Unexpected taxes can hurt seniors who work longer: Kotlikoff

By Editorial Staff *Thu, Sep 29, 2016*

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People who have earned income and take Social Security benefits can face unexpectedly high tax rates on their earnings, according to Boston University economist, software maker and presidential candidate Larry Kotlikoff.

"Senior workers earning an average income can easily lose more than half of their earnings to higher taxes and reduced government benefits," said Kotlikoff, in a press release. "In some cases, workers can lose 95 cents out of each dollar they earn."

Kotlikoff, a senior fellow at the Goodman Institute, studied the tax impact of working in one's 60s with University of California at Berkeley economist Alan Auerbach and two co-authors. The Sloan Foundation funded the **study**.

The economist analyzed penalties for working that can arise from some 30 major federal and state tax and transfer programs. The economists also consider how the additional earnings could affect future taxes and transfers. They summarize the financial impact in what they call the worker's "lifetime marginal net tax rate."

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The study shows how the Social Security System penalizes working:

- Beyond a certain income level, early retirees from age 62 to the year they turn 66 lose 50 cents of Social Security benefits for each dollar they earn—a 50% tax rate.
- From Jan. 1st in the year in which they turn 66 until their 66th birthday, they lose 33 cents of benefits for each dollar of wages—a 33% tax rate. These taxes are in addition to income, payroll and other taxes.

Though government begins adding the benefit reduction back once the worker reaches the normal retirement age, many seniors don't realize that or don't understand it, so the reductions may discourage them from working.

"If we abolished these 'earning penalties' the government would probably be a net winner.

Seniors would work more and earn more and the other taxes they pay would more than make up for any short term revenue loss," said Kotlikoff.

Another impediment to work is the Social Security benefits tax, he said:

Beyond a certain threshold, seniors must pay income taxes on 50 cents of Social Security benefits for each dollar they earn – increasing their marginal tax rate by 50%. After a certain point, they must pay income taxes on 85 cents of Social Security benefits for each dollar they earn – increasing their marginal tax rate by 85%.

When the Social Security benefits tax is added to the earnings penalty, the tax rate on moderate-income seniors can reach 95%, Kotlikoff said in a release. For someone in the 15% bracket for ordinary income, the Social Security benefits tax can increase the tax rate on pension income and IRA withdrawals to 27.75%, and raise the tax on capital gains and dividend income from zero to 12.75%. Even tax-exempt income can be taxed at a rate of 12.75%.

"These high marginal tax rates only hit in the middle of the income ladder. They don't affect the work incentives of the rich or the poor," said Kotlikoff. "However, the loss of the Earned Income Tax Credit and the potential loss of Medicaid and other entitlement benefits create high marginal tax rates for low income workers in other ways."