



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

August 7, 2009

Number: **INFO 2009-0160**
Release Date: 9/25/2009

CONEX-132964-09

UIL 86.01-03

The Honorable John Cornyn
United States Senator
Providence Towers
5001 Spring Valley Road, Suite 1125E
Dallas, TX 75244

Attention:

Dear Senator Cornyn:

This letter responds to your inquiry dated July 10, 2009, on behalf of your constituent, asked about the inclusion of municipal bond tax-exempt interest in determining the amount of his taxable social security benefits.

Gross income may include a portion of social security benefits [section 86(a)(1) of the Internal Revenue Code]. 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, if in addition to social security benefits the recipient receives other income, then a portion of social security benefits may be taxable. Where the total income exceeds certain amounts, a part of the social security benefits are taxable. This practice assures that lower-income individuals, who rely on their benefits to afford basic necessities, are not taxed on their benefits and that individuals who have substantial taxable income from other sources are taxed on a portion of their benefits.

Taxpayers must calculate their modified adjusted gross income to determine if social security benefits are taxable [section 86(b)(2) of the Internal Revenue Code]. They must include tax-exempt interest in modified adjusted gross income when calculating the amount of taxable social security benefits. Although tax-exempt interest is not itself taxable, it can cause the taxation of additional social security benefits because the interest is added to adjusted gross income to form a larger modified adjusted gross income.

As the Congress explained in the legislative history when it enacted section 86, the law does not affect the exclusion from income for interest on tax-exempt obligations. It merely requires the inclusion of tax-exempt interest in adjusted gross income when determining the amount of taxable social security benefits. [Senate Report No. 98-23, 98th Congress, 1st Sess. 25, 27 (1983), 1983-2 Cumulative Bulletin 326, 328].

I hope this information is helpful. If you would like to discuss this further, please contact
or me at () .

Sincerely,

Michael Swim
Senior Technician Reviewer
Employment Tax Branch 1
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt & Government Entities)