

IMPORTANT INFORMATION ABOUT WORK INCENTIVES, INCOME TAX IMPLICATIONS AND REJECTING MEDICARE PART B COVERAGE

KEY WORK INCENTIVES

Many people are afraid to try to work for fear that they will immediately lose their benefits. The Social Security Act has several work incentives. Below is an explanation of some of the important ones and how they work together?

The Social Security Act guarantees the right to try to work without losing benefits. The most important of the work incentives are the ***“Trial Work Period” (TWP)***, the ***“Extended Period of Eligibility” (EPE)***, and ***Medicare continuation***.

- **TWP:** Your TWP protection begins with the month in which you become entitled to cash benefits. Under the TWP rules, you will receive your full benefits for you and your family for at least nine months, regardless of your earnings level. These nine months do not have to be consecutive, and SSA will ignore work you did more than five years ago when counting the nine months.

To count as one of the nine months, your earnings for the month must be at least \$720 (for 2011 and 2010, up from \$700 for 2009 and \$670 for 2008) gross wages (for employees) or \$720 net earnings (for the self-employed)(for 2011 and 2010, up from \$700 for 2009 and \$670 for 2008). A month also counts toward the TWP if the total time spent in the business exceeds 80 hours, even if the net earnings for the month are below \$720.

After the ninth month of trial work, and assuming your work continues, SSA pays benefits for the next three months, again regardless of your earnings level. This is called the “grace period.” Once these grace benefits are paid, an important benefit protection remains: the “Extended Period of Eligibility” (EPE).

- **EPE.** The EPE is a period of 36 months beginning immediately after the ninth month of trial work. Benefits for you and your family are reinstated at the full amount during the EPE for any month in which your work activity either stops or fall below a level called “substantial gainful activity” (SGA).

Work is generally considered to be SGA if your gross wages from employment (or your net earnings from self employment) are \$1000 (for 2011 and 2010, up from \$980 for 2009 and \$940 for 2008) or more per month. When deciding if your work is SGA, SSA will deduct from your gross earnings the cost of any items and services you need in order to keep working despite your disability.

Note that benefits can resume and stop any number of times during the EPE. Once the EPE ends, cash benefits will continue indefinitely if you are not working at the SGA level. However, even **one month** of earnings over \$1000 after the EPE will cause your disability claim to terminate.

- **Medicare Continuation.** Medicare health insurance coverage for the disabled begins on the second anniversary of your cash benefits. After you complete the ninth month of your TWP, most people will remain eligible for low-premium Medicare for **at least** the following 93 months, **assuming your medical disability continues**, even if you are working at the SGA level. You may also be eligible to buy Medicare coverage after returning to work

(sometimes with State assistance if you are low income and of limited resources) if you are not yet age 65, you continue to have a disabling impairment, and your Medicare stopped due to work.

- **Continuing Disability Reviews.** The three main work incentives (the TWP, the EPE and Medicare continuation) all depend on one added factor: SSA must agree that your medical impairments remain at the potentially disabling severity. SSA is required to review your continuing disability from time to time. If medical improvements allow you to resume work, your benefits may end even if you have not received the full advantage of the three work incentives.
- **Vocational Rehabilitation Protection.** If you participate in a Vocational Rehabilitation Program which is approved by SSA and you medically recover while in that program, your benefits will still continue until you complete the Program.

SOCIAL SECURITY BENEFITS AND INCOME TAX

A question often asked is the tax implications of the receipt of SS benefits, how does a tax preparer handle the retroactive lump sum resulting from a disability appeal, and how much of an ongoing Social Security benefit is subject to income tax? What about the attorney fee--is it deductible? Some clients owe most of the Social Security lump sum to a long-term disability carrier; how do they avoid double taxation?

To get answers for these questions you need to speak with a tax professional. I do want to share some general information with you. Please make certain to review this information with a tax professional as it is only meant as general guidance and not meant as specific advice for your situation.

Lowering the tax impact of a lump sum:

Congress has provided a special election allowing a client to take advantage of the tax-exempt base amount for each of the retroactive years represented in a Social Security lump sum. [I.R. Code §86(e); see I.R.S. Publications 915] In most cases, this special election will be desirable, because it enables you to offset the lump sum with a multiple of base amounts, described below. Also, the election removes the need to amend prior tax returns.

Social Security is required to send each benefit recipient an SSA-1099 by February 1 of the following year, specifying how much of the Social Security benefit received in the lump sum was really a payment for some prior year or years. The 1099 also lists the attorney fee. These SSA-1099 forms are often inaccurate, and you must use the award notices to double check the 1099.

Income tax on Social Security benefits.

Federal income tax on Social Security has become a complicated topic thanks to changes in the law. This section is likely to be common knowledge for any tax professional, but the basics are set out here. Social Security disability benefits and retirement benefits are treated the same for income tax purposes.

The Basic Rule: Up to 50% of Social Security benefits are taxable if total "provisional income" (pensions, wages, tax-exempt interest and on half of Social Security benefits) exceeds a base amount: \$25,000 for single tax payers and \$32,000 for married taxpayers filing jointly. At this level, taxes are payable on the lesser of (1) 50% of Social Security benefits received, or (2) one half of the difference between provisional income and the

applicable base amount. Fortunately, this is the end of the taxation story for most recipients of disability benefits.

The Second Tier: A second tier of income tax - reaching up to 85% of Social Security benefits received - kicks in (1) for single taxpayers with provisional income over \$34,000, (2) for married taxpayers filing jointly with provisional income over \$44,000, and (3) for married taxpayers who file separate returns, but do not live apart. The formula to compute income tax for second-tier beneficiaries is complex and beyond the scope of the information I can provide you, but seldom applies to recipients of Social Security disability benefits.

Deductions for the Self-Employed. Since the self-employed pay all of their Social Security and Medicare taxes, these workers receive a Social Security tax deduction and an income tax deduction at tax time, designed to achieve parity with the employed, who do not pay FICA or income tax on the value of the employer's FICA tax payment. For the Social Security tax deduction, the self-employed deduct 7.65% of net earnings before computing the tax at 15.3%. For the income tax deduction, 50% of the net social security tax liability (after applying the Social Security tax deduction above) is deducted from gross earnings as a business expense.

Attorney fee deduction. If you discover that some of the Social Security lump sum - when added to regular benefits received in the same year - turns out to be taxable, the attorney fee may be deducted from income, but only to the same extent that Social security is taxed. For example, if you paid on 50% of SSA benefits received, you may deduct half of the attorney fee paid or incurred during the same year. [IRS Revenue Ruling 87-102] Even this limited deduction is further subject to the "2% of adjusted gross income" ceiling on miscellaneous itemized deductions.

Worker's Compensation offset. Social Security income may be reduced for worker's compensation and other public disability benefits. Unfortunately, the amounts deducted are included as benefits received for purposes of income tax. [I.R. Code §86(d)(3)]

Auxiliary [child/spouse] benefits. Benefits are included in the taxable income of the person who has the legal right to receive them. For example, a child's benefits are added to the *child's* other income (if any) to determine taxability, even though the benefits are paid on the parent's earnings records. The child receives a separate SSA-1099.

LTD reimbursement. What if you used all or part of a Social Security back payment to reimburse a long-term disability carrier? Special tax relief is available under §1341 of the Internal Revenue Code, again avoiding the need to amend a prior tax return. See IRS Publication 525. If the repayment to the LTD carrier is under \$3,000, you get a deduction on the current year's tax return. For repayments over \$3,000 you may choose either the deduction or a tax credit for the excess tax paid in the prior year. LTD reimbursements may also cause "phantom" taxable income in some cases due to the separate 1099 forms completed for the year by SSA and the carrier. You will need to discuss this with your tax professional.

Tax Liens and Social Security. To collect delinquent taxes, the IRS is authorized by the Taxpayer Relief Act of 1997 to impose an administrative offset against disability or retirement benefits. 26 USC 6334(c). The offset provision applies to delinquent income taxes, corporate withholding and FICA withholding falling within the 10-year look back range of the law.

The collection is 15% per month, with no income exemptions or set asides. There are no collections from children's benefits, from benefits already being reduced to collect a Social Security overpayment, or from SSI benefits.

For concurrent (Social Security and SSI) beneficiaries, 15% of the Social Security benefit will be taken, with no corresponding increase in SSI for the month. Couples jointly liable for a tax debt will lose 30% of their Social Security income during the collection period.

Note that beneficiaries do have the right to appeal the accuracy of the debt, to offer a compromise lump sum, to request repayment at a slower rate, and to seek a hardship exemption. These rights are administered by the IRS, not Social Security. Debt collection activity should stop while the beneficiary seeks this relief.

The elderly and disabled incur income tax liability from a surprising array of sources, including self-employment efforts, the taxable portion of Social Security benefits as detailed above, emergency withdrawals from IRAs, gains from the early and unplanned sale of investments, and damage awards that include lost wages. The vast majority of this population incurred the tax liability unexpectedly, and without adequate resources to cover the debt. These beneficiaries now face the loss of critical Social Security income through a tax lien, and affected individuals should be encouraged to contact the Taxpayer Advocate Service, a remarkably helpful and independent entity within the IRS: 1-877-777-4778 (toll free), or www.irs.gov/advocate.

MEDICARE PART B: THE OPTION TO REJECT PREMIUM COVERAGE

Many clients ask about rejecting Medicare Part B (SMIB), to avoid the monthly premium. They tell me that they have comprehensive health coverage - typically to age 65 - either through an employer's group health plan or through membership in a large group health plan. **As a general rule my advice is: (1) the risks of rejecting SMIB exceed its modest cost, and (2) SMIB should be accepted to keep as many "safety nets" as possible.**

For disability applicants qualifying for Medicare in the 25th month of benefits, Social Security will process an automatic SMIB enrollment during the "initial enrollment period" (IEP). The IEP is a 7-month window extending 3 months before and 3 months after the 25th month of disability benefits. The applicant can reject SMIB at any time during the IEP, typically by signing a rejection statement on the back of the health insurance identification card and returning the card to the agency.

The SMIB "general enrollment period" (GEP) occurs each year, from January through March, for those who failed to enroll during the IEP, or whose enrollment has terminated for other reasons such as non-payment of premiums. The GEP has two important warnings. First, SMIB coverage does not begin until July 1, the fourth month after the end of the GEP. Second, there is a 10% premium increase for each period of 12 full calendar months of voluntary SMIB rejection.

Note that your private carrier plan may REQUIRE acceptance of the earliest possible SMIB enrollment, or may covert the private plan involuntarily to a Medicare supplement plan - leaving you with inadequate health coverage. I therefore urge you to review all of these factors VERY carefully before deciding to reject SMIB.

SCHIFFMAN LAW OFFICE, P.C.
4506 N. 12TH STREET
PHOENIX, AZ 85014
TEL.: 602-266-2667 TOLL FREE: 800-545-7372