

INTERNAL REVENUE SERVICE

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The Honorable John Cornyn
United States Senator
Occidental Tower
5005 LBJ Freeway, Suite 1150,
Dallas, TX 75244

Attention: Aaron Christian

Dear Senator Cornyn:

This letter responds to your inquiry dated February 7, 2005, on behalf of your constituent, . He believes the tax code discriminates against senior citizens over age 65 because they must include tax-exempt bond interest when determining taxable social security benefits. As a result, senior citizens have to pay more income tax or receive a lower income tax refund.

may be referring to the rules under section 86 of the Internal Revenue Code (the Code). The Congress enacted this provision in 1983 as part of the Social Security Amendments of 1983, Pub.L. 98-21. Subject to certain limitations, this provision taxed social security benefits above a certain base amount up to a maximum of one-half of the taxpayer's total social security benefit. The Omnibus Budget Reconciliation Act of 1993 (OBRA), Pub.L. 103-66, amended section 86 of the Code for 1994 and later years, by taxing up to 85 percent of the taxpayer's social security benefit after applying certain limitation amounts.

The taxable amount of social security benefits depends on whether the recipient has income from other sources. The law takes into account income from other sources such as tax-exempt interest when determining the amount of social security benefits taxed. It does not convert the tax on social security benefits into a tax on the tax-exempt interest. For example, if the taxpayer's adjusted gross income (as modified under section 86 of the Code) does not exceed the base amount, then no portion of the social security benefits is taxable despite inclusion of the tax-exempt interest. Also, once the taxpayer reaches the maximum amount of social security benefits subject to tax, any additional tax-exempt

interest does not increase the amount of tax. I am enclosing two court opinions that support this interpretation of the law.

I hope this information is helpful. If you have additional questions, please call me or _____ of my staff at (202) 622-0047.

Sincerely,

Janine Cook
Chief, Employment Tax Branch 1
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Governmental Entities)

Enclosures (2)