Huge 2022 Social Security Increase Might Cost You

by George Schneider

Ordinarily, an increase in your monthly Social Security payment on the order of 6% would be cause for celebration.

With the biggest Social Security increase in 20 years scheduled to take effect this January, 2022, you'd think seniors would be popping corks right now. After all, last year's increase was just 2.2%, and for the past ten years, it's been in the range of 0% to 2%, averaging 2.2% most of the time.

What, Me Worry?

So, what's to be worried about? How can a 6% increase in your Social Security payment be anything less than a cause celeb? Could you actually be better off without any increase at all? Could you actually take home less from your 2022 Social Security benefit than this year?

When Social Security benefits increase by an estimated 6% next year to keep pace with rampant inflation, the larger payments may come with a significant caveat for some beneficiaries. The historic jump in Social Security's annual Cost of Living Adjustment (COLA) expected in January could push your income beyond the thresholds that determine your Medicare Part B premiums and how much of your Social Security benefits are subject to income tax.

The federal government adjusts the amount of Social Security that beneficiaries receive each year in order to keep pace with inflation. This change is known as a Cost of Living Adjustment or COLA, and it's intended to preserve the purchasing power of Social Security benefits.

The Social Security Administration calculates its COLA each year by measuring inflation during the third quarter from the prior year. To do this, the government examines the 12-month change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) and then increases Social Security benefits to match the rate of inflation.

With the price of goods and services soaring in 2021, Social Security collectors could see their benefits rise by as much as 6.2% next year, according to the Senior Citizens League. While that sounds like great news, it could mean some beneficiaries will also see their Medicare Part B premiums increase and more of their benefits withheld for taxes.

This is one of those times that more might actually mean less.

COLA and Medicare Part B Premiums

Medicare Part B premiums, which cover physician and outpatient services, are deducted from a person's monthly Social Security check. How much you pay is linked to your income. If your modified adjusted gross income (MAGI) is above a certain amount, you may pay what's called an Income Related Monthly Adjustment Amount (IRMAA).

The monthly premium for single individuals with incomes of $88,000 or less and married couples with $176,000 or less is $148.50 in 2021. For taxpayers who make more, premiums can reach as high as $504.90 per month.

Here's a look at income thresholds and corresponding monthly Part B premiums, projected for 2022.

How Much Will Part B Cost in 2022?

Medicare Part B uses your tax return from two years earlier to determine the monthly premium you will pay. For 2022, your 2021 return will be used.

The standard Part B premium amount in 2022 is $144.60. Unless your individual income exceeded $87,000 or joint income was more than $174,000, you will pay this monthly premium.

Additionally, Medicare Part B beneficiaries need to pay the annual deductible fee of $198 in 2022. The 7% increase from 2019 is primarily due to rising spending on physician-administered drugs.

Part B Premiums in 2022

Individual Yearly Income	Joint Yearly Income	File married & separate tax return	Monthly Premium
$0 – $87,000	$0 – $174,000	$0 – $87,000	$144.60
$87,001 – $109,000	$174,001 – $218,000	Not applicable	$202.40
$109,001 – $136,000	$218,001 – $272,000	Not applicable	$289.20
$136,001 – $163,000	$272,001 – $326,000	Not applicable	$376.00
$163,001 – $500,000	$326,001 – $750,000	$87,001 – $413,000	$462.70
$500,001 and above	$750,001 and above	$413,001 and above	$491.60

Annual COLAs can catapult a Social Security beneficiary into the next income bracket and result in higher Part B premiums. For instance, a single person with $109,000 in yearly retirement income will have **$202.40** deducted from his Social Security benefits each month for Part B. But after receiving a 6% bump in Social Security via next year's COLA, the person will exceed his current income threshold and pay **$289.20** per month in Part B premiums (about $87 per month, more).

Meanwhile, premiums have risen faster than COLA increases in recent decades. According to "The Impact of Inflation on Social Security Benefits" published by the Retirement Research Center at Boston College, Part B premiums jumped by an annual average of 5.9% between 2000 and 2020. Increases in Social Security benefits averaged just 2.2% per year during the same time span.

The impact of rising Part B premiums would be even greater for high income individuals, because their premiums constitute a larger share of their Social Security benefits.

COLA and Taxes

Like Part B premiums, next year's COLA could have a more significant impact on the way Social Security benefits are taxed than in years prior. Under current federal law, individuals with between $25,000 and $34,000 in combined gross income pay federal income taxes on up to 50% of their Social Security benefits, while people with over $34,000 in combined gross income will pay federal income taxes on up to 85% of their benefits. Married couples, meanwhile, pay taxes on up to 50% of their combined gross income if it's between $32,000 and $44,000. Up to 85% of benefits are taxable if a couple's combined gross income is over $44,000.

However, the Retirement Research Center notes these income thresholds do not increase each year "in response to either wage or price growth," leaving more and more Social Security beneficiaries to pay taxes on their benefits.

"A personal income tax with unindexed thresholds for benefit taxation means that wage growth and inflation will subject an increasing portion of Social Security benefits to taxation. Taxation further reduces the net benefit that people will receive.

How to Protect Your Social Security Benefits

Reducing gross income is one of the most common strategies for protecting assets like Social Security benefits from higher tax rates. But keep in mind that purposely reducing your income simply to reduce your Medicare premiums could backfire. It's a very delicate balance and requires some good math to make it work in your favor. You don't want to reduce your income by more than what your Medicare premium and tax savings might be. That would be cutting off your nose to spite your face.

If you are pre-disposed to give to charity, a qualified charitable distribution from an IRA is one way to accomplish this feat.

A qualified charitable deduction or QCD is money transferred directly from an IRA to a charity. The contribution is not considered part of your taxable income and can satisfy your required minimum distributions (RMDs). For example, someone who is required to withdraw $20,000 from their IRA can instead simply transfer the money to a qualified charitable organization, lowering their tax bill.

Using Required Minimum Distributions (RMD) toward charities is a great way to lower your income especially as the RMD grows. So instead of the money coming from your checking or savings account use your IRA’s RMD to fund your charitable contributions.

For example, if you’re required to withdraw $30,000 from your IRA and find yourself $10,000 over a particular Medicare income threshold, you could make a $10,000 charitable donation directly from your retirement account and avoid paying higher Part B premiums.

Since you’ll be making donations anyway, it’s just a matter of how and where you’re making the donations.

Your Takeaway

As the price of goods and services continues to increase, the federal government uses an annual Cost of Living Adjustment to ensure Social Security benefits can keep pace. Next year’s COLA is expected to be the largest increase in decades (6.2%) but could actually result in larger tax bills and higher Medicare Part B premiums for some Social Security beneficiaries. This means you might have been better off without getting that increase, since your net Social Security income will be less than this year! Reducing your gross income by donating required minimum distributions from an IRA to charity can help mitigate the potential negative impact of next year's historic COLA.

Consult your tax advisor before making any decisions.

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Best,

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