



VERMONT LEGISLATIVE
Joint Fiscal Office

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Issue Brief

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Vermont Taxation of Social Security Benefits

Executive Summary

The number of Vermonters and the amount of tax the State of Vermont collects from Social Security benefits have grown significantly over the past 10 years. As in many other states, much of the Social Security income received by those recipients is already exempt from Vermont income taxes. Vermonters receiving Social Security with incomes below \$50,000 pay little to no Vermont tax on their benefits.

What is Social Security?

While many think of Social Security as a social insurance program that provides a benefit to those who have retired, Social Security's more formal name is the Old Age, Survivors, and Disability Insurance program (OASDI). The program pays benefits to retirees, disabled people, and survivors as well as to the dependents of those recipients, including spouses and children. The program is funded through a payroll tax on their wages and salaries. Employed individuals and their employers each pay 6.2 percent of wages while the self-employed pay 12.4 percent of wages.

To receive retirement benefits, an individual must have worked at least 40 quarters (10 years), earning at least a threshold amount in each quarter. They must be age 62 or older to receive any benefits. To receive "full" benefits, an individual must claim benefits at their full retirement age, currently between ages 66 and 67. If they retire before their full retirement age, the benefit is reduced; enhanced benefits are paid to those who claim after their full retirement age.

To receive disability benefits, an individual must first qualify as disabled, defined as being mentally or physically unable to perform gainful work for at least 12 months. In addition, they must have worked some number of quarters, depending on age. Generally, this is 10 years of work but is less for younger workers.

Family members of Social Security beneficiaries may also be eligible for survivor benefits. Eligible survivors include but are not limited to the widow/widower, unmarried children under the age of eighteen, older disabled children, and dependent parents. The benefits a survivor receives are based upon the benefits of the deceased individual, but also on other factors. For instance, the

benefits for surviving spouses are 100 percent if the widow/widower is at full retirement age. For minor children, generally the benefit is 75 percent of the deceased’s benefit.

Taxation of Social Security Income

Vermont taxes on all types of Social Security income depend upon a taxpayer’s income. Vermonters with Social Security income benefit from two tax benefits:

An exemption of a portion of the benefits from taxation at the federal level,

A further Vermont-specific exemption on top of that federal exemption.

At the federal level, only a portion of total Social Security benefits are included in total income and Adjusted Gross Income (AGI) for tax purposes. The first 15 percent of benefits are nontaxable for everyone. For taxpayers with low incomes, 100 percent of benefits are exempt (see table below).

How much is exempt federally depends upon the taxpayer’s “combined income.” Combined income is defined as the sum of wages, self-employment income, interest, dividends, nontaxable interest, and one-half of their Social Security benefits. The percentage of benefits that is subject to the federal income tax is shown in the table below.

| Federal Tax Exemption for Social Security Benefits | | |
|---|-------------------------------------|--|
| Combined Income | | |
| Single Filer | Married Filer Filing Jointly | Share of Social Security Benefits that are Exempt |
| <\$25,000 | <\$32,000 | 100% exempt |
| \$25,001-\$34,000 | \$32,001-\$44,000 | At least 50% exempt |
| \$34,001 and over | \$44,001 and over | At least 15% and up to 50% exempt |

Because Vermont uses AGI as its starting point for state income tax calculations, Social Security benefits that are taxed at the federal level are included in the state taxable income base. This also means the tax exemption at the Federal level flows through to Vermont. In other words, even without a Vermont-specific exemption, all Vermonters that receive Social Security payments benefit from a federal and Vermont tax exemption of at least 15% of their benefits. For beneficiaries with lower incomes, and especially those relying primarily on Social Security for their income, all or most Social Security benefits are exempt from federal and Vermont taxation, even in the absence of a Vermont-specific exemption.

In addition to this, Vermont passed Act 11 in 2018, which fully exempted Social Security benefits from taxation for single filers with AGI below \$45,000 and married filers below \$60,000. Over the next \$10,000 of income, the exemption is phased out. As a result, single taxpayers with incomes above \$55,000 and married taxpayers with incomes above \$70,000 do not receive any Vermont-specific exemption but still benefit from the Federal exemption that flows to Vermont which is at least 15 percent of benefits.

Data on Vermont Taxes on Social Security Income

Based upon data from the Social Security Administration, as of 2020, there were 156,005 recipients of Social Security benefit payments in Vermont. This is about 25 percent of the total population, the third highest share in the country after West Virginia and Maine. A total of \$225.2 million in benefits were paid in 2020, which was 28 percent higher than 2015.

The number of beneficiaries and benefits paid are growing quickly as a result of a couple of factors. First, Vermont’s population is aging, adding more beneficiaries. Second, the size of benefits grows with each new cohort of retirees every year. Benefits are tied to an individual’s wages over their working career. As a result, newer retirees have larger benefits because wages on average grow with inflation and the economy over time.

One example of the growth in benefits can be seen looking at tax years¹ from 2013 to 2022 – the amount of tax collected doubled in 10 years even with the additional Vermont exemption added in 2018. According to 2013 tax year data, JFO estimated that Vermont collected \$29.7 million² from Social Security benefits. For tax year 2022, JFO estimates that Vermont will collect \$60.3 million in personal income tax revenues on Social Security benefits; \$58.3 million of this is from resident Vermont tax returns.

JFO estimates that 79,962 tax returns report Social Security benefits. However, only 41,161 of these paid any tax on their Social Security. As Table 1 shows, tax filers with Social Security benefits and AGI below \$50,000, which represent almost half of the total population of Social Security recipients, paid zero or very minimal tax on their Social Security income. As noted above, taxpayers who rely heavily on Social Security for their income are likely not paying any tax on their benefits in Vermont.

For the other half of tax returns that do pay tax on their Social Security income, the average tax paid on Social Security benefits is \$1,434. This is due to the rapid phase-out of the Vermont exemption and Vermont’s progressive tax rate structure.

| Income Group | Tax Returns Collecting Social Security | Total Tax Paid on Social Security (in millions) | Average Tax Paid on Social Security Benefits |
|--------------|--|---|--|
| Negative | \$25,000 | 27,282 | \$0.00 |
| \$25,000 | \$40,000 | 7,628 | \$0.00 |
| \$40,000 | \$50,000 | 4,460 | \$0.09 |
| \$50,000 | \$75,000 | 10,995 | \$5.04 |
| \$75,000 | \$100,000 | 9,081 | \$9.14 |
| \$100,000 | \$125,000 | 6,617 | \$10.37 |
| \$125,000 | \$150,000 | 4,345 | \$9.32 |
| \$150,000 | \$200,000 | 4,414 | \$8.13 |
| \$200,000 | \$300,000 | 3,010 | \$8.17 |
| \$300,000 | Infinity | 2,130 | \$8.06 |
| Total | | 79,962 | \$58.3 |
| | | | \$729 |

¹ Defined as January to December in a given year

² JFO published an Issue Brief on Social Security benefits in 2016:

https://jfo.vermont.gov/assets/docs/issue_briefs_and_memos/315cdd1b60/2016-10-Social-Security-Benefits.pdf

Taxation of Social Security Income in Other States

Thirty-seven states either have no state income tax or fully exempt Social Security benefits from their income tax. Vermont is one of thirteen states that partially tax Social Security benefits. A majority of states that offer a partial exemption offer a full exemption depending upon a taxpayer's income and, in some cases, age (Tables 2 and 3).

| Table 2: States with Full Exemptions on Social Security or No Income Tax | |
|--|--|
| Exemption Type | States |
| No State Income Tax | Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Washington, Wyoming, New Hampshire |
| Full Exemption or Not Included in Tax Base | Alabama, Arizona, Arkansas, California, Delaware, DC, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Virginia, Wisconsin |

| Table 3: States with Partial Exemptions on Social Security Income | |
|---|--|
| State | Details |
| Colorado | Age 55-64 up to \$20,000 pension income – including SS benefits -- are exempt. Age 65+ up to \$25,000 pension income – including SS benefits -- are exempt. |
| Connecticut | Exemption for under \$75,000 single and \$100,000 married |
| Kansas | Exemption for under \$75,000 in AGI regardless of filing status |
| Minnesota | Deduction based upon "provisional income"(AGI plus half of Social Security plus taxable interest), if below \$81,850 single and \$103,930 married |
| Missouri | Full exemption if AGI is less than \$85,000 single and \$100,000 married, and over 62 |
| Nebraska | Full exemption if AGI is less than \$43,000 single and \$58,000 married. Federal exemption otherwise |
| North Dakota | Full exemption if AGI under \$50,000 single and \$100,000 married. |
| Rhode Island | Full exemption if AGI is under \$81,900 single and \$102,400 married |
| Vermont | Full exemption if AGI is under \$45,000 single and \$60,000 married |
| West Virginia | Beginning tax year 2022, full exemption if AGI is under \$50,000 single and \$100,000 married. |
| Montana | Full exemption if AGI is less than \$25,000 single and \$32,000 married |
| Utah | Utah taxpayers may be able to claim a retirement tax credit of up to \$450 under age 65 and \$900 over age 65. |
| New Mexico | Full exemption for taxpayers with AGI less than \$25,000 single and \$32,000 married (Federal treatment) |