



# What Changes You Should Make with the Social Security Inflation Bump

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Last fall the Social Security Administration announced they would be a cost-of-living (COLA) adjustment. [Around 70 million Americans will receive an 8.7% increase in their Social Security Income benefit for 2023](#), marking the highest single-year increase to Social Security Income in over 40 years. That amounts to an average of more than \$140 of extra money from social security monthly.

## What is a COLA Adjustment and How is it Calculated?

COLA stands for cost-of-living adjustment. [The cost-of-living adjustment \(COLA\) aims to ensure that the purchasing power of Social Security benefits and SSI payments are not eroded by inflation](#). Each year the Social Security Income (SSI) cost of living adjustment [is determined by the Consumer Price Index \(CPI\) based on the third quarter of the previous calendar year](#). So, your 2023 cost of living benefit increase is based on inflation from July 2022 through September 2022.

## Advantage of the 2023 COLA

Inflation during Q3 of 2022 was lower than the 2022 peak in June of 9.8%, but the 8.7% increase is a permanent adjustment. Fortunately, the most recent CPI data shows 6.5% inflation as of December 2022, continuing the trend of inflation cooling off that we have seen recently. Since the 8.7% increase is permanent, as inflation continues to fall this could present a nice benefit for retirees' cash flow. Due to the SSI increase occurring once per year, it naturally lags actual inflation costs. As a result, most Americans have already baked the effect of inflation into their monthly spending. Combining additional Social Security income with lower inflation will likely create some free cash flow compared to living expenses from 6-12 months ago.

## Maximize Your COLA Increase

Of course, this begs the question, "how big of a deal is this for me?" Unfortunately, the answer to this question will be specific to whoever is asking it. While this is neither clear cut nor particularly helpful in of itself, this potential free cash flow may present an opportunity to maximize your benefit.

If you find yourself in this situation, here are some options you may consider:

### Invest It

This is the most prudent option if the situation is right. If you're living off your social security and other income sources (pensions, rental income, etc.) and do not need portfolio withdrawals, why not add a bit to your investments? Given the rocky road markets have been through in the last year, it is a great time to put some dry powder to work.

Consider reading more: [How Much Should I Save for Retirement? \(allegHENYfinancial.com\)](#)

### Build Cash Savings

An alternative for those (like in the scenario above) not regularly drawing from their investment portfolios to cover cash flow needs. While this won't add any growth potential to your investment portfolio, building extra cash is rarely bad. Having money stashed in your bank account for your next unexpected expense, purchase, or other cash need is always beneficial.

### Reduce Portfolio Withdrawals

This is another excellent option for many retirees. Most retirees take distributions from their investment portfolios to support their lifestyles in retirement to some extent. Reducing the amount you withdraw each month or skipping a withdrawal here and there keep more assets in your retirement accounts longer. The longer those assets stay invested, the more opportunity you have for growth.

### Treat Yourself

Yes, you read that correctly. I did say to spend it. While certainly the least productive of the options from a cash flow planning standpoint, only some dollars have to be utilized to maximize savings or investment growth. I recommend going about this similarly to how you would build cash savings, as discussed above. The only difference is that instead of saving up for a future cash flow need, you spend it on yourself! It can be on anything-- a day at the spa, a seat upgrade on your

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vacation flight, or some new golf clubs. Sometimes it is good to treat yourself!

### Medicare Part B Reduction Bonus

One final note in the realm of cash flows is a nice bonus to go along with the 2023 Social Security Income increase. In addition to the 8.7% COLA for Social Security, [Medicare part B premiums went down \(although only slightly\)](#) for the first time in over a decade. Since most have their Medicare costs deducted from their Social Security Income, an increase in Medicare costs usually eats away a portion of Americans' Social Security increase each year. Even though the decrease in Medicare for 2023 is slight, it is a nice bonus for those who are collecting Social Security and have started Medicare.

### Social Security Tax Changes May Impact You

The income and tax ramifications from the 2023 Social Security Income cost of living adjustment could affect you. There are several changes to the federal tax on social security and how you'll pay taxes on your social security. One change to affect taxes is new earnings limits regarding Social Security taxes and Social Security reductions.

[The maximum amount of earnings subject to Social Security tax has increased to \\$160,200 for 2023.](#) For those high-income earners still paying into Social Security, you will now have an additional \$13,200 of income subject to the 6.2% Social Security tax.

For those currently [collecting Social Security benefits and younger than their full retirement age, the earnings limit has been increased to \\$21,240](#), up from \$19,560 in 2022. For every \$2 earned over \$21,240, your Social Security benefit will be reduced by \$1.

For those currently [collecting Social Security benefits and are reaching their full retirement age in 2023, the earnings limit has increased to \\$56,520](#), up from \$51,960 in 2022. For every \$3 earned over \$56,520, your Social Security benefit will be reduced by \$1.

Unfortunately, not all income limits are being increased. The limits used to determine how much of your social security benefit is taxable have stayed the same. For lower-income individuals, the Social Security cost of living increase could cause more of their benefits to be taxable than in previous years. [Use the following formula to calculate how much of your Social Security is taxable: take one-half of Social Security income received during the year and add it to other income \(wages, pensions, interest, dividends, and capital gains\).](#) The resulting number determines the taxability of benefits using the following brackets:

### Not Taxable (0%)

- o Under \$25,000 for Single, Head of Household, Qualified Widow(er), and Married Filing Separate tax filers.
- o Under \$32,000 for Married Filing Joint tax filers.

### 50% Taxable

- o Between \$25,000 and \$34,000 for Single, Head of Household, Qualified Widow(er), and Married Filing Separate tax filers.
- o Between \$32,000 to \$44,000 for Married Filing Joint tax filers.

### 85% Taxable

- o Over \$34,000 for Single, Head of Household, Qualified Widow(er), and Married Filing Separate tax filers.
- o Over \$44,000 for Married Filing Joint tax filers.

Another negative of this is that unlike income tax brackets, where only the income above the bracket limit gets taxed at a higher rate, with Social Security, once you breach the income limit, the entire amount is taxed at the higher rate.

### Talk to a Tax Planning Professional

This article covers some of the major items that the 2023 Social Security cost of living adjustment could affect regarding your income, taxes, and cash flow planning. But as mentioned earlier, the effects of this change are specific to each individual and their situation. For a comprehensive analysis on Social Security, discuss your situation with a CERTIFIED FINANCIAL PLANNER™ practitioner.

***This article is meant to give a brief overview and does not constitute financial or tax planning advice. Consult with a financial planning or tax professional for more information.***

### Sources:

<https://www.ssa.gov/cola/>

<https://www.bankrate.com/retirement/social-security-benefits-changes-in-2023/>

<https://www.schwab.com/learn/story/social-security-inflation-bump-what-does-it-mean>

[Don't forget, Social Security benefits may be taxable | Internal Revenue Service \(irs.gov\)](#)