

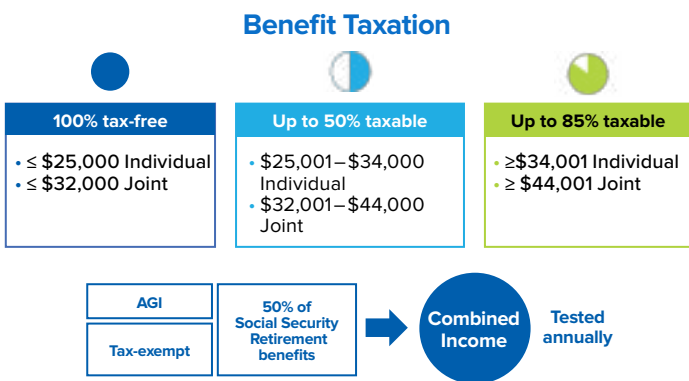
## Social Security: A Tax-Exempt Lifetime Payment with a COLA

Social Security retirement benefits provide lifetime payments with cost-of-living adjustments (COLAs) for individuals and their spouses. They also are partially exempt from income taxes—a factor that may be missed by clients.

For many retirees, Social Security retirement benefits are their only source of guaranteed income. With that in mind, many financial professionals focus solely on Social Security providing lifetime payments, but may neglect to mention that these benefit payments are at least partially exempt from income taxes. This means a higher Social Security retirement benefit can translate into lower reported income for both federal and state tax purposes. Let's examine how this works more closely.

### Social Security Retirement Benefits Are At Least 15% Federal Income-Tax-Free

Social Security retirement benefit payments can be subject to federal income taxes. If the benefit exceeds the thresholds noted in the chart below, a percentage of the benefit is



Source: Social Security Administration. "Publication 05-10035, Retirement Benefits." January 2024. Accessed March 18, 2024.

<sup>1</sup>Social Security Program Fact. "Fact Sheet on the Old-Age, Survivors, and Disability Insurance Program." December 31, 2023.

<sup>2</sup>Fact Sheet. 2024 Social Security Changes. Social Security Administration. November 2023.

<sup>3</sup>Cagnassola, Mary Ellen. "Which States Tax Social Security Benefits? Missouri, Nebraska Change Rules." January 02, 2024.

added into the client's adjusted gross income (AGI). However, the maximum amount of taxable Social Security retirement benefits is 85%, leaving 15% free from federal income taxes.

In 2023, the average Social Security retirement benefit was \$1,897<sup>1</sup>; for an annual total of \$22,764. That translates to an average federal income tax-free income of \$3,415. As the benefit increases, the tax-free amount increases as well. If a client receives the [maximum 2024 payment of \\$3,822](#) at full retirement age (FRA),<sup>2</sup> the federal income tax-free amount increases to \$6,880, reducing AGI.

### Taxable Amounts Depend on State of Residence

As of 2024, only 10 states still assess state income taxes on Social Security retirement benefits: Colorado, Connecticut, Kansas, Minnesota, Montana, New Mexico, Rhode Island, Utah, Vermont, and West Virginia.<sup>3</sup> In other states with income taxes, a higher Social Security retirement benefit means a lower AGI for state income-tax purposes. This further reduces the effective tax rate on income received.

For tax purposes, a client's state of residence does matter. Some states, like Florida, do not impose any state income tax. In a few states, Social Security retirement benefits are not taxed, and there is a cap on state income-tax-free IRA and 401(k) distributions and pension income. If a client lives in a state with high income taxes, such as California or New York, state income-tax-free Social Security retirement benefits can significantly affect the overall tax bill.

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### When Should Clients Claim Social Security Retirement Benefits?

Clients should consider the tax implications outlined above along with their retirement income needs as they decide when to claim Social Security retirement benefits. If a client claims early, the benefit payment will be reduced, meaning less tax-free income overall. Additional income from traditional qualified accounts is taxed at the federal level and likely at the state level, which also can affect a client's claiming decision.

Software is available to help guide clients through the decision-making process. Some tools will calculate how much their Social Security retirement benefits might be taxed at the federal level; some include state taxes as well. Other tools, like Pacific Life's [Social Security Analyzer](#), can help determine when might be the optimal time to claim a Social Security retirement benefit. Using the information provided in a client's data form submission, this tool offers a personalized chart and written description of potential claiming options. This can help the client evaluate the options and consider what might work for his or her circumstances.

### Putting It All Together

The decision to claim Social Security retirement benefits has multiple planning implications, and it's important for clients to keep tax possibilities in mind. As a lifetime payment with a COLA, these benefits provide retirement income that is partially tax-exempt at the federal level and in many states. Including other tax-exempt options such as Roth IRAs, or tax-deferred options such as annuities, in their overall retirement income plan, a client can manage their income tax obligations and potentially keep more of their income for their retirement lifestyle.

#### ACTIONS YOU CAN TAKE RIGHT NOW

- **Identify clients who are within three to five years of retirement.**
- **Evaluate claiming strategies using software like Pacific Life's Social Security Analyzer.**
- **Meet with each client to determine and fund a retirement-income strategy.**

## Additional Resources and Links

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[Social Security Tax Calculator](#)

[Social Security Analyzer](#)

[Social Security and Longevity Planning—It's a Match](#)

For more information about retirement planning,  
please contact our Retirement Strategies Group at  
[RSG@PacificLife.com](mailto:RSG@PacificLife.com) or (800) 722-2333, ext. 3939.

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3 of 3

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