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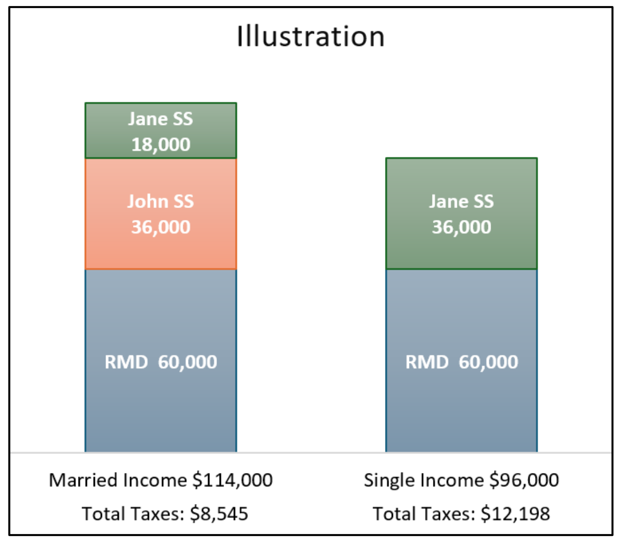
What is the Widow's Penalty?

By Xenia Woltmann

Navigating through the tasks and emotions of losing a spouse is not only an incredibly painful experience, but also a complete life change for the survivor. Every day will be different and plans for the future will eventually change. It takes time, sometimes years, to forge a new path. While you do not have to make all decisions for your future right away, proper planning can help ease the burden.

In a nutshell, the widow's penalty is the increase in income taxes paid when a spouse passes away because their tax status changes from married filing jointly to single. This can be remarkably staggering when combined with the loss of income that may occur when social security or other payments cease. You can still file a joint return in the year your spouse dies (with some stipulations). For the next two years, the IRS does provide a short-term tax break by allowing a qualifying surviving spouse status if requirements are met, most notably you must have dependents and have not remarried. Otherwise, single filing status will likely be required.

Let's consider an example: John & Jane Smith both have required IRA distributions (RMDs) of $30,000 each and social security income of $36,000 for John and $18,000 for Jane. Assuming 2023 tax rates, no adjustments or credits and a standard deduction, their tax bill is approximately $8,545 (7.5% of their income of $114,000). When John passed away, Jane lost $18,000 in social security benefits. With her new individual tax filing status, Jane's tax bill increases to $12,198 (12.7% of her $96,000 income). In this case, the widow's penalty is the $3,653 tax increase and $18,000 loss of social security income. Over $21,000! (Source: FINRED https://finred.usalearning.gov)



If Jane needs to increase her IRA distributions to make up for the lost income, her tax bill increases to $16,158. Nearly double the taxes paid while John was still alive.

Understanding the loss of income and tax impact of losing a spouse is the first step to take when deciding on the best plan for you. There are many retirement income and tax strategies to consider, including Roth conversions, charitable giving, gifting, delaying social security and reviewing pension options. One or more of these may allow for a less impactful reduction of income, tax savings and even the potential for reduced taxation of social security in the future.

Working closely with trusted financial and tax advisors now can help ease a future burden. This is only one of several aspects of financial planning and no two situations are alike. It is never too late to prepare for the future.