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Nationwide Retirement Institute® | Social Security

Minimizing taxes on Social Security benefits

How a diversified approach can help clients

Key takeaways

- Social Security benefits offer tax-advantaged income to retirees throughout retirement.
- Diversifying where clients save can help lessen taxes on Social Security benefits and other income in retirement.
- Demonstrate your value by creating a tax-efficient withdrawal strategy to help clients minimize taxation of Social Security benefits.

2 out of 3 affluent individuals say tax knowledge tops the list of important considerations when selecting a financial adviser.

Your clients may dislike taxes even more now than they did just a few years ago. According to a recent Gallup study, attitudes about federal income taxes in the U.S. are the worst in about 20 years. 6 in 10 Americans think their taxes are too high, according to the study. That's up 6% from 2022 and 15% higher than in 2019.[1]

As a financial professional, this gives you an opportunity to provide a service that's not only critical to your clients' financial success but also highly valued by them: helping to minimize their tax burden. In fact, **2 out of every 3 affluent individuals say tax knowledge tops the list** of important considerations when selecting a financial adviser.[2]

There are a lot of ways to help clients plan for taxes — particularly during retirement. Many investors don't understand that income taxes could be their single largest expense in retirement. You can provide valuable guidance by educating them on this fact and helping them implement strategies to minimize the expense. A great place to start is with the foundation of their retirement income: Social Security benefits.

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Social Security is a tax-advantaged benefit

Ask your pre-retirement clients if Social Security benefits are taxable. Chances are more than a few will say these benefits are 100% tax-free. But, of course, that isn't necessarily the case. Retirees with other income sources — such as pensions, withdrawals from tax-deferred retirement accounts, or from part-time work — may have to pay taxes on a portion of their Social Security benefits.

But there's a silver lining. The federal government can tax only up to 85% of Social Security benefits. So at least **15% of Social Security retirement benefits are always tax-free — for everyone**. That's a potentially significant benefit — one you can help clients feel good about — if you understand how it works.

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How taxes on Social Security benefits are calculated

To help clients minimize taxes on their income in retirement, you'll first need to determine how much of their Social Security benefit may be taxable. The Internal Revenue Service (IRS) uses a taxpayer's provisional income (sometimes called combined income) to determine how much of their Social Security benefits may be subject to federal income tax.

Provisional income is the total of:

50% of Social Security benefits

\+ Tax-exempt interest

\+ The rest of adjusted gross income (AGI)

= **Total provisional income**

Next, the percentage of Social Security benefits subject to federal income tax is determined by provisional income and filing status. You can determine this using the table shown below. Or you can use the **Interactive Tax Assistant at irs.gov**.

Provisional income thresholds determining taxation of Social Security benefits

Single filers; head of household; qualified widower	Married filing jointly	Married filing separately, lived apart all year	Married filing separately, lived together at some point in the year	% of Social Security benefits subject to federal income tax
Equal to or less than $25,000	Equal to or less than $32,000	Equal to or less than $25,000	N/A	0%
$25,001 – $34,000	$32,001 – $44,000	$25,001 – $34,000	N/A	Up to 50%
Over $34,000	Over $44,000	Over $34,000	Over $0	Up to 85%

Source: "Income Taxes and Your Social Security Benefit," Social Security Administration, www-origin.ssa.gov/benefits/retirement/planner/taxes.html.

Case studies: Diversified income sources can reduce tax burdens

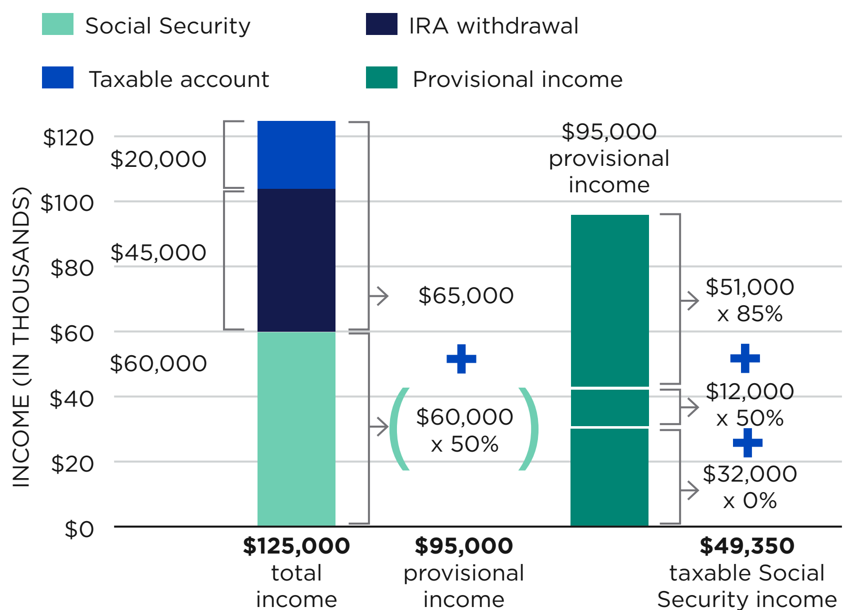
Sources of retirement income can make a big difference in how much of Social Security benefits are taxed (or even if they're taxed at all). Let's look at case studies of 2 retired couples.

Couple 1

Both in their early 70s, married and filing taxes jointly, they want income of just over $10,000 per month ($125,000 per year). Their combined Social Security benefits fulfill about half of that, so they draw from 2 other sources:

$60,000	combined Social Security benefits
$45,000	traditional IRA (ordinary income)
$20,000	taxable account (long-term capital gains)
$125,000	annual pre-tax income

Result: Couple 1's annual provisional income is $95,000, making nearly $50,000 of their $60,000 in total annual benefits taxable.



Couple 2

This pair is also both in their early 70s, married and filing taxes jointly. They too want income of just over $10,000 per month ($125,000 per year). Their combined Social Security benefits fulfill about half of that, and so they draw from 2 other sources:

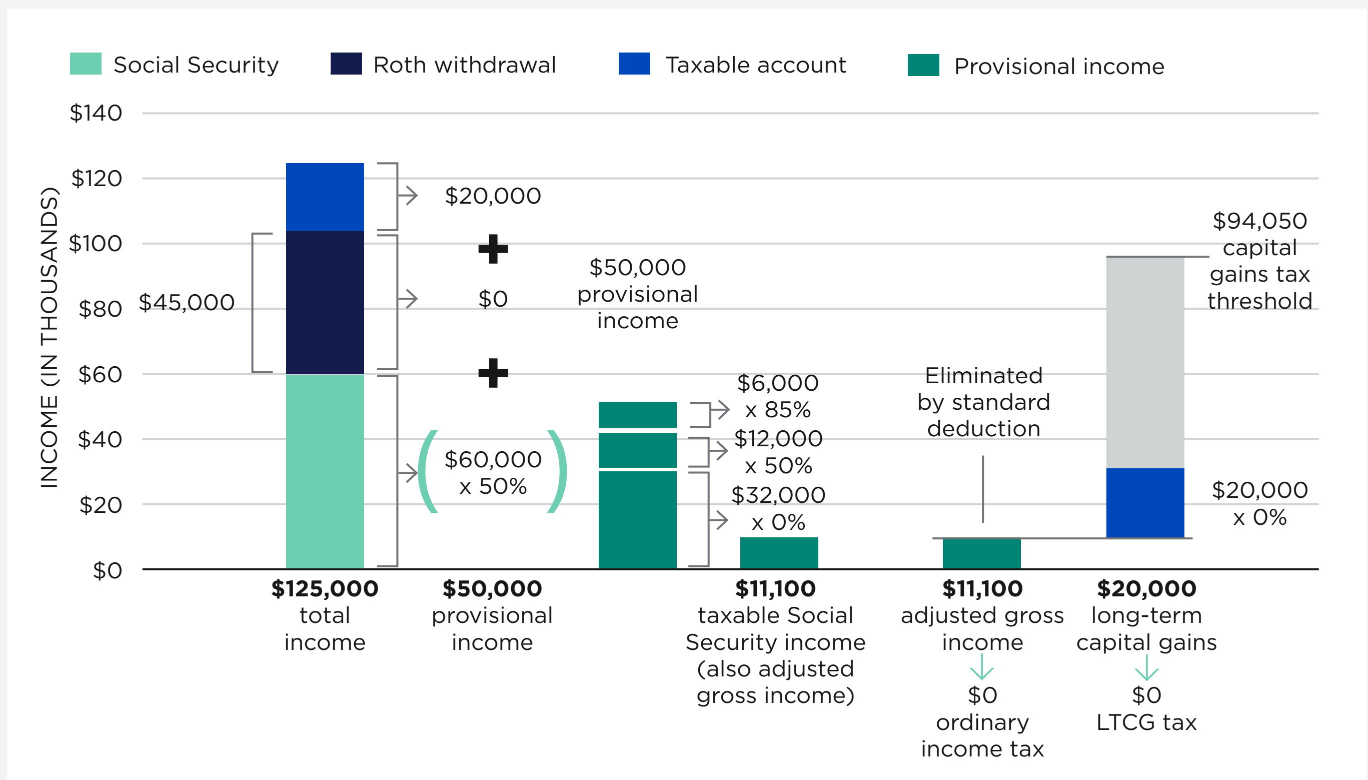
$60,000 combined Social Security benefits

$45,000 Roth IRA (not taxable)

$20,000 taxable account (long-term capital gains)

$125,000 annual income (no income taxes owed)

Result: Couple 2's annual provisional income is $45,000 lower and totaled just $50,000 (50% of their Social Security benefits, or $30,000, plus $20,000 in income from their taxable account). That means their Social Security benefits are roughly 80% tax-free. As a bonus, Couple 2 also owes $0 in long-term capital gains taxes because taxable income remained low enough to keep them in the 0% bracket.



Comparing the 2 couples, we see a significant difference in the amount of Social Security benefits subject to tax.

	Couple 1	Couple 2
	Provisional income	
50% of Social Security benefits	$30,000	$30,000
Tax-deferred accounts: Traditional IRA	$45,000	
Taxable account: long-term capital gains	$20,000	$20,000
Tax-free accounts: Roth IRA and HSA	•	$45,000 (not included in provisional income)
Total Provisional Income	**$95,000**	**$50,000**
Portion of Social Security benefits subject to taxation	**82.25%**	**18.5%**

Tax management strategies

How can you help clients optimize their retirement income sources and mitigate their tax liabilities? It all depends, of course, on each client's needs and goals, but you can keep these strategies in mind as you evaluate options:

- **Consider Roth conversions:** A Roth IRA conversion allows your clients to move money from a traditional IRA into a Roth IRA. While the conversion itself is a taxable event, future withdrawals from the Roth IRA in retirement are tax-free and don't contribute to Social Security provisional income.
- **Regulate withdrawals from taxable and tax-deferred accounts:** By carefully balancing withdrawals from taxable and tax-deferred accounts such as brokerage accounts and traditional IRAs and 401(k)s, you can manage your client's adjusted gross income to keep it below the threshold where Social Security benefits would be taxed.
- **Leverage health savings accounts (HSAs):** HSAs can provide a triple tax benefit. Contributions are tax-deductible, growth is tax-free, and withdrawals for qualified medical expenses are tax-free. After age 65, HSA funds can be withdrawn for any reason without penalty, although income tax applies to non-medical withdrawals. Importantly, tax-free withdrawals don't count toward provisional income.
- **Incorporate tax-efficient investments:** Encourage clients to invest in tax-efficient strategies such as cash-value life insurance or using index funds, ETFs, or tax-managed funds in taxable brokerage accounts. These can help provide income that is either not taxed or taxed at reduced rates — keeping the client's overall income lower and potentially reducing taxes on Social Security benefits.
- **Strategize the timing of Social Security benefits:** For clients who have other income sources, delaying Social Security benefits can sometimes result in larger levels of lifetime benefits and lower overall taxable income earlier in retirement. However, the decision to delay benefits should be balanced against the client's overall financial picture and life expectancy.
- **Plan charitable contributions:** For clients who are charitably inclined, qualified charitable distributions (QCDs) from an IRA can satisfy required minimum distributions (RMDs) while excluding the distribution from income, potentially reducing the tax on Social Security benefits.

3 steps to add value through tax efficiency

Building a combination of taxable, tax-deferred and tax-free retirement income sources creates opportunities for tax-efficient withdrawals — and client satisfaction.

- **Diversify savings to minimize taxes.** Advising pre-retirement clients to diversify their saving and investment vehicles can help them pay significantly less in taxes on Social Security benefits and other income during retirement.
- **Boost clients' portfolio longevity.** Research shows that minimizing one's tax bill can add years to retirement portfolio longevity.[3] This will be critically important as artificial intelligence (AI) and other technologies increase life expectancy.
- **Show clients the savings you generate.** As noted earlier, the majority of affluent investors put tax expertise at the top of their must-have list when selecting a financial professional.

Learn additional strategies to minimize taxes in retirement by reviewing our white paper, ***Withdrawal sequencing strategies that could enhance tax efficiency***, brought to you by the Nationwide Retirement Institute®.

[1] "Americans' Views of Federal Income Taxes Worsen," Gallup, May 19, 2023.
[2] "Build your tax and financial planning advisory services," Association of International Certified Professional Accountants (AICPA & CIMA), accessed July 2, 2023.
[3] "A Tax-Savvy Approach to Help Make the Most of Your Retirement Income," Roger Young, T. Rowe Price insights on Retirement (April 2022).

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Federal income tax laws are complex and subject to change. The information in this white paper is based on current interpretations of the law and is not guaranteed. It should be regarded as educational information on Social Security and is not intended to provide specific advice. If you have questions regarding your particular situation, you should contact the Social Security Administration and/or your legal or tax advisors.

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