that the Part B premiums remain at the 2022 levels, in 2024 and 2025, Shannon and Jason should both anticipate paying a monthly Part B premium of $442.30. This amount is $272.20 more per month than the $170.10 they would have paid without the Roth conversion income. Kate projects the total additional cost for both years at $13,065.60 ($272.20 × 2 people × 24 months).

If the scope is limited only to Medicare Part B premiums, the comparison is straightforward. Comparing the two tax results indicates that the additional premium paid with Tax Result A is $4,084.80 lower than Tax Result B ($13,065.50 Tax Result B – $8,980.80 Tax Result A), which unsuccessfully attempts to dilute the additional premium by taking the Roth conversion income over two years.

As Shannon and Jason's tax advisor, Kate would be wise to project the additional **income tax** created by the two Roth conversion strategies, thereby expanding the scope of the comparison. In this example, Tax Result A is likely to increase the tax liability for Shannon and Jason from $8,582 to $135,831, an increase of $127,249, as shown in the following table. Tax Result B is likely to increase their tax liability to $60,894, an increase of $52,312 ($60,894 – 8,582). This is still a major tax increase, but even taken over two years saves the couple $22,625 ($127,249 Tax Result A additional income tax – 2 years × $52,312 Tax Result B additional income tax per year).

Scenario	Expected Annual Federal Tax	Tax Increase vs. No Roth Conversion Per Year
No Roth conversion	$ 8,582	$ 0
Tax result A: Roth conversion within 2022	135,831	127,249
Tax result B: split Roth conversion between 2022 and 2023	60,894	52,312

The federal tax with Tax Result B is lower than that from Tax Result A when considered over two years. Assuming that Shannon and Jason use the standard deduction, their result is lower by $22,625 ($127,249 – (2 years × $52,312 per year)). If Kate takes into account the time value of money, Tax Result B is even better.

Caution. If Shannon and Jason's income had come from interest, dividends, or another form of investment, the Roth conversion as described in **Example 25** might trigger NIIT.

Taxation of Social Security Benefits.[148] When deciding whether to convert a traditional IRA to a Roth IRA, the taxpayer needs to consider the effect on the taxation of their social security retirement benefits.[149] A relatively small Roth conversion on top of a relatively small combined income amount may not increase a taxpayer's income above the first tier of taxation. In this rare case, social security benefits would remain untaxed. Alternately, a Roth conversion may move them into the third tier of social security taxation, in which 85% of social security benefits are taxed. Even without a formal income projection, a Roth conversion makes it more likely that 85% of an elderly taxpayer's social security benefits are taxed, as discussed previously.

148. IRC §86.

149. IRC §86(b).

Example 26. Rosalie is single and turns 69 in 2022. Her income for 2022 is $24,000, consisting entirely of social security retirement benefits. Because her income is below the first-tier base amount, none of her social security benefits is taxable.

Rosalie has a traditional IRA valued at $700,000. Because she reaches age 72 in 2025, she plans to take an RMD in that year. Using the IRS's uniform lifetime table,[150] if her IRA balance on December 31, 2024, is still $700,000, Rosalie's accountant, Elmer, tells her to plan on receiving a 2025 RMD of $25,547 ($700,000 IRA balance ÷ 27.5 years). Rosalie can delay her first RMD until April 1, 2026, but she must plan on taking two RMDs in 2026 if she waits.

Because Rosalie does not have to take an RMD until 2026, she has an opportunity to convert funds in her traditional IRA to a Roth IRA for several years without incurring federal income liability. For example, if Rosalie uses the standard deduction in 2022 ($14,700 for a taxpayer who is single, not a surviving spouse, and over age 65),[151] she can take a Roth conversion of as much as $14,133 before a 2022 income tax greater than $0 is imposed.

As long as Rosalie's AGI is equal to or less than her standard deduction, her income tax is $0, even if a small portion of her social security benefits is taxable. To calculate the maximum Roth conversion amount that keeps her AGI equal to her standard deduction, she uses the following formula.[152]

$$\begin{aligned}
\textbf{Maximum Roth conversion} &= \frac{(\mathbf{2} \times \textbf{Standard deduction}) - (\textbf{Social Security benefits} \div \mathbf{2}) + \mathbf{\$25{,}000}}{\mathbf{3}} \\
&= \frac{(\mathbf{2} \times \mathbf{\$14{,}700}) - (\mathbf{\$24{,}000} \div \mathbf{2}) + \mathbf{\$25{,}000}}{\mathbf{3}} \\
&= \frac{\mathbf{\$29{,}400} - \mathbf{\$12{,}000} + \mathbf{\$25{,}000}}{\mathbf{3}} \\
&= \mathbf{\$14{,}133}
\end{aligned}$$

If Rosalie's Roth conversion does not exceed $14,133, her taxable income is $0. Even if it exceeds this amount, her marginal tax rate is low enough that a substantial tax liability does not result. This equation only works in circumstances where the taxpayer's MAGI for social security is in the second tier of social security taxation (i.e., MAGI is between $25,000 and $34,000).

Given his knowledge of Rosalie's upcoming IRA distributions, Elmer can assist Rosalie in evaluating the option of Roth conversions before she is required to take RMDs. If Rosalie converts funds now while her income is low, she likely incurs very little additional income tax while enabling tax-free withdrawals in the future. At the same time, she reduces the balance in her IRA, thereby reducing the RMDs that start after she turns 72.

NIIT. A Roth conversion can also trigger the NIIT, even though the Roth conversion itself is not directly taxed. As discussed previously, Roth conversions are treated as any other distributions for the calculation of taxable social security benefits.

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150. TD 9930, 2020-49 IRB 1400; 85 Fed. Reg. 72,472 (Nov. 12, 2020). See table 2 to paragraph (c) on page 72,478.

151. Rev. Proc. 2021-45, 2021-48 IRB 764.

152. This formula is very situation-specific and cannot be applied to other taxpayer facts and circumstances. Consult IRC §86 to determine calculations for other taxpayer scenarios.

Other Pros and Cons of Converting an IRA. In determining whether converting a traditional IRA to a Roth IRA benefits a particular taxpayer's situation, many additional factors must be weighed. These include the following.

- **The taxpayer's present income tax rate versus the rate expected during retirement** — If the taxpayer expects to be in a higher tax bracket after retirement, the option of converting from a traditional IRA to a Roth IRA should be given serious consideration.
- **Taxpayer's income needs** — Does the taxpayer need to take distributions from the IRA, or do they prefer to pass on the investment to heirs? With a Roth, there is no requirement to take mandatory distributions, whereas, with a traditional IRA, distributions must generally begin by age 72 for taxpayers born after June 30, 1949.
- **Any previous deductible or nondeductible contributions made to a traditional IRA** — If the contributions are mostly nondeductible, the tax impact of converting to a Roth is reduced because the investment earnings and deductible contributions are the only items taxed at conversion.
- **Taxpayer's current income tax rate** — If it is lower than usual, it might be a good time to convert the IRA, provided the taxpayer has enough funds available outside the IRA to pay the applicable taxes. However, if converting to a Roth IRA pushes the taxpayer into a higher tax bracket, it might be advisable to wait until a later year to convert or to make only a partial conversion in the current year.
- **The number of years before the taxpayer retires** — Generally, the more years until retirement, the more beneficial the conversion, given that there are more years to "earn back" the taxes due at conversion.
- **Available non-IRA funds to pay the taxes due after conversion** — If available, the tax-free growth of the Roth IRA can be dramatic compared to investments subject to tax. If not, the conversion may end up costing the taxpayer money.

Example 27. Sasha, age 60, has $50,000 in a traditional IRA. She wants to convert this IRA to a Roth IRA but does not have enough money to pay the taxes. She decides to proceed with the conversion and retains some of the money from the IRA to pay the taxes.

Sasha is in the 15% tax bracket. She owes $7,500 in taxes on the conversion ($50,000 × 15%), which she must retain from the conversion. She can convert the balance of $42,500 ($50,000 − $7,500) to a Roth IRA.

If Sasha leaves the converted balance of $42,500 in the Roth IRA for 12 years, assuming an average return of 7%, her projected balance is $95,718 ($\$42,500 \times (1 + 7\%)^{12}$). If she had not converted and left the money in the traditional IRA, she also would have $95,718 after paying taxes at 15% ($\$50,000 \times (1+7\%)^{12} \times (1 - 15\%$ tax rate)). The Roth conversion provided a similar result for Sasha because she did not have to pay the penalty on the amount not converted to pay the incremental income tax due on the Roth conversion. However, by depositing the funds into a Roth account, Sasha removes uncertainty regarding future tax rates.

INHERITED IRA RULES

The SECURE Act significantly reduced the benefit of the stretch IRA by requiring most beneficiaries to distribute the entire inherited IRA over 10 years.[153] For most beneficiaries, the Act does not specify any rate at which distributions must be taken, only that the account must be entirely distributed by the end of the tenth calendar year following the owner's death.[154]

153. IRC §401(a)(9)(H)(i)(I).

154. IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs).*

An exception exists for eligible designated beneficiaries allowing them to base their withdrawals from the inherited IRA based on their life expectancy. They include the following.[155]

- Surviving spouses
- Minor children of decedents, but only while they are minors
- Disabled persons
- Chronically ill persons
- Persons not more than 10 years younger than the decedent

On February 23, 2022, the IRS released proposed regulations that require the distribution to be made:

> *. . . at least as rapidly as under the distribution method being used under section 401(a)(9)(A)(ii) as of the date of the employee's death.*[156]

The proposed regulation refers to Treas. Reg. §1.401(a)(9)-5 for more information about the distribution period, which proposes using the beneficiary's remaining life expectancy, provided that the original IRA owner died after their required beginning date and had a shorter life expectancy at death than the beneficiary.

> **Caution.** Although these are proposed regulations, tax practitioners may wish to advise their clients of the possibility of RMDs from inherited IRAs at rates based on their life expectancies. If implemented by the IRS, this interpretation may result in elderly taxpayers having additional taxable income if they have inherited traditional IRAs. If they are beneficiaries of IRAs owned by someone who died in 2020, the possibility of penalties may exist for RMDs not taken during 2021.

QUALIFIED CHARITABLE DISTRIBUTIONS[157]

Taxpayers facing RMDs may consider the use of qualified charitable distributions (QCDs) as an option to comply with RMD rules while being provided with a financial motivation to donate to churches, veterans organizations, and IRC §501(c)(3) organizations. In doing so, the taxpayer decreases both their total income and AGI. A lower AGI can increase itemized medical deductions, possibly reduce the IRMAA surtax on Medicare premiums, and possibly even reduce alternative minimum tax. Thus, a taxpayer facing an RMD can use the QCD option to make a long-term difference to the organizations they value while potentially improving their tax situation.

Minimum Age for Making QCDs

Congress first made QCDs possible in 2006 with the Pension Protection Act of 2006.[158] At the time, tax law required taxpayers to start RMDs at age 70½.[159] The SECURE Act raised the beginning RMD age to age 72, but only for taxpayers who reached age 70½ after December 31, 2019.[160] Taxpayers born before July 1, 1949, were still required to start taking RMDs upon reaching age 70½. However, the SECURE Act had no provision to increase the age at which a taxpayer can make a QCD. Consequently, a taxpayer born after June 30, 1949, can make a QCD before they are required to take an RMD. However, taxpayers cannot make a QCD before they turn 70½.

155. IRC §401(a)(9)(E)(ii).
156. 87 Fed. Reg. 10,526 (Feb. 24, 2022). In this quote, the employee is the original IRA owner who is deceased.
157. IRC §408(d)(8).
158. *Pension Protection Act of 2006,* PL 109-280, §1201(a) adding paragraph (8) to IRC §408(d).
159. *Small Business Job Protection Act of 1996,* PL 104-188, §1404(a).
160. *Further Consolidated Appropriations Act, 2020.* PL 116-94, §114.

QCD Mechanics

The trustee or custodian of a taxpayer's IRA can make the QCDs directly to an organization listed in IRC §170(b)(1)(A), which includes churches, educational organizations, governmental units, public charities, and other organizations that can receive tax-deductible contributions. A taxpayer cannot make a legal QCD to a donor-advised fund or a supporting organization supporting other charities, as described in IRC §509(a)(3). A trustee may print a check payable to an organization eligible to receive a QCD and can mail it to the taxpayer so that they can present it. This contribution is still considered a valid QCD.[161]

Taxpayers must observe the following rules with QCDs.[162]

- QCDs cannot exceed $100,000 in any one year.
- Contributions must be deductible under §170.
- Taxpayers may not also claim an itemized charitable deduction or reduction in AGI or taxable income for the QCD.
- The charity must provide a receipt that meets the requirements of §170(f)(8).
- If the taxpayer is making IRA contributions after reaching RMD age as permitted under the SECURE Act,[163] these post-RMD contributions are not eligible for QCDs.[164]

For tax years ending after 2017, a QCD is reported on Form 1040, line 4a. Generally, the full amount of the charitable distribution is reported on line 4a. If the entire amount distributed is a QCD, a zero is entered on line 4b for the taxable amount. If only part of the distribution is a QCD, the part that is not a QCD is entered on line 4b. "QCD" is entered in the space next to line 4b.[165]

Example 28. George was born June 28, 1950, and celebrates his 72nd birthday by making a large contribution to his church. He uses funds in his traditional IRA to make a $10,000 QCD. He contacts the custodian for his IRA and requests that they withdraw $10,000 and create a check payable to his church for that amount. The custodian sends a check payable to "First Community Church" to George at his home address on July 6, 2022. George gives the check to his church on July 10. He advises his tax practitioner of the QCD and, in March 2023, presents an acknowledgment from his church. The receipt shows the QCD, among other contributions. Following IRS rules, the tax practitioner omits the QCD from the itemized charitable contributions on George's Schedule A, *Itemized Deductions,* for 2022. It is also not included in the taxable IRA distributions shown on Form 1040, line 4b.

If a taxpayer continues to work after age 70½, QCDs are complicated if the taxpayer continues to make deductible contributions to their IRA. The amount of the QCD is reduced by the cumulative amount of IRA deductions taken through the end of the current tax year, less cumulative reductions of QCDs through the end of the previous tax year. As a result, tax practitioners need a chart showing a taxpayer's history of IRA deductions since the year they turned 70½ and their history of QCDs. This presents a special challenge when first working with new clients who are inclined to use their IRAs to make charitable contributions. The following example illustrates an approach to address this.

161. IRS Notice 2007-7, 2007-5 IRB 395.

162. IRC §408(d).

163. *Setting Every Community Up for Retirement Enhancement Act (SECURE),* PL 116-94, §107(a).

164. Ibid, §107(b).

165. *IRA FAQs — Distributions (Withdrawals).* Sep. 30, 2021. IRS. [www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-irasdistributions-withdrawals] Accessed on May 11, 2022; Instructions for Form 1040.

Example 29. Use the same facts as **Example 28,** except that George, still working, made deductible IRA contributions of $4,500 in 2019, and $5,000 in both 2020 and 2021. He made a $6,000 contribution from his traditional IRA to his church in 2021, in addition to the $10,000 contribution in 2022; no such contributions were made in 2020. IRC §408(d)(8)(A) provides that the excludable amount of the 2021 contribution be reduced by the full $5,000 amount of the 2020 deductible IRA contribution and $1,000 of the 2021 deductible IRA contribution, thereby reducing George's 2020 QCD exclusion to $0. George must pay income tax on the 2021 distribution, even though it was given to a qualified charity. For 2022, the $10,000 gift is reduced by the remaining $4,000 of George's 2021 IRA contribution deduction. George's 2022 QCD exclusion is $6,000 ($10,000 total distribution – $4,000 remaining from the 2021 deduction). The 2019 deductible IRA contribution does not affect the QCDs in the later years because it was made before the year in which George turned 70½. George's tax practitioner constructs the following chart to track George's IRA contributions and how they were used to reduce his QCD amounts.

Year	George's Age on December 31	Deductible IRA Contribution Made	Cumulative IRA Contribution Made	Charitable Contribution Made	Cumulative IRA Less Charitable Contribution	QCD
2019	69½	$4,500				
2020	70½	5,000	$ 5,000			
2021	71½	5,000	10,000	$ 6,000	$4,000	$ 0
2022	72½	0		10,000	0	6,000

The QCD for 2019 does not affect QCDs because the Code only limits QCDs for "taxable years ending on or after the date the taxpayer attains age 70½."[166] Because George turned 70½ on December 28, 2020, the first year of limitation is 2020. The $5,000 George contributed to his IRA during 2020 affects the QCD calculation during 2021, reducing the potential QCD to $1,000. Because George made another deductible IRA contribution during 2021, not only is the QCD eliminated for 2020, another $4,000 remains to reduce future years' QCDs. In fact, it reduces the 2022 QCD by $4,000, leaving a QCD on George's 2022 return of only $6,000.

Practitioner Planning Tip

In most cases, such as the example illustrated, the taxpayer receives a Form 1099-R with no mention of any amounts distributed via a QCD. Practitioners are encouraged to ask taxpayers in RMD years if any distributions were, in fact, QCDs.

Note. For more information on QCDs, see the 2019 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 1: Individual Taxpayer Issues. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

166. IRC §408(d)(8)(A)(i).

TAX ISSUES OF AGING-IN-PLACE

According to the American Association of Retired Persons, 77% of adults ages 50 and older wish to remain in their home (and age-in-place) as opposed to moving to an assisted living center or other alternatives such as living with family members.[167] For tax practitioners representing these clients, several tax-related issues emerge.

HOME RENOVATIONS TO ADDRESS MOBILITY CHALLENGES

Improvements to a taxpayer's residence to increase mobility may appear at first glance to be reasonable and necessary deductible medical expenses. Examples include widening doorways, adding ramps, powered stairlifts, disabled access cabinetry and vanities, walk-in tubs, grab bars, etc. However, these types of improvements are only deductible to the extent the improvement does not add to the value of the home[168] and must be an "essential element of treatment and would not have otherwise been incurred for nonmedical reasons."[169]

Practitioner Planning Tip

Taxpayers are advised to have their home appraised before and after medically oriented improvement work is done to the home to determine if the home value has increased. As previously mentioned, only those expenses that do not increase the home's value may be considered potentially deductible medical expenses. Even with this information available, the potential tax benefits of expenditures could still be limited by 7.5% of AGI[170] and the overall standard deduction for the taxpayer's filing status.[171]

Example 30. Berta Harper is getting older and is confined to a wheelchair. To maintain her independence by continuing to live in her own home, she spends $50,000 on improvements to make moving around her home easier. Prior to contracting for the improvements, she had the home appraised by a licensed appraiser. The report came back with an estimated value of $500,000. After her disabled access improvements were completed, she requested a new appraisal. The appraiser commented that the area she lives in is a "hotbed" for retirees and his report came back with a new appraised value of $600,000. Because the change in value was more than what she spent on the improvements ($100,000 increase in value – $50,000 cost of improvements), none of the accessibility improvements qualify as medical expenses.

167. *Most Retirees Prefer to Stay Put.* Oct. 10, 2018. American Association of Retired Persons (AARP). [www.aarp.org/retirement/planning-for-retirement/info-2018/retirees-age-in-place-aarp-study.html] Accessed on Feb. 8, 2022.

168. IRC §213(e)(1)(iii).

169. *Jacobs v. Comm'r*, 62 TC 87 (1974).

170. IRC §213(a).

171. IRC §63(c).

Example 31. Use the same facts as **Example 30.** After the first appraisal, Berta has the appraiser return to re-evaluate the value of her home. The appraiser mentions that, in their opinion, she has limited the marketability of her home and has reduced the value of the home from $500,000 to $400,000. Her improvements did not increase the value of her home and could be considered potentially deductible medical expenses (but limited to her $50,000 expenditure, not the $100,000 decrease in appraised value).

Observation. Medically necessary home improvements are not limited to older clients. A young person with a neuro-muscular issue, for example, may be prescribed by his physician to swim laps in a pool every day. The decision to install a lap pool in the taxpayer's home per the physician's order may or may not result in a potential tax deduction. The taxpayer should have a qualified appraisal performed before and after the item is installed to determine its impact on the home value, even though the improvement is considered medically necessary.

DEDUCTING THE COST OF IN-HOME CARE PROVIDERS

If a taxpayer hires someone to assist them around the house with normal chores, the expenses likely are not tax-deductible. If the caregiver is hired to provide medical care, the expenses may be deductible if it can be determined these services qualify as long-term care services[172] for a **chronically ill person.**[173]

A chronically ill individual is certified (at least annually) by a licensed health care practitioner as requiring substantial supervision to protect the individual from harm due to severe cognitive impairment. Additionally, the individual is unable to perform, without substantial assistance, at least two of the following daily living activities for at least 90 days due to a loss of functional capacity.

- Eating
- Toileting
- Transferring
- Bathing
- Dressing
- Continence

Note. An individual who is physically able but has a cognitive impairment such as Alzheimer's disease or another form of irreversible loss of mental capacity is treated similarly to an individual who is unable to perform at least two activities of daily living.

172. IRC §213(d)(1)(C).

173. IRC §7702B(c).

Practitioner Planning Tip

If the taxpayer meets the requirements for being chronically ill, payments received from a long-term care policy (discussed later) for in-home care may be nontaxable. However, the payments made for qualified medical expenses are not deductible because they were paid with nontaxable receipts from the long-term care policy.

Caution. Hiring in-home care may rise to the level of the taxpayer becoming a household employer. Tax practitioners are encouraged to familiarize themselves with the rules for household employers by reviewing IRS Pub. 926, *Household Employer's Tax Guide,* and the IRS-provided guidance on this topic at **uofi.tax/22b1x2** [www.irs.gov/businesses/small-businesses-self-employed/hiring-household-employees].

HOME EQUITY LOANS

Home equity loans are commonly available, but homeowners can no longer deduct interest on these loans unless they use the proceeds to acquire, construct, or improve a principal residence.[174] Long-term care expenses paid with proceeds from a home equity loan are deductible as itemized medical expenses to the extent that a deduction is provided in IRC §213(a). Although interest on home equity indebtedness is not presently deductible, the current limitation expires December 31, 2025.[175]

REVERSE MORTGAGES

Taxpayers may need additional sources of funds to satisfy a variety of needs, including medical needs. One source is a reverse mortgage. According to the Federal Trade Commission, borrowing of this type is explained as part of the homeowner's equity being converted into payments to the homeowner.[176] The receipt of the funds is generally tax-free.[177] However, the mortgage accrues interest, but the accrued interest is not tax-deductible[178] because repayment is not required until a triggering event occurs, such as death, sale of the home, or the homeowner moving out of the home. Any of these occurrences may cause repayment of the loan. Even in such an event, the limitations on the uses and dollar limits of home equity proceeds, as discussed previously, may prevent accrued interest from being tax-deductible.[179]

Caution. The reverse mortgage discussion is not designed to be a recommendation. Rather, it is mentioned as information for use by the tax practitioner, who must understand any potential tax implications of a client's decision to use such an income creation product.

174. IRC §163(h)(3)(F)(i)(I) as amended by *Tax Cuts and Jobs Act,* PL 115-97, §11043.

175. Ibid.

176. *Reverse Mortgages*. Jun. 2015. Federal Trade Commission Consumer Information [www.consumer.ftc.gov/articles/0192-reverse-mortgages] Accessed on Feb. 15, 2022.

177. *Are the proceeds I receive from a reverse mortgage taxable to me?* Nov. 4, 2021. IRS. [www.irs.gov/faqs/other/for-senior-taxpayers/for-senior-taxpayers] Accessed on Feb. 15, 2022.

178. Ibid.

179. Ibid. See also IRS Pub. 936, *Home Mortgage Interest Deduction*.

LONG-TERM CARE ISSUES

The costs of living in a long-term care facility are rising rapidly. During 2020, the median cost of a private room in a nursing home exceeded $105,000, reflecting more than a 3.5% increase over 2019.[180] Americans aged 65 have a 69% chance of needing long-term care during their lives. On average, men can expect long-term care for 2.2 years, while women can expect long-term care for 3.7 years.[181]

Practitioner Planning Tip

Practitioners should request monthly invoices from the skilled nursing facility for their clients who are living in such a facility. Not all charges assessed to a taxpayer living in skilled nursing are tax-deductible. For example, if the facility has a barbershop or a beauty parlor, charges for their services may appear on monthly invoices. However, they are not deductible medical expenses, even if a licensed doctor has ordered full nursing care for the taxpayer. An exception to this statement would be expenses for maintenance and personal care services for chronically ill persons.[182]

PRIVATE SOLUTIONS

Private solutions include third-party alternatives, such as long-term care insurance and life insurance policies with special riders. Private solutions also include personally developed alternatives, such as annuities, personal savings, IRA withdrawals, using health savings accounts (HSA), or obtaining critical illness insurance. Additionally, clients may consider generating income by selling personal assets.

Long-Term Care Insurance

Long-term care insurance was originally positioned as a nursing home insurance product to complement the other health insurance products provided by insurance companies.[183] It offers the ability to accumulate assets over time that can provide long-term care funding when needed.

It has been increasingly difficult to purchase long-term care policies in recent years, as many insurance companies have left the market. Insurance costs have increased significantly as medical costs have increased significantly for doctors, hospitals, and nursing homes. However, it is generally less expensive to purchase long-term care insurance when an individual is younger. For example, it may be less expensive to pay for a policy from age 50 to 75 than to purchase one from the same insurer at age 65 and maintain it for just 10 years.

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180. *Cost of Care Survey.* Feb. 12. 2021. Genworth Financial, Inc. [www.genworth.com/aging-and-you/finances/cost-of-care.html] Accessed on Oct. 12, 2021.

181. *How Much Care Will You Need?* Feb. 18, 2020. Administration for Community Living. [acl.gov/ltc/basic-needs/how-much-care-will-you-need] Accessed on Oct. 12, 2021.

182. IRC §§7702(B)(C)(1), (2) and (3).

183. *Long-Term Care Insurance Research Brief.* May 31, 2012. U.S. Department of Health and Human Services. [aspe.hhs.gov/reports/long-term-care-insurance-research-brief-0] Accessed on Oct. 13, 2021.

Premiums paid for long-term care insurance can be deducted, but only to a point. The Code specifies a limit on the deductible amount based on the insured taxpayer's age. Consequently, a taxpayer no older than age 40 can deduct only $450 for long-term care in 2022. In contrast, a taxpayer at least 71 years old can deduct up to $5,640 of premiums in 2022.[184] If an employer provides long-term care insurance, it is a tax-free benefit.[185] Self-employed individuals, partners, and 2% S corporation shareholders can treat it as self-employed health insurance. However, an employer may not offer long-term care insurance through an IRC §125 cafeteria plan.

The tax treatment of claims on a long-term care policy depends on the insurance policy's wording. There are three ways that claims paid on the policy may be excluded from taxable income.

1. Benefits based on **actual expenses** paid are excluded from taxable income.[186]
2. Benefits paid on behalf of a **terminally ill** person may be excluded from taxable income.[187]
3. Taxpayers can exclude a **per-diem** amount based on limits set annually. The Secretary of the Treasury sets the amount each year in coordination with the Secretary of Health and Human Services. For 2022, the limit is $390 per day.[188]

Life Insurance with a Long-Term Care Rider. Life insurance policies that use riders to fund long-term care fall into three categories.[189]

1. In the first and most commonly used category, an insurance company offers a cash-value life insurance policy with an attached rider offering limited long-term care insurance benefits. If a long-term care claim arises, the amount of the claim is deducted from the face value of the insurance. The claim payment reduces the benefit paid on the policy upon the insured's death. Thus, the rider acts to provide an accelerated death benefit.[190]
2. A second category is a **linked benefit** the insured typically purchases with a single premium payment. A linked benefit arises from the asset that funds the long-term care and is linked to the policy. In this circumstance, the insured likely has access to a long-term benefit that is several times the amount of the premium but a relatively small death benefit.[191]
3. A third category is the life insurance policy with a critical illness rider. With this type of policy, the premium paid may have two components, one for life insurance and another for critical illness insurance. A claim on the critical illness rider becomes relevant if the insured has an incurable chronic illness. It might not provide benefits for a knee replacement, but it might cover benefits for a nursing home stay associated with, for example, terminal cancer or irreversible Parkinson's Disease.

These hybrid life insurance policies address one issue that has limited the adoption of conventional long-term care insurance. Conventional policies usually have a provision that allows the insurance company to increase premiums, often because costs of care increase. Companies selling hybrid policies cannot raise premiums once they issue the policy. These policies may also be called asset-based long-term care policies.[192]

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184. Rev. Proc. 2021-45, 2021-48 IRB 764.
185. IRC §7702B(a)(3).
186. IRC §7702B(a)(2).
187. IRC §7702B(d)(1).
188. IRC §§7702B(d)(4) and (5), as updated by Rev. Proc. 2021-45, 2021-48 IRB 764.
189. *How Hybrid Life Insurance Pays for Long-Term Care*. Huddleston, C. Jul. 20, 2020. Forbes. [www.forbes.com/advisor/life-insurance/long-term-care-hybrid/] Accessed on Nov. 18, 2021.
190. Ltr. Rul. 200919011 (Feb. 2, 2009).
191. *Linked Benefits.* Advisors Insurance Brokers. [www.advisorsib.com/products/linked-benefits] Accessed on Nov. 18, 2021.
192. *How Hybrid Life Insurance Pays for Long-Term Care*. Huddleston, C. Jul. 20, 2020. Forbes. [www.forbes.com/advisor/life-insurance/long-term-care-hybrid/] Accessed on Nov. 18, 2021.

Tax Treatment. IRC §7702B establishes the tax-deductibility of qualified long-term care insurance. **A qualified long-term care insurance** contract has the following attributes.

- The only insurance protection it provides is coverage of qualified long-term care services.
- The insurance contract does not reimburse or pay expenses that are reimbursable under Medicare.
- The insurance policy is guaranteed to be renewable.
- The insurance policy does not have a cash surrender value that can be borrowed or used as collateral for a loan.
- If the refund or a dividend is payable under the insurance contract, the contract must stipulate that the refund or dividend either pays future premiums or increases future benefits.
- The insurance contract must meet consumer protection provisions of §7702B(g).

In contrast, a hybrid policy likely has no tax-deductible portion. Any payment charged against the cash surrender value of a life insurance contract disallows the deduction.

Example 32. John wants long-term care insurance and is open to a life insurance policy with a long-term care rider. The long-term care rider contains the following clause.

In the event of the claim under section 14.5 of this policy, the surrender value of this policy shall be reduced by the value of the claim once the claim is paid.

Because the policy has a clear provision that the surrender value is reduced by the amount of any claims paid, the premium paid for the policy is not a deductible itemized expense, nor would it be deductible as a self-employed owner's health insurance.[193]

Life insurance is not generally a deductible expense, and a long-term care rider does not make it deductible.

Annuities

An annuity is a financial contract that requires regular payments for a period exceeding one year to a person entitled to receive them. This person is called an **annuitant.** An annuitant may purchase an annuity, or they may acquire the annuity through an employer. An employer may provide some portion of the purchase price of the annuity.[194] Some annuities pay a fixed amount immediately upon purchase on a regular schedule, while other annuities provide for a delayed payment based on a future event. The regular fixed payment ceases at the annuitant's death in a classical annuity, but sometimes annuities pay the regular amount for a specific period and then terminate. Annuity payments may end with the annuitant's death, or the balance of the annuity may be paid to an estate or beneficiaries, depending on the terms of the annuity.

Annuities are useful for long-term care planning. Annuities designed to be used for long-term care purposes typically establish two funds, one for payment of long-term care needs and another to be used for any legal purpose.[195] Payments from the fund for long-term care needs are based on the covered person's inability to perform normal daily living activities for a specific period.[196] The annuity contract probably specifies an elimination period that must expire before the contract pays claims for long-term care benefits.

Tax Treatment. When a taxpayer receives a distribution from an annuity, a portion of the distribution corresponding to earnings is normally subject to income tax.

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193. Ibid.

194. *Annuities — A Brief Description.* Jul. 1, 2021. IRS. [www.irs.gov/retirement-plans/annuities-a-brief-description] Accessed on Oct. 13, 2021.

195. *Long-Term Care Rider.* Oct. 14, 2020. Annuity.org [www.annuity.org/annuities/riders/long-term-care/] Accessed on Oct. 13, 2021.

196. IRC §7702B(c)(2)(A)(i).

Example 33. The first mate of an ocean-going ship, the *Pequod 2*, acquires an annuity with a long-term care rider because of his coffee-drinking habit. He makes a single $75,000 payment to purchase an annuity with a face value of $100,000. If he withdraws $2,000 in 2022, 25% (($100,000 face value – $75,000 premium paid) ÷ $100,000 face value) or $500 is considered due to earnings. The $500 is taxable income, and the remaining $1,500, or 75%, is a nontaxable return of principal.

Amounts paid for any portion of the annuity contract should not be deducted as an itemized medical expense under §213(a).[197] Annuity contracts also fail the test for qualified long-term care insurance contracts under §7702B(b)(1)(D). If the linked amount reduces the annuity contract's cash value, the benefits paid are not taxable income. This treatment assumes they do not exceed the per-diem maximum.[198] A letter ruling applies §7702B to a specific long-term care insurance product; although this cannot be cited as precedent, it is an informative guide to the IRS's interpretation of this section of the Code. This letter ruling highlights three key attributes of long-term care insurance.[199]

1. A long-term care contract can be considered an insurance contract if it meets the requirements of §7702B(b)(2) and shifts the risk of economic loss transfers among a large group of persons who purchase insurance contracts.
2. Benefits not exceeding the per-diem limitations allow the contract owner to exclude the benefits from their gross income.
3. Payments of benefits under the insurance contract reduce the investment in the contract.[200]

Personal Savings[201]

Taxpayers may accumulate savings to fund long-term care during their earning years. The funds could accumulate in a bank account or in an investment account. Paying for long-term care from accumulated assets receives no special tax treatment. However, to the extent that the taxpayer eventually spends them on long-term care needs, future expenditures can result in itemized medical deductions under §213(a).

Traditional IRA Withdrawals[202]

Withdrawing money from traditional IRAs and 401(k) accounts results in taxable income, even if the withdrawals are used for long-term care needs. However, to the extent that taxpayers spend the income on eligible medical expenses for long-term medical care, the amount of income that is taxable may be offset by itemized deductions if the taxpayer is able to itemize.

IRAs cannot invest in life insurance contracts.[203] An individual should not invest the proceeds of an IRA in a life insurance contract having a long-term rider, as this is a prohibited transaction that subjects the IRA to lose its exempt status on the first day of the year.[204] It may be possible to invest in an annuity that has no life insurance component, paying tax when the annuity makes distributions.[205] The exceptions that permit this are so narrow as to require careful planning for any IRA acquiring an annuity.[206]

197. IRC §7702B(e)(2).
198. IRC §104(a)(3).
199. Ltr. Rul. 200919011 (Feb. 2, 2009).
200. IRC §72.
201. *Planning for Retirement? Include Long-Term Care Needs*. Ali Khawar. Nov. 16, 2021. U.S. Department of Labor. [blog.dol.gov/2021/11/16/planning-for-retirement-include-long-term-care-needs] Accessed on Nov. 18, 2021; *How can I pay for nursing home care?* Centers for Medicare and Medicaid. [www.medicare.gov/what-medicare-covers/what-part-a-covers/how-can-i-pay-for-nursing-home-care] Accessed on Nov. 22, 2021.
202. *9 Ways To Pay For Long-Term Care Without Buying Insurance.* Fivecoat-Campbell, Kerri. May 16, 2018. Next Avenue. [www.forbes.com/sites/nextavenue/2018/05/16/9-ways-to-pay-for-long-term-care-without-buying-insurance/] Accessed on Nov. 18, 2021.
203. IRC §408(a)(3).
204. IRC §408(e)(2)(A).
205. Treas. Reg. §1.408-4(e).
206. IRC §§408((b)(1), (3), (4) and (5).

Withdrawals to Pay for Long-Term Care Insurance. Withdrawals from qualified plans are taxable in the year they are distributed; there is no general exception for payment of long-term care insurance.[207] However, a retired public safety officer may elect to have up to $3,000 per year distributed directly from their employer's plan to a provider of long-term care insurance or health insurance. This distribution is not included in the retiree's gross taxable income.[208]

Health Savings Accounts

A taxpayer can use an HSA to fund long-term care expenses or to pay long-term care insurance premiums.[209] Many long-term care expenses are eligible for reimbursement through HSA distributions. The taxpayer must maintain records establishing the following.

- The expenses were made to pay or to reimburse qualified medical expenses.
- The expenses were not paid through insurance reimbursement.
- The expenses were never included in itemized deductions on Schedule A.

A once-in-a-lifetime distribution can be made from an IRA to fund an HSA.[210] This opportunity comes with the following limitations and requirements.

- The distribution is limited to the HSA limit in effect on the first day of the month the contribution is made.[211]
- The distribution is based on the taxpayer's age at the end of the year.
- Contributions to HSAs cannot be made after a taxpayer is entitled to Medicare benefits.[212]
- The individual making the funding distribution must maintain eligibility for the HSA for 12 months after the health funding distribution. If they do not, the distribution becomes a taxable event subject to a 10% penalty.[213]
- The HSA contributions made directly and HSA funding distributions from traditional IRAs cannot exceed $3,650 for a self-only plan and $7,300 for a family plan for taxpayers under age 55 for 2022.[214] The amounts are increased by $1,000 for each taxpayer at least age 55.[215] Consequently, an individual over age 55 can contribute $4,650 to an HSA account, while a married couple age 55 or older with family coverage can contribute $9,300 during 2022.
- Neither a simplified employee pension (SEP) nor a savings incentive match plan for employees (SIMPLE) plan can fund an HSA funding distribution.[216] This funding distribution must be a direct rollover from the IRA trustee to the HSA trustee.[217]

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207. IRC §402.
208. IRC §402(l).
209. IRC §223(c)(1)(B)(ii); IRS Pub. 969, *Health Savings Accounts and Other Tax-Favored Health Plans.*
210. IRC §408(d)(9)(C)(ii)(I).
211. IRC §408(d)(9)(C)(i).
212. IRC §223(b)(7).
213. IRC §408.
214. IRS Notice 2008-51, 2008-25 IRB 1163; Rev. Proc. 2021-25, 2021-21 IRB 1161.
215. IRC §223(b)(3).
216. IRC §408(d)(9)(B).
217. Ibid.

Practitioner Planning Tip

Clients with IRA assets and an HSA-qualified high deductible health plan may consider a once-in-a-lifetime direct transfer of IRA assets to their HSA, which may then be used to pay qualified medical expenses on a tax-free basis. While not a discussion limited to just older clients, those taxpayers nearing Medicare enrollment age who are contemplating such an asset transfer must realize the HSA must remain in effect for 12 months after the asset transfer or risk the transfer being considered a taxable event. Further, the amount eligible for trustee-to-trustee transfer is limited to the HSA maximum contribution for the year, depending on the participant's age and whether the participant has self-only or family coverage with the HSA qualified high deductible health plan. The amount transferred also reduces the amount the participant may fund themselves to the HSA.[218]

IRC §480(d)(9) imposes a requirement for a 12-month testing period, which starts the month **after** the distribution is contributed to an HSA. This distribution must be made by a trustee-to-trustee transfer directly from the traditional IRA, moving IRA assets directly to the HSA.

Example 34. Ron is single and 62 years old. He has worked many years for a local manufacturing firm, which sponsors an HSA-qualified high deductible health insurance plan. This plan enables Ron to fund his HSA regularly. Ron also has a traditional IRA with a $300,000 balance.

Ron reaches age 65 in November 2024 and plans to start Medicare on the first of the following month. He considers making a one-time HSA funding distribution but is advised by his tax practitioner that he must make this distribution no later than October 2023. Ron decides to make this one-time funding distribution in January 2022. By making the transfer more than a year before the potential termination, he can satisfy the 12-month requirement.

Acting on this plan, Ron requests a transfer of $4,650 on January 4, 2022, because the HSA contribution limit for 2022 is $4,650 ($3,650 + $1,000 catch up contribution).[219] Because he has made the maximum contribution early in the year, he cannot make any additional HSA contributions during 2022. Ron plans to avoid using this money until he needs it for long-term care purposes. He has effectively transferred $4,650 from his traditional IRA to his HSA, making it available for qualified medical expenses, including long-term care or long-term care insurance premiums.

Critical Illness Insurance[220]

Critical illness insurance can serve a limited role in financing the costs of long-term care. Critical illness insurance claims are triggered when an individual is diagnosed with an illness specifically covered in the critical illness insurance policy. The illnesses covered are typically very serious, such as cancer, heart attack, or stroke. Different insurers have policies that cover different illnesses.[221]

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218. IRS Pub. 969, *Health Savings Accounts and Other Tax-Favored Health Plans.*

219. Ibid.

220. *Long-Term Care vs. Long-Term Disability vs. Critical Illness Insurance.* National Education Association. [www.neamb.com/family-and-wellness/longterm-care-vs-longterm-disability-vs-critical-illness-insurance] Accessed on Oct. 18, 2021.

221. *Filling the Gaps with Critical Illness Insurance*. Sammer, Joanne. Jun. 16, 2011. Society for Human Resource Management. [www.shrm.org/resourcesandtools/hr-topics/benefits/pages/criticalillnessinsurance.aspx] Accessed on Nov. 19, 2021.

The narrow list of illnesses represents the problem of financing long-term care with a critical illness insurance policy. Unless an individual is ill with one of the exact illnesses covered in the policy, it is unlikely the policy is an effective source of insurance. The benefit to these policies is that they are significantly less expensive, and they typically pay benefits in a lump sum as soon as a diagnosis is confirmed. For this reason, they are frequently used by younger people, whereas the population of insureds with long-term care insurance tends to be older.[222]

Tax Treatment. Because critical illness insurance recoveries are not required to reimburse specific medical costs, premiums paid for these policies are generally **not** tax-deductible.[223] However, some employers may offer these policies as a pretax benefit. Employers may offer it through a cafeteria plan. Claims paid on a policy provided through a §125 cafeteria plan would not be taxable.

Selling Assets[224]

For many taxpayers, selling assets to finance long-term care may be an alternative. If the assets to be sold are financial instruments, capital gains tax consequences are likely.[225] Selling shares of stock from an investment portfolio, for example, might result in a significant capital loss or capital gain.

Collectibles may be problematic due to the uncertainty in their estimated value. The capital gains tax rate on collectibles is 28%, which is applied to coin and stamp collections, as well as works of art, certain rugs and antiques, precious metal bullion, and some other forms of tangible property.[226] The sale of collectibles could raise cash to fund long-term care needs. However, the individual in charge of selling the assets must set aside enough money to pay the associated income tax.

> **Caution.** A need for long-term care may accompany a need to sell a business. Taxpayers selling an interest in a closely-held business should anticipate complex tax planning needs. The proceeds from the sale of these assets could address long-term care needs, but their availability is dependent on the timing of different aspects of the business sale. The circumstances involved with the sale of a business for long-term care needs go beyond the scope of this chapter. For more information on the sale of a **service** business, see the 2022 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: Terminating a Business Interest.

PUBLIC SOLUTIONS[227]

Medicare generally does not pay for long-term care stays in nursing homes or long-term care facilities. Medicare claims may still be made for hospital care, the services of medical professionals, and some medical supplies when an individual is in a long-term care facility, but usually, an individual starts payment of long-term care with funds they have previously acquired.

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222. *Long-Term Care vs. Long-Term Disability vs. Critical Illness Insurance.* National Education Association. [www.neamb.com/family-and-wellness/longterm-care-vs-longterm-disability-vs-critical-illness-insurance] Accessed on Oct. 18, 2021.

223. IRC §213(d)(1); *Critical Illness Insurance.* Aug. 30, 2019. Manulife Investment Management. [www.manulifeim.com/retail/ca/en/viewpoints/tax-planning/taxation-of-critical-illness-and-disability-insurance-living-benefits-products] Accessed on Oct. 18, 2021.

224. IRC §§1201–1278.

225. IRC §§1221–1223.

226. IRC §§1(h)(5) and 408(m)(2).

227. *How can I pay for nursing home care?* Centers for Medicare and Medicaid Services. [www.medicare.gov/what-medicare-covers/what-part-a-covers/how-can-i-pay-for-nursing-home-care] Accessed on Nov. 22, 2021.

Medicaid[228]

Medicaid is a joint program of the federal and state governments. Title XIX of the Social Security Act lays out the broad framework of the Medicaid program, including eligibility categories, but each state develops the details of its own unique Medicaid plan. A state's plan must meet certain federal requirements in order to receive federal Medicaid funds.[229]

The Medicaid program provides funding for a greater percentage of long-term care than any other payment source. In 2019, Medicaid paid $1 of every $6 of healthcare expenses incurred.[230]

Before the Affordable Care Act (ACA),[231] the Social Security Act required a state electing to participate in the Medicaid program to cover certain mandatory eligibility categories, and it permitted a state to cover additional optional eligibility categories. Nothing in the federal statute forces a state to participate in the Medicaid program, but all states do. The main eligibility categories covered are children, pregnant women, parents of eligible children, individuals age 65 and above, and disabled persons. Many individuals could not receive Medicaid assistance supported by federal funds, particularly nondisabled adults who were neither pregnant nor had qualifying children and who were not eligible for Medicare.

The ACA broadens Medicaid eligibility to cover taxpayers between the ages of 18 and 64 with income at or below 133% of the federal poverty guidelines. The ACA does not change otherwise existing eligibility categories, but the Centers for Medicare and Medicaid Services (CMS) has attempted to streamline eligibility categories through regulations.[232]

> **Note.** Individual states govern Medicaid eligibility. Information about the Illinois Medicaid program is available through the Illinois Department of Healthcare and Family Services and at **uofi.tax/22b1x3** [www.medicaid.gov/state-overviews/stateprofile.html?state=illinois].

For individuals who qualify for Medicaid benefits with their states, Medicaid generally covers most health-related expenses not otherwise paid by Medicare or other sources.[233] Medicaid also covers long-term care expenses, including nursing home care. Historically, Medicaid's long-term care coverage focused on nursing home care, but this focus was broadened to support community-based long-term care services.[234]

> **Note.** For a detailed discussion of Medicaid eligibility and coverage for long-term care, see the 2011 *University of Illinois Federal Tax Workbook*, Chapter 2: Long-Term Care. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

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228. 42 USC §1396a.

229. *Medicaid.* Medicaid.gov. [www.medicaid.gov/medicaid/index.html]. Accessed on Feb. 24, 2022.

230. *Medicaid Coverage for Nursing Homes: Don't 'Spend Down' Without a Plan.* Oct. 15, 2021. American Association of Retired Persons (AARP). [www.aarp.org/caregiving/financial-legal/info-2019/medicaid-nursing-home-coverage.html] Accessed on Feb. 24, 2022.

231. *Patient Protection and Affordable Care Act*, PL 111-148, §10201.

232. Department of Health and Human Services, *Medicaid Program: Eligibility Changes Under the Affordable Care Act of 2010; Final Rule,* 77 Fed. Reg. 17144, 17147 (Mar. 23, 2012). ("The Affordable Care Act did not eliminate or change the requirements of existing Medicaid eligibility groups, except to require the use of MAGI-based financial methodologies for the populations included under MAGI.")

233. *Medicaid Pocket Primer*, p. 2. Jun. 2017. The Henry J. Kaiser Family Foundation. [files.kff.org/attachment/Fact-Sheet-Medicaid-Pocket-Primer] Accessed on Mar. 29, 2022.

234. *Long-term Care Services & Supports*. CMS. [www.medicaid.gov/medicaid/long-term-services-supports/index.html] Accessed on Mar. 29, 2022.

Although the ACA expands Medicaid eligibility, it does not change eligibility provisions applicable to elderly taxpayers (age 65 or older). Accordingly, the rules remain the same for most taxpayers needing long-term care assistance through Medicaid. **Before the ACA**, an unmarried individual could not own more than $2,000 in assets in most states. The value of an automobile used for transportation by the Medicaid applicant or household member was excluded from the asset computation, as was the value of the applicant's residence (up to $500,000 in equity value) and most household furnishings, including clothes and other similar personal items. **The same basic standard applies after the ACA.**[235]

Qualifying for Medicaid Benefits. Special asset determination rules apply when a married Medicaid applicant becomes a nursing home resident while the applicant's spouse remains in the community.[236] The rules attempt to prevent spousal impoverishment.[237] Among other protections, the community spouse is allowed to retain assets up to the maximum community spouse resource allowance (CSRA).[238] The CSRA varies by state but is subject to maximum and minimum limits established by CMS. For 2022, the maximum CSRA is $137,400, and the minimum CSRA is $27,480.[239]

Special income determination rules also apply to a married Medicaid applicant who is (or plans to be soon) a nursing home resident while that applicant's spouse remains in the community.[240] For example, a community spouse's income is deemed "unavailable" to a nursing home spouse for purposes of Medicaid. These rules were not changed by the ACA.

Transfers to Family Members. To reduce assets to allow a person, particularly one who requires nursing home care, to qualify for Medicaid, individuals may wish to give various amounts to family members, friends, and perhaps even charities. Although such actions may not trigger negative federal income tax consequences, such gifts may be considered disqualifying transfers for purposes of determining Medicaid eligibility.

Medicaid Look-Back Period. If an individual seeking Medicaid eligibility has transferred assets for less than their fair market values during a look-back period to anyone (including a charity) for any reason, the value of the assets transferred is still considered in determining eligibility. The look-back period for any transfers made after February 7, 2006, is 60 months before the date on which the transferring individual is institutionalized or applies for Medicaid, unless the individual resides in California, in which case the look-back period is 30 months.[241]

There are exceptions to the disqualifying transfer rule. Transfers to a spouse or to a blind or disabled child generally do not count as disqualifying transfers, nor do transfers to a trust established solely for the benefit of a disabled person who has not yet attained age 65.[242]

In addition, Medicaid allows an individual applying for Medicaid to transfer their home to certain family members without the transfer triggering a period of disqualification.[243] Such a transfer can be made to the individual's spouse or the individual's child who is either under age 21 or is blind or disabled.[244]

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235. *2022 SSI and Spousal Impoverishment Standards*. Daniel Tsai. Nov. 23, 2021. CMS. [www.medicaid.gov/federal-policy-guidance/downloads/cib11232021.pdf] Accessed on Mar. 29, 2022. *Estate Recovery*. CMS. [www.medicaid.gov/medicaid/eligibility/estate-recovery/index.html] Accessed on Mar. 29, 2022.

236. 42 USC §1396r-5.

237. *Spousal Impoverishment*. CMS. [www.medicaid.gov/medicaid/eligibility/spousal-impoverishment/index.html] Accessed on Mar. 29, 2022.

238. *Determining Eligibility for Medicaid.* CMS. [www.medicaid.gov/medicaid/eligibility/index.html] Accessed on Feb. 24, 2022.

239. *2022 SSI and Spousal Impoverishment Standards*. Nov. 23, 2021. Daniel Tsai. CMS [www.medicaid.gov/federal-policy-guidance/downloads/cib11232021.pdf] Accessed on Mar. 29, 2022.

240. 42 USC §1396r-5(b).

241. *Medicaid's Look-Back Period Explained.* (Dec. 14, 2021). American Council on Aging. [www.medicaidplanningassistance.org/medicaid-look-back-period/] Accessed on Feb. 24, 2022.

242. 42 USC §1396p(c)(2)(B).

243. 42 USC §1396p(c)(2)(A).

244. 42 CFR §1396p(c)(2)(A)(ii).

> **Note.** The American Council on Aging provides a Medicaid Eligibility Test. For more information, see **uofi.tax/22b1x4** [www.medicaidplanningassistance.org/medicaid-eligibility-test].

> **Caution.** Tax practitioners are warned not to make uninformed recommendations regarding asset spend-down strategies for taxpayers facing long-term care decisions. Practitioners are encouraged to refer these types of clients to elder-care experts such as attorneys who specialize in this area of law.

Medicare

Medicare pays a significant amount for skilled nursing care. In 2019, Medicare funded 20.5% of the nation's overall spending on long-term services and supports.[245] Medicare consists of the following parts.[246]

- Part A provides in-patient hospital insurance, short-term nursing home coverage under limited circumstances, some home health care coverage, and hospice care.
- Part B provides insurance coverage for services by health care professionals (including doctors), medical equipment, outpatient medical care, some home health care, and a variety of other health-related services or items.
- Part C (referred to as Medicare Advantage) provides private insurance alternatives to Parts A and B (often called traditional or original Medicare).
- Part D provides prescription drug coverage (through private insurers).

Medicare Part A covers short-term skilled nursing care in limited circumstances. The care must be provided in a skilled nursing facility (SNF) that has been approved by Medicare, and the following must apply.[247]

- The beneficiary must be admitted to the SNF within 30 days of discharge from an inpatient hospital stay that extended at least three days, including the day of admission, but not the day of discharge.
- Skilled nursing care must be medically necessary on a daily basis to treat a condition related to the preceding hospital stay.

As long as these requirements are satisfied, Medicare Part A generally covers up to 100 days in an SNF for each benefit period or spell of illness.[248] Medicare considers a spell of illness as a period that begins on the first day an individual is admitted for inpatient care and ends 60 days after the last day on which the individual was an inpatient at a hospital, an SNF, or another type of rehabilitative facility.[249] The first 20 days do not require any coinsurance from the beneficiary. However, the period from the 21st day through the 100th day is subject to a daily coinsurance payment, which is $194.50 in 2022.[250]

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245. *Who Pays for Long-Term Services and Supports?* Colello., Kirsten J. Aug. 5, 2021. Congressional Research Service. [crsreports.congress.gov/product/pdf/IF/IF10343]Accessed on Mar. 29, 2022.

246. See *Parts of Medicare.* Medicare.gov. [www.medicare.gov/basics/get-started-with-medicare/medicare-basics/parts-of-medicare] Accessed on May 11, 2022.

247. 42 USC §1395x(i).

248. 42 USC §1395d(a)(2)(A).

249. 42 USC §1395x(a)(2).

250. *Skilled nursing facility (SNF) care*. CMS. [www.medicare.gov/coverage/skilled-nursing-facility-snf-care] Accessed on Mar. 29, 2022.

Medicare covers home healthcare services under both Parts A and B. In general, eligibility for home health care services requires the following.[251]

- The Medicare beneficiary must be under a physician's care and receiving health care services under a plan of care established and reviewed regularly by a physician.
- The Medicare beneficiary must require (as certified by a physician) intermittent skilled nursing care, physical therapy, speech-language pathology services, or continued occupational therapy (or more than one of these services).
- The home health agency providing the home health care services to the Medicare beneficiary must be approved by Medicare.
- The Medicare beneficiary must be certified by a physician as homebound. **Homebound** means that the Medicare beneficiary cannot leave home without assistance due to a medical condition, that leaving home requires considerable and taxing effort, and that leaving home is not recommended due to the medical condition.

Note. Just because a Medicare beneficiary is certified as homebound does not mean that the beneficiary can never leave home. For example, trips for medical care and infrequent other trips, such as to their church, are permitted.

- The beneficiary must require no more than part-time or intermittent skilled nursing care. **Part-time or intermittent** skilled nursing care generally means care provided for fewer than seven days each week or less than eight hours each day over a period of 21 days (or less).

If a beneficiary qualifies for Medicare-covered home health care, Medicare pays for any of the following if considered "reasonable and necessary" for the treatment of the beneficiary's condition.[252]

- Skilled nursing care, which must be provided by a registered nurse or a licensed practical nurse and does not include any care that could safely be provided by a nonmedical person
- Physical therapy, occupational therapy, and speech-language pathology
- Medical social services, if they are provided under the direction of a physician in connection with the beneficiary's medical care
- Medical supplies

Home health care under Medicare Part A is covered 100% (other than the cost of durable medical equipment) with no cost to a beneficiary.[253] Durable medical equipment provided in connection with covered home health care services is subject to the beneficiary's 20% coinsurance payment. Durable medical equipment includes such items as wheelchairs and walkers.[254]

Home health care is not covered under Part A, but that meets the requirements specified earlier for Medicare coverage is covered under Part B. In addition to the annual deductible ($233 in 2022), services and supplies provided under Part B are generally subject to 20% coinsurance payments.[255]

[251] *Medicare & Home Health Care.* CMS. [www.medicare.gov/Pubs/pdf/10969-medicare-and-home-health-care.pdf] Accessed on Mar. 29, 2022, and 42 USC 1395x(m).

[252] *Home Health Services.* CMS. [medicare.gov/coverage/home-health-services] Accessed on Mar. 29, 2022.

[253] *Medicare & Home Health Care.* Sep. 2020. CMS. [www.medicare.gov/Pubs/pdf/10969-medicare-and-home-health-care.pdf] Accessed on Mar. 29, 2022; *Medicare costs at a glance*. 2022. CMS. [www.medicare.gov/your-medicare-costs/medicare-costs-at-a-glance#collapse-4808] Accessed on Mar. 29, 2022.

[254] 42 USC §1395x(n).

[255] *Medicare costs at a glance.* 2022. CMS. [www.medicare.gov/your-medicare-costs/medicare-costs-at-a-glance#collapse-4808] Accessed on Mar. 29, 2022.

Veterans' Benefits

The U.S. Department of Veterans Affairs (VA) provides a wide range of health benefits to qualifying veterans, including long-term care. Eligibility for VA long-term benefits requires enrollment in the VA health benefits system. Any taxpayer who had active U.S. military service and was discharged under conditions other than dishonorable may be eligible for VA health benefits.[256] However, whether an individual qualifies for benefits varies depending on when, where, and how long an individual served and whether that individual suffered some service-related injury, among other factors.

In general, a minimum-duty requirement applies to qualify for VA health benefits. Most veterans who enlisted after September 7, 1980, or entered active duty after October 16, 1981, must have served 24 continuous months or the full period for which they were called to active duty to be eligible. However, numerous exceptions apply, particularly in cases in which a veteran suffers a disability incurred or aggravated in the line of duty.

A veteran who is eligible for VA health benefits is assigned to one of eight priority groups that determine the details of enrollment in VA health coverage.

> **Note.** For further details regarding the eight priority groups, see **uofi.tax/22b1x5** [www.va.gov/health-care/eligibility/priority-groups].

All veterans who are enrolled in VA health benefits are eligible for long-term care services through the VA.[257] Depending on the veteran's needs, available services range from community-based services (such as adult daycare, respite care, and skilled home health care) to institutional care in nursing homes. These services may include nursing homes operated directly by the VA.

In addition to the long-term care assistance available as part of the VA health benefits package, the VA also provides enhanced financial assistance for low-income veterans who receive a VA pension and are homebound or in need of aid and attention.[258] Similar assistance is available in some cases for the surviving spouses of certain low-income veterans.

> **Note.** Veterans' benefits are very complicated, in part because of the vast number of exceptions that exist. A useful starting point is the VA website at **uofi.tax/22b1x6** [benefits.va.gov/benefits].

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256. *About VA health benefits.* Oct. 12, 2021. VA. [www.va.gov/health-care/about-va-health-benefits/] Accessed on Mar. 29, 2022.

257. *Geriatrics and Extended Care*. Jul. 9, 2021. VA. [www.va.gov/GERIATRICS/pages/Paying_for_Long_Term_Care.asp] Accessed on Mar. 29, 2022.

258. *Enhanced or Special Monthly Pension Aid and Attendance or Housebound*. Aug. 2018. VA. [benefits.va.gov/BENEFITS/factsheets/limitedincome/EnhancedorSpecialPension.pdf] Accessed on Jun. 13, 2022.