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[REDACTED]

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This letter is in response to your inquiry, dated March 16, 2001, on behalf of your constituent, [REDACTED]. Your constituent believes minimum required section 401(k) and individual retirement account (IRA) distributions should be excluded from "provisional income." Provisional income is an amount used to determine if social security benefits are taxable.

Income Tax Treatment of Social Security Benefits

The income tax treatment of social security benefits is governed by section 86 of the Internal Revenue Code (the Code).

Prior to 1983, social security benefits were not subject to income tax. The legislative history of section 86 states that it was enacted because Congress believed the prior policy of excluding all social security benefits from a recipient's gross income was inappropriate. Social security benefits are similar to benefits received under other retirement systems, which are subject to taxation to the extent they exceed a worker's after-tax contributions. Consequently, taxing a portion of social security benefits improves tax equity by treating more nearly equally, all forms of retirement and other income designed to replace lost wages (for example, unemployment compensation and sick pay). See S. Rep. No. 98-23, 98th Cong., 1st Sess. 25 (1983), 1983-2 C.B. 326, 328.

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.

Income Tax Treatment of Section 401(k) and IRA Distributions

A qualified plan (including a cash or deferred arrangement under section 401(k)) or an IRA must make minimum required distributions generally when the participant or owner becomes age 70-1/2. The amount must be distributed annually over the life expectancy or joint life expectancies of the participant or owner and designated beneficiary(ies). The minimum required distribution must begin no later than April 1 of the year following the year in which the participant or owner becomes age 70-1/2. Amounts distributed from a qualified plan or IRA are includable in gross income and taxable in the year distributed. Thus, a section 401(k) or an IRA distribution is included in the taxpayer's adjusted gross income when determining the taxable amount of social security benefits.

Calculation of Modified Adjusted Gross Income

Taxpayers must calculate their modified adjusted gross income to determine if social security benefits are subject to tax [section 86(b)(2)]. "Modified adjusted gross income" is determined by adding to the taxpayer's adjusted gross income:

- (1) Any exclusions for income on savings bonds used to pay higher education expenses under section 135,
- (2) Any exclusions for amounts paid under an adoption assistance program of the employer under section 137,
- (3) Any deductions for interest on qualified educational loans under section 221,
- (4) Any exclusions applicable to citizens or residents of the United States living aboard under section 911,
- (5) Any exclusions for income from sources within possessions of the United States under section 931,
- (6) Any exclusions for income from sources within Puerto Rico under section 933, and
- (7) Any tax-exempt interest received or accrued by the taxpayer during the taxable year.

Taxable Amount of Social Security Benefits

A portion of the social security benefits a taxpayer receives is includable 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 exceeds certain threshold levels [section 86]. The term "provisional income" describes the sum of modified adjusted gross income and one-half of the social security benefits received. The term "provisional income" is not defined in the Code but is referred to in the legislative history

of section 86. See H. Rep. No. 103-111, 103d Cong., 1st Sess. 654 (1993), 1993-3 C.B. 167, 230.

Under section 86, married taxpayers filing jointly with provisional income above \$44,000 include up to 85 percent of social security benefits in income. Married taxpayers filing jointly with provisional income above \$34,000, but not above \$44,000, include up to 50 percent of social security benefits in income.

Your constituent is correct about increases in other income (for example, an IRA distribution) leading to higher effective tax rates on social security benefits. Because the federal income tax is a progressive tax, successively higher rates apply to incremental amounts of income.

To exclude section 401(k) and IRA distributions from provisional income would require more than a change in the form instructions for Form 1040, U.S. Individual Income Tax Return, as your constituent suggests. This exclusion would require legislative action. In determining provisional income, the only modifications allowed to adjusted gross income are those in section 86 (listed above).

I enclosed a copy of Publication 915, Social Security and Equivalent Railroad Retirement Benefits, which provides 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. If you have further questions, please call me or Margaret A. Owens (ID# 50-05478) of my staff at (202) 622-6040.

Sincerely,

Will E. McLeod
Acting Chief, Employment Tax Branch 1
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(Tax Exempt & Government Entities)

Enclosure