DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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The Honorable Arlen Specter
United States Senator
9400 Federal Building
600 Arch Street
Philadelphia, PA 19106

Dear Senator Specter:

I apologize for the delay in responding to your inquiry dated November 27, 2007, on behalf of your constituent, . He objects to the tax treatment of social security benefits and believes that including taxable Individual Retirement Account (IRA) distributions in the calculation of taxable social security benefits is wrong because contributions to IRAs are subject to Federal Insurance Contributions Act (FICA) taxes. As you know, FICA taxes and income taxes are two different types of taxes. Thus, even though FICA has already been applied at the time the IRA contributions were made, the inclusion of IRA distributions in the calculation of the amount of social security benefits subject to income taxation does not result in any sort of double taxation insofar as each type of tax is imposed only once. I am providing the following information to assist you in your response to .

Section 86 of the Internal Revenue Code

The Social Security Amendments Act of 1983 added section 86 to the Internal Revenue Code (the Code) and the Omnibus Budget Reconciliation Act of 1993 amended it. As a general rule, if the only source of a recipient's income is social security benefits, then those benefits are not subject to income tax. However, a portion of social security benefits may be taxable if the recipient receives other income in addition to social security benefits. Where the total income exceeds certain amounts, a part of the social security benefits is taxable.

Tax Treatment of Individual Retirement Accounts

An IRA is a trust or custodial account that a taxpayer can set up for the exclusive benefit of the taxpayer or his beneficiaries. A taxpayer can set up and make contributions to a traditional IRA if the taxpayer received taxable compensation during the year.

Generally, compensation is what a taxpayer earns from working, including salaries, tips, professional fees, bonuses, and other amounts received for providing personal services. If the amounts a taxpayer contributes to an IRA are remuneration for employment, then those amounts are considered wages for purposes of the taxes imposed under the Federal Insurance Contributions Act (FICA). Generally, the law requires an employer to withhold FICA taxes from all wages paid to an employee.

A taxpayer may be able to take an income tax deduction for some or all of his contributions to a traditional IRA. An IRA must make minimum required distributions generally when the owner becomes age 70-1/2. If a taxpayer's traditional IRA includes only deductible contributions, all amounts distributed from the IRA are includable in gross income and taxable in the year distributed. Thus, an IRA distribution is generally included in the taxpayer's adjusted gross income when determining the taxable amount of social security benefits. However, contributions to a traditional IRA that are nondeductible are not included in the taxpayer's gross income in the year distributed and thus, are not included in the taxpayer's adjusted gross income when determining the taxable amount of social security benefits. Thus, a taxpayer's contributions to a traditional IRA are taxed only once for income tax purposes, either in the year the taxpayer makes the contribution (nondeductible contribution) or upon distribution from the plan (deductible contribution).

Taxable Amount of Social Security Benefits Under Section 86

Only a portion of the social security benefits a taxpayer receives is includible in gross income and is subject to federal income tax, if the recipient's modified adjusted gross income and one-half of the social security benefits received exceed certain threshold levels [section 86]. If a taxpayer is married and files a joint return, the taxpayer and his or her spouse must combine their income and social security benefits in deciding if any part of their combined benefits is taxable. This rule applies even if one spouse did not receive social security benefits.

The phased-in method for taxing social security benefits under section 86 assures that only taxpayers who have substantial income from other sources will be taxed on a portion of the benefits they receive. Under section 86, the taxable portion of social security benefits depends on the benefit amount, the amount of other income, and the filing status. To determine if social security benefits are subject to income tax and, if so, the amount subject to tax, the taxpayer must first determine the taxpayer's adjusted gross income. Generally, the lower a person's adjusted gross income, the lower the portion of social security benefits, if any, that will be taxed.

Distinction Between FICA Taxation and Income Taxation

is correct that any wage amounts contributed to an IRA are subjected to FICA taxes prior to contribution to the IRA. Wages are subject to FICA taxes when paid by the employer and are subject to income taxes either when contributed to a traditional IRA (nondeductible contribution) or when distributed from a traditional IRA (deductible contribution). Distributions from a traditional IRA are not subject to FICA taxes regardless of whether the distribution is taxable or nontaxable.

The social security program imposes FICA taxes on wages paid for employment in order to fund the social security benefits which replace the income of beneficiaries when that income is reduced on account of retirement and disability. Income taxes and FICA taxes are two separate and distinct types of taxes with significantly different objectives. Social security benefits are never subject to FICA tax and are subject to income tax in accordance with the provisions of section 86. Thus, the imposition of FICA taxes on amounts contributed to an IRA does not justify the exclusion of IRA distributions attributable to such amounts when determining the taxability of social security benefits.

I have enclosed a copy of *Publication 915, Social Security and Equivalent Railroad Retirement Benefits*, which provides more detailed information on the income tax rules for social security benefits.

Under the Freedom of Information Act, we will make this letter available to the public after we delete names, addresses, and other identifying information.

I hope this information is helpful. As you requested, I am replying in duplicate and returning your enclosure. If we can be of further assistance, please contact me or of my staff at ( ) .

Sincerely,

Nancy J. Marks
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)