

Minnesota's tax treatment of Social Security income

SEAN WILLIAMS

LEGISLATIVE ANALYST, MINNESOTA HOUSE RESEARCH DEPARTMENT

Presentation to the Tax Committee

March 9, 2023

Federal Social Security exclusion

- For all taxpayers, 15% to 100% of Social Security benefits are nontaxable federally.
- Amount of nontaxable benefits varies by income.

| Married Couple's Provisional Income | Single Filer's Provisional Income | Exclusion Percentage |
|-------------------------------------|-----------------------------------|----------------------|
| \$32,000 or less | \$25,000 or less | 100% |
| Tier 1: \$32,000 to \$44,000 | Tier 1: \$25,000 to \$34,000 | 50% |
| Tier 2: \$44,000 or greater | Tier 2: \$34,000 or greater | 15% |

State Social Security subtraction

- Taxpayers may subtract \$5,840 (married joint) or \$4,560 (single) of federally taxable benefits on their state return.
- Phased out, at the following amounts of provisional income:
 - \$88,630 (married joint)
 - \$69,250 (single/head of household)
- Fully phased out at the following amounts of provisional income:
 - \$117,830 (married joint)
 - \$92,050 (single/head of household)
- Forecasted to reduce revenues by **\$92.6 million** in TY 23. 362,900 returns forecast to receive an average benefit of \$255.

Example calculator on House Research website

Social Security Taxation Calculator

This tool estimates state income tax liability for a taxpayer with social security income. It estimates tax liability under current law and shows how this liability would change if Minnesota (1) did not have a subtraction for social security income, and (2) fully exempted social security income from state income tax. For more on Minnesota taxation of social security benefits, see "[Taxation of Social Security Benefits in Minnesota](#)" (or the [publication version](#)).

Income other than SS

30000

Social Security Benefits

39000

Filing Status

Married Joint

| | Current Law | No MN Sub. | Full Exemption |
|---|-------------|------------|----------------|
| Income Other than Social Security | 30,000 | 30,000 | 30,000 |
| Social Security Income | 39,000 | 39,000 | 39,000 |
| Provisional Income | 49,500 | 49,500 | 49,500 |
| SS Benefits Taxable Federally | 10,675 | 10,675 | 10,675 |
| Adjusted Gross Income | 40,675 | 40,675 | 40,675 |
| - Minnesota Standard Deduction | 30,550 | 30,550 | 30,550 |
| - Minnesota Social Security Subtraction | 5,840 | 0 | 10,675 |
| = Minnesota Taxable Income | 4,285 | 10,125 | 0 |
| Minnesota Tax | 229 | 542 | 0 |
| Change in Tax | 0 | 312 | -229 |

Estimates are for tax year 2023, assume taxpayers claim the standard deduction, and are 65 years or older. In 2023, married taxpayers receive an 'additional' standard deduction amount of \$1,450 for each spouse who is 65 or older. Unmarried taxpayers receive an additional standard deduction of \$1,850.

Estimates also assume taxpayers did not have nontaxable income or above-the-line deductions reducing FAGI.

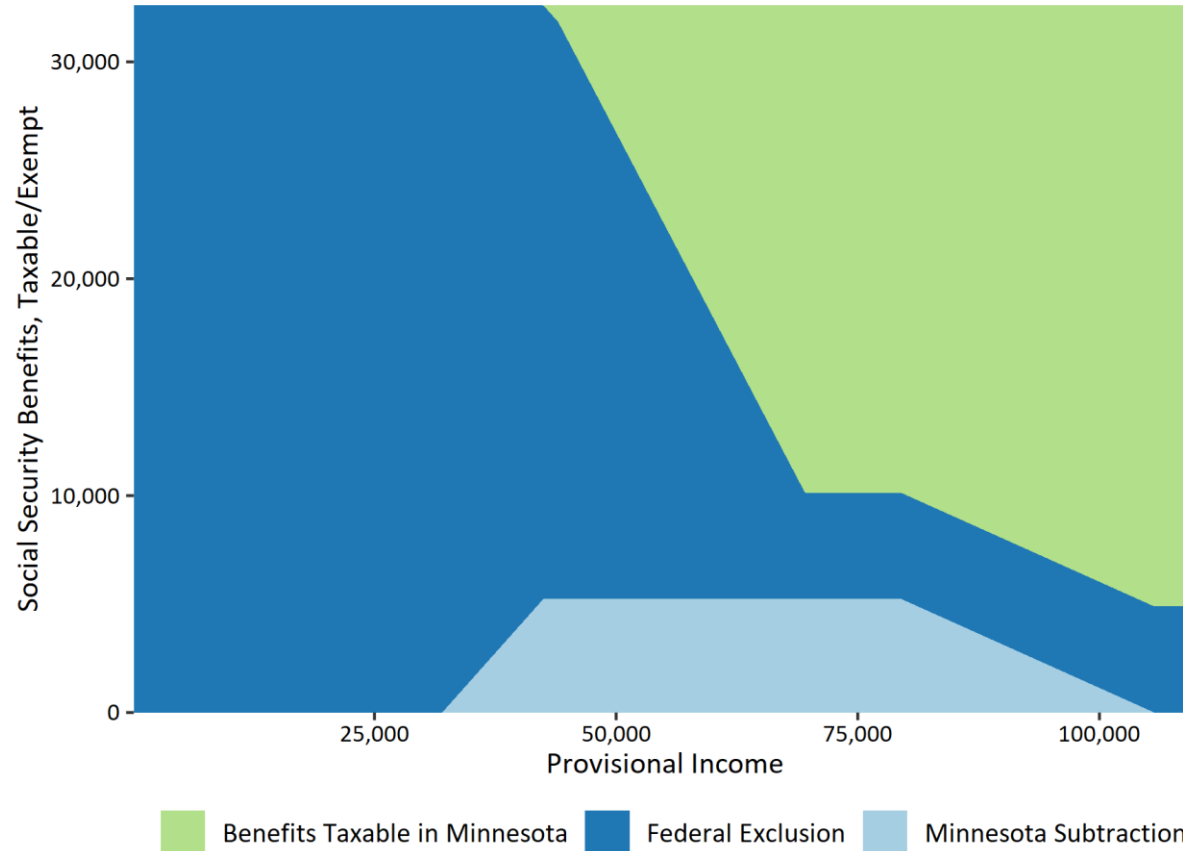
The average OASDI Social Security beneficiary in Minnesota received about \$19,468 in annual benefits as of December 2021, the most recent year for which data is available. (Social Security Statistical Supplement, 2021)

House Research Department, January 2023.

House Research website:
<https://www.house.mn.gov/hrd/socsectax.aspx>

Tax treatment of Social Security

Figure 1: State Tax Treatment of Social Security Benefits
Married Couple with \$32,600 in Benefits, TY 2020



Source: MN House Research Department.

“Provisional income”

- Provisional income is a federal income definition used to calculate the federal Social Security exclusion
- Starts with modified adjusted gross income—for many taxpayers broader than FAGI (includes nontaxable interest)
- Can be lower than FAGI for taxpayers with a large federal exemption for Social security

Provisional Income

= FAGI – Taxable Social Security Benefits + 50% of Social Security Benefits + Nontaxable Interest + Certain "above the line" deductions

Social Security benefits subject to Minnesota income taxes

| | Amount of Benefits (\$1,000) | Percent of All Benefits |
|---|------------------------------|-------------------------|
| Total OASDI benefits in Minnesota | 19,289,208 | 100% |
| - Individuals not filing a return | 4,328,407 | 22.4% |
| = Total benefits reported on 2020 resident income tax returns | 14,960,801 | 77.6% |
| - Federal exclusion | 7,763,582 | 39.8% |
| = Federally taxable benefits | 7,287,219 | 37.8% |
| - Minnesota subtraction | 1,276,784 | 6.6% |
| = Remaining potentially taxable benefits | 6,010,434 | 31.2% |
| - Benefits from taxpayers without state liability | 93,323 | 0.5% |
| = Benefits subject to Minnesota income tax | 5,917,111 | 30.7% |

Total benefits estimate is December 2020 monthly benefits payments, multiplied by 12. Social Security Administration, “Number of Recipients, by state or other area, eligibility category, age, and receipt of ASDI benefits, December 2020.”

Tax Return data compiled by House Research from the 2020 Department of Revenue Tax sample

Households subject to Minnesota income taxes

| | OASDI Social Security Recipients | Percent of Households Receiving Social Security |
|---|----------------------------------|---|
| Total individuals receiving Social Security benefits | 1,069,913 beneficiaries | |
| Estimated total tax households with benefits | 829,200 | 100.0% |
| - Estimated 28% of households w/Social Security that do not file a return | 232,100 | 28% |
| Minnesota resident tax returns with Social Security income | 597,000 | 72.0% |
| - Returns with 100% federal exclusion | 150,200 | 18.1% |
| = Returns with federally taxable Social Security income | 446,900 | 53.9% |
| - Returns where state subtraction wipes out taxable SS | 81,500 | 9.8% |
| = Returns with potentially taxable Social Security income | 365,400 | 44.1% |
| - Returns w/potentially taxable benefits but no state liability | 16,700 | 2.0% |
| = Returns paying state tax on Social Security | 348,700 | 42.0% |

Beneficiaries estimate from December 2020 monthly benefits payments. Social Security Administration, "Number of beneficiaries in current-payment status, by state or other area, type of benefit, and sex of beneficiaries aged 65 or older. December 2020."

Estimate of non-filers from Patrick Purcell, "Income Taxes on Social Security Benefits," Social Security Administration Issue Paper 2015-02, December 2015;

<https://www.ssa.gov/policy/docs/issuepapers/ip2015-02.pdf>.

Tax Return data compiled by House Research from the 2020 Department of Revenue Tax sample

Distributional analysis of taxable benefits

| Adjusted Gross Income (FAGI) | Benefits Taxable in MN (\$1,000) | Share of Total Benefits Taxable in MN | Resident Returns w/MN Taxable Benefits | Share of Resident Returns w/ MN taxable benefits | Resident Returns with Social Security Income | Share of Returns w/Social Security Paying Tax |
|------------------------------|----------------------------------|---------------------------------------|--|--|--|---|
| Less than \$10,000 | 600 | 0.0% | 100 | 0.0% | 104,700 | 0.1% |
| \$10,000 to \$25,000 | 9,700 | 0.2% | 3,900 | 1.1% | 100,700 | 3.9% |
| \$25,000 to \$50,000 | 382,000 | 6.5% | 71,900 | 20.6% | 109,500 | 65.7% |
| \$50,000 to \$75,000 | 1,237,500 | 20.9% | 94,400 | 27.1% | 100,700 | 93.7% |
| \$75,000 to \$100,000 | 1,253,200 | 21.2% | 65,100 | 18.7% | 67,000 | 97.2% |
| \$100,000 to \$150,000 | 1,775,500 | 30.0% | 69,700 | 20.0% | 70,400 | 99.0% |
| \$150,000 to \$200,000 | 548,900 | 9.3% | 19,700 | 5.6% | 19,800 | 99.5% |
| \$200,000 or Greater | 709,700 | 12.0% | 23,900 | 6.9% | 24,000 | 99.6% |
| Total | 5,917,100 | | 348,700 | | 596,800 | 58.4% |

Source: House Research Analysis of the 2020 Department of Revenue Tax sample

Social Security vs. other retirement income

Three tax regimes for retirement income:

- “Traditional” IRA, 401(k), 403(b)
 - Contributions are pre-tax, distributions are taxable
- Roth-style retirement accounts
 - Contributions are after-tax, distributions are tax-free
- Defined benefit pensions and some annuities
 - Some use same structure as traditional or Roth IRAs
 - Some are partly taxable, because a portion of contributions were pre-tax and a portion was after tax.
 - Pension payments are also partly taxable, based on the ratio of after-tax contributions to benefits received.

Social Security financing is similar to defined benefit pensions

Social Security taxes are most similar to some defined benefit pensions. Three sources of funding for Social Security benefits:

- Employee contributions (after-tax, non-deductible)
- Employer contributions (pre-tax deductible to the employer)
- Interest earned in the Social Security trust fund on Treasury Securities.

1993 Social Security changes

- Current federal exemption is designed to mimic the treatment of pension income, where contributions are partially taxable and benefits are partially taxable.
 - 1993 House Budget Committee Report: "The committee desires to more closely conform the income tax treatment of Social Security benefits and private pension benefits by increasing the maximum amount of Social Security benefits included in gross income for certain higher-income beneficiaries."
 - 1993 Omnibus Budget Reconciliation Act added second tier the federal exclusion, subjecting up to 85% of benefits to tax
- 1993 Social Security Actuary study estimated that if we applied pension tax rules to Social Security, the average ratio of taxes paid to benefits was 4-5%.
- The Social Security Actuary estimated that the highest ratio of taxes paid to benefits received was 15% (for single, highly paid males), meaning up 85% of benefits could be taxed without any double taxation. Therefore, Congress decided to tax 85% of benefits above second tier.
- Social Security Actuary has not released an updated analysis, meaning it is unclear if any benefits are currently subject to double taxation.
- The Social Security Administration does say that "almost all Social Security beneficiaries still enjoy more favorable tax treatment of their benefits than is the case for recipients of private pensions." The favorable treatment is due to the 100% and 50% exclusion tiers.

Questions?



Minnesota House Research Department provides nonpartisan legislative, legal, and information services to the Minnesota House of Representatives.

www.house.mn/hrd | 651-296-6753 | State Office Building | St. Paul, MN 55155