

Social Security Lump Sum Payments

Background

The process of applying for and being awarded Social Security Disability Insurance (SSDI) benefits is frequently very lengthy. An applicant must provide extensive medical records, sometimes be examined by SSA-referred physicians, and go through several administrative appeal processes, all of which may take several years to complete. When it is determined that an applicant is in fact disabled, the Social Security Administration establishes an "onset date" -- the date on which the applicant became permanently disabled. SSDI benefits are paid retroactively to the onset date. This means that in the year in which the applicant receives a favorable decision, they receive a check which pays them all benefits to which they were entitled while going through the application process. The check may pay them for several years of disability benefits; they receive a lump sum payment.

Foundation Communities Policy

All income received during the tax year is taxable, unless it is specifically excluded. Supplemental Security Income (SSI) benefits are specifically excluded from taxable income, because SSI is a needs-based program (SSI recipients must be disabled and also must meet very strict income and asset tests). Do not confuse SSDI and SSI -- SSDI may be taxable; SSI never is. SSDI recipients receive a Form SSA-1099; SSI recipients do not receive any tax form because their benefits are never taxable income. Some clients may receive both SSDI and SSI. Their Form SSA-1099 reports *only* their SSDI benefits.

How To Assist Tax Clients

If the client received a lump sum SSDI payment, there will be a notation toward the bottom of their Form SSA-1099 which lists the amount paid for each year. Box 3 lists the entire amount received. It is not necessary to file amended returns for each prior year for which benefits are paid. There is a Lump Sum Payments worksheet in TaxSlayer on which you will note the client's filing status and AGI in the prior year for which they received SSDI benefits; the client must have a copy of their tax return(s) for these prior years. Once entered, TaxSlayer will calculate the correct taxable amount of SSDI in those years and include that on line 20b of Form 1040. See pages D-27 and D-28 in Pub 4012 for instructions on entering the lump sum distribution.

By utilizing the Lump Sum Payments worksheet, TaxSlayer correctly calculates the taxable amount of benefits received for each year and the income tax, if any, owed for those years. This minimizes the amount of income tax the client must pay in the current tax year. As mentioned earlier, using the lump sum worksheets also eliminates any need to amend the prior year returns.