Social Security: Raising or Eliminating the Taxable Earnings Base

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Summary

Social Security taxes are levied on covered earnings up to a maximum level set each year. In 2010, this maximum—or what is referred to as the taxable earnings base—is $106,800. The taxable earnings base serves as both a cap on contributions and a cap on benefits. As a contribution base, it establishes the maximum amount of each worker's earnings that is subject to the payroll tax. As a benefit base, it establishes the maximum amount of earnings used to calculate benefits.

Since 1982, the Social Security taxable earnings base has risen at the same rate as average wages in the economy. However, because of increasing earnings inequality, the percentage of covered earnings that are taxable has decreased from 90% in 1982 to 85% in 2005. The percentage of covered earnings that is taxable is projected to decline to about 83% for 2014 and later. Because the cap was indexed to the average growth in wages, the share of the population below the cap has remained relatively stable at roughly 94%. Of the 9.5 million Americans with earnings above the base, roughly 80% are men and only 9% had any earnings from self-employment income. New Jersey has the highest share of the population above the maximum (11.6%) and South Dakota has the lowest share (2.1%).

CRS estimated the potential impact of eliminating the taxable wage base on future benefits and taxes. If the base were removed in 2013, CRS estimates that by 2035, 21% of beneficiaries would have paid some additional payroll taxes over the course of their lifetimes. However, the average change in taxes and benefits would be small. Looking *only* at individuals who would pay any additional taxes over the course of their lifetimes, at the median, total lifetime tax payments would rise by 3% and benefits would increase by 2% relative to current law. In general, those in the highest income groups would have the largest changes in both tax payments and in benefits relative to current law.

Raising or eliminating the cap on wages that are subject to taxes could reduce the long-range deficit in the Social Security Trust Funds. For example, if the maximum taxable earnings amount had been raised in 2005 from $90,000 to $150,000—roughly the level needed to cover 90% of all earnings—it would have eliminated roughly 40% of the long-range shortfall in Social Security. If all earnings were subject to the payroll tax, but the base was retained for benefit calculations, the Social Security Trust Funds would remain solvent for the next 75 years. However, having different bases for contributions and benefits would weaken the traditional link between the taxes workers pay into the system and the benefits they receive.

This report will be updated as legislative activity warrants.

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Background

Since the beginning of the program, Social Security taxes have been levied on covered earnings up to a maximum level set each year, referred to as the taxable earnings base. Social Security was enacted in 1935, and the Social Security payroll tax was first levied in 1937. From 1937 through 1949, the tax rate was 1% (on employee and employer, each) on earnings up to $3,000 a year. Since that time the rate has risen to 6.2% and the taxable earnings base has been increased to help meet the financing needs of the program, and to keep up to date with changing earnings levels. Since 1982, the Social Security earnings base has risen at the same rate as wages in the economy. By law, the Commissioner of Social Security is required to raise the base whenever an automatic benefit increase—cost of living adjustment (COLA)—is granted to Social Security recipients, assuming wages have risen. The increase in the base from 2009 to in 2010 is based on the increase in average wages from 2007 to 2008.[1]

Origin and History of the Taxable Earnings Base

In 1935, the designers of Social Security, President Franklin Roosevelt's Committee on Economic Security, did not recommend a maximum level of taxable earnings in its plan, and the draft bill that President Roosevelt sent to the Hill did not include one. The bill emphasized who was to be covered by the system, not how much wages should be taxed. Being in the midst of the Depression, the Administration's attention was on the large number of aged people living in poverty. Its goal in proposing a Social Security program was to complement public assistance measures (Old-Age Assistance) in its plan. The plan offered immediate cash aid to the aged poor and created an earnings-replacement system intended to lessen the need for welfare benefits in the long run. It was recognized that the new system would not be sufficient to provide full income in retirement, but would provide a "core" benefit as a floor of protection against poverty. Not concerned about high-income retirees, the Administration's proposal exempted non-manual workers earning $250 or more a month from coverage (i.e., $3,000 on an annual basis). Manual workers were to be covered regardless of their earnings, but few had earnings above this level.

It was the Social Security bill reported by the House Ways and Means Committee that clearly established a maximum taxable amount, which it set at $3,000 per year.[2] In addition, the committee dropped the exemption for non-manual workers with high earnings. The committee's report and floor statements made at the time give no clear record as to the reasoning for the taxable limit, but concerns about tax equity and attaining as much program coverage of the workforce as possible were suggested as factors for rejecting the high-earner exemption. Not covering them meant that they would not pay the tax where lower-wage earners would, and coverage would be erratic for workers whose earnings fluctuated above and below the $250 monthly threshold.

Although tax policy concerns were raised in later years, with a higher base preferred by those seeking a more proportional tax system, there was little if any serious attention given to

[1] The reason for the two-year lag in reflecting increases in average wages in the taxable earnings base is that average wages for the year immediately prior to the year of the increase simply are not known in time.

[2] The maximum for a worker was to be $3,000 per year per employer, so that, under the original legislation enacted in 1935, someone could have paid tax on more than $3,000 in earnings per year (and received benefits from all such wages) if they worked for more than one employer.

eliminating the base entirely. In the late 1940s and early 1950s and to a lesser extent later on, the major arguments were over the base's size and how it affected the development of Social Security. A larger base meant that more earnings would be credited to a person's Social Security record and would lead to higher benefits (since benefits are based on a worker's earnings). Proponents argued that the base needed to be raised to reflect wage or price growth so that the benefits of moderate and well-to-do recipients would not erode over time (thereby preserving their support for the system). Critics argued that this would increase benefits for people who could save on their own while making saving by private means more difficult. In 1972, as a means of financing COLAs for Social Security recipients, procedures were enacted that increased the base automatically to reflect the growth in average wages. In 1977, the base was raised beyond what resulted from the automatic increase provision (by $7,500 over three years) as a means of raising revenue to help shore up the program's ailing financial condition. These ad hoc adjustments were intended to achieve a base under which 90% of all covered payroll would be subject to tax.

Medicare was enacted in 1965 with the hospital insurance (HI) portion of the program financed with payroll taxes. The HI tax was first levied in 1966 at a rate of 0.35% (on employee and employer, each) and the maximum taxable amount was set at the same level as Social Security's.[3] The HI rate was subsequently raised periodically (reaching its current level of 1.45% in 1986) to meet the financing needs of the program. However, its base continued to be the same as Social Security's through 1990. Then, to reduce federal budget deficits, the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-518) raised the HI base to $125,000. The HI base then rose automatically to $135,000 over the next two years. In 1993, as part of his plan to reduce budget deficits, President Clinton proposed that the HI base be eliminated entirely. As part of the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66) the HI base was removed, raising an estimated $29 billion in revenues over the FY1994-FY1998 period. As there is no maximum taxable earnings amount in Medicare, Medicare financing will not be discussed further in this report.

The Taxable Earnings Base

The Taxable Earnings Base Today

In 2010, an estimated 162 million workers will pay Federal Insurance Contributions Act (FICA) taxes and Self-Employment Contributions Act (SECA) taxes on their wages and net self-employment income.[4] Both employers and employees contribute earnings at the FICA rate and SECA taxes are paid by the self-employed. Both taxes have three components: Old Age and Survivors Insurance (OASI), Disability Insurance (DI), and the HI part of Medicare. The OASDI tax is levied on earnings up to $106,800 in 2010. The HI tax is levied on all earnings.

[3] The same maximum taxable amount was set for the self-employed when they were covered in 1951 and for the Disability Insurance (DI) portion of the tax when it was first levied in 1957.

[4] Social Security Administration, Office of the Chief Actuary, *Social Security Program Fact Sheet*, available at http://www.ssa.gov/OACT/FACTS/index.html. Some workers (approximately 4%) are exempt from Social Security payroll taxes and are therefore not "covered" by Social Security. From this point forward, all references to earnings are "covered" earnings and workers are "covered" workers. For a listing of workers who are exempt from Social Security taxes, see CRS Report 94-28, *Social Security and Medicare Taxes and Premiums: Fact Sheet*, by (name redacted).

The taxable earnings base limits the amount of wages or self-employment income used to calculate contributions to Social Security. Unlike income taxes, workers who have earnings over the limit, whether they earn $110,000 or $1 million, pay the same dollar amount in Social Security payroll taxes. Under the 2010 limit of $106,800, the maximum amount a wage and salary worker contributes to Social Security is $6,622 (his or her employer contribute an equal amount) whereas a self-employed individual contributes a maximum of $13,243.[5]

The taxable earnings base also limits the annual amount of earnings that are used in benefit calculations and thus sets a ceiling on the amount Social Security pays in benefits. For example, the maximum amount of earnings in 2010 used to calculate a worker's benefit is $106,800, regardless of whether the worker earned above that amount. If an individual earned at or above the earnings base for his or her entire career[6] and retired in 2010 at the full retirement age, his or her annual benefit would be $28,164 ($2,347 per month), the maximum benefit payable under current law.[7] However, very few Americans receive the maximum benefit as it is extremely rare to have had such consistently high earnings over a lifetime.

Table 1. 2010 Social Security and Medicare Tax Rates and Maximum Taxable Earnings, Maximum Taxes Paid, and Maximum Retirement Benefits

FICA and SECA Tax Rates:	**FICA**	**SECA**[a]
Old-Age and Survivors Insurance	5.30%	10.60%
+ Disability Insurance	0.90%	1.80%
= Subtotal Social Security (OASDI) tax rate	*6.20%*	*12.40%*
+ Hospital Insurance tax rate	1.45%	2.90%
Total FICA and SECA Rate	**7.65%**	**15.30%**
Combined Employee and Employer FICA Tax Rates:		
Employee	7.65%	
+ Employer	7.65%	
Combined FICA Rate	**15.30%**	
Maximum Taxable Earnings:		
Social Security	$106,800	
Hospital Insurance	no maximum	
Maximum FICA/SECA Taxes	**OASDI**	**HI**
Employee/Employer (each)	$6,622	No limit
Self-Employed	$13,243	No limit

5 $106,800 x 6.2% = $6,622 and $106,800 x 12.4% = $13,243.

6 The Social Security benefit formula calculates benefits based on a worker's highest 35 years of earnings.

7 Social Security Administration, 2009 Fact Sheet, available at http://www.ssa.gov/pressoffice/factsheets/colafacts2009.pdf.

Social Security Benefit for 2010 Retiree With Earnings at or Above the Maximum for Entire Career

	Monthly	Annual
Retired at age 62	$1,824	$21,888
Retired at full retirement age (66)	$2,346	$28,152

Source: SSA http://www.ssa.gov/pressoffice/factsheets/colafacts2010.pdf.

a. Certain adjustments and income tax deductions apply.

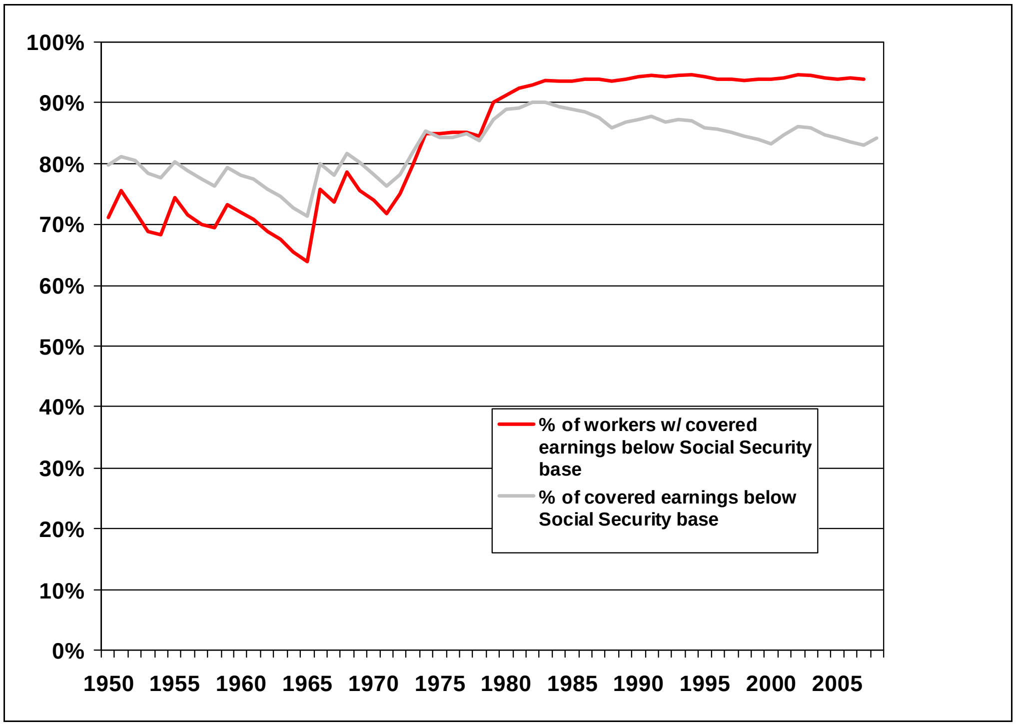
The Taxable Earnings Base Over Time

The portion of Social Security covered earnings that are subject to the payroll tax has fluctuated over time (**Figure 1**). When the program began in 1937, taxable earnings represented 92% of covered earnings (**Table A-1**). By 1965, this ratio had dropped to its low of 71%. Prior to 1972, the taxable earnings base was updated periodically by Congress, which contributed to its dramatic fluctuations in the 1950s and 1960s. Since 1972, the base has been indexed to the increase in wages in the economy, which has reduced the volatility somewhat. As described earlier, to raise revenue, Congress raised the taxable earnings base in the 1977 amendments to the Social Security Act to a level that would cover 90% of aggregate earnings by 1982.

Since the 1980s, the share of covered *workers* below the taxable earnings base has remained relatively stable at roughly 94%. However, the share of covered *earnings* that are taxed has fallen from 90% of all earnings in 1982 to 83% in 2007. The large declines in the late 1990s were mainly because salaries for top earners grew faster than the pay of workers below the cap.[8]

[8] At least some of this decline and subsequent increase in the ratio after 2000 is believed to be due to stock option activity surrounding the stock market bubble in 2000 and is not likely to recur. (SSA, *2005 OASDI Trustees Report*.)

Figure 1. Share of Earnings and Workers Below the Taxable Earnings Base, 1950-2007



Source: Figure prepared by CRS based on data from the Social Security Administration, Annual Supplement, 2009.

The Taxable Earnings Base by State

In 2007, 6% of workers had earnings above the taxable base of $97,500.[9] However, focusing on the nationwide average hides the diversity among the states and the District of Columbia. The share of the population above the base ranges from a high in New Jersey, where nearly 12% of covered workers earn above the base, to a low in South Dakota, where 2% of workers earn above this amount (see **Table A-2**). The states with the lowest share of workers over the base are South Dakota, Mississippi, North Dakota, Arkansas, and West Virginia. Those with the highest share of workers over the base are New Jersey, the District of Columbia, Connecticut, Massachusetts, and Maryland.

The Taxable Earnings Base by Employment Status and Gender

According to statistics from the Social Security Administration, a small share of workers earn above the taxable earnings base each year. In 2007, 6% of workers (10.0 million individuals) earned more than the taxable earnings base (**Table A-3**).[10] Most of the individuals earning above

[9] Note that the years denoted for **Table A-1**, **Table A-2**, and **Table A-3** differ slightly due to differences in availability of data.

[10] Social Security Administration, *Annual Statistical Supplement 2009*, http://www.ssa.gov/policy/docs/statcomps/supplement/2009/4b.html#table4.b1. (Hereinafter referred to as SSA Statistical Supplement, 2009.)

the base were men (7.4 million individuals or roughly 80% of the total). In 2007, 9% of all male workers and 3% of all female workers had earnings above the maximum. Most individuals earning above the base were wage and salary workers (roughly 93% of the total). Only 6.4% of individuals who earned above the base were self-employed.

The Future of the Taxable Earnings Base

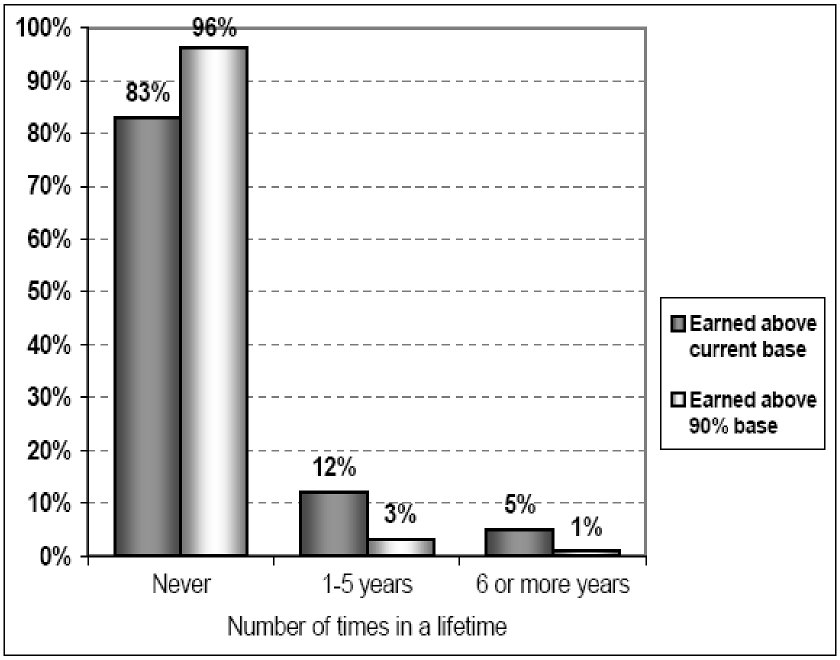
The taxable wage base is increased annually by the average growth in wages, so the share of the population below the cap is expected to remain relatively stable over time. However, because of increasing earnings inequality, the share of payroll that is taxed is expected to decline even further. Under the intermediate assumptions of the 2007 Trustees Report, the percentage of covered earnings that is taxable is projected to decline to about 83% for 2015. However, the Trustees Report assumes the levels will remain stable thereafter.

Projections of the Share of the Population Earning Above the Taxable Wage Base Over Their Lifetime

Workers' earnings rise and fall during their careers, so any analysis of the population that earns above the taxable wage base in a given year is limited in that it may miss individuals who were above the base in previous years or will have earnings above the base in the future. To address this issue, CRS used the Dynasim microsimulation model to estimate the share of individuals in the future who will *ever* have earned above the current-law taxable wage base over the course of their lifetimes.[11]

[11] The Urban Institute's Dynamic Simulation of Income Model (Dynasim) is a computer model that uses survey data to project earnings, demographic changes, retirement income, and Social Security benefits through the year 2050. For more information about the model, how it works, and how to interpret results, see CRS Report RL33840, *Options to Address Social Security Solvency and Their Impact on Beneficiaries: Results from the Dynasim Microsimulation Model*, by (name redacted) et al.

Figure 2. Share of the Population with Earnings Above the Taxable Wage Base Over Their Lifetime



Source: CRS calculations using the Urban Institute's Dynasim microsimulation model.

In 2007, 6% of workers earned more than the taxable earnings base.[12] The Dynasim model projects this share will remain relatively constant over time. Although a small share of workers are projected to earn above the taxable earnings base in a given year, the model estimates that roughly one in five individuals would earn above the maximum at some point in their lifetimes (**Figure 2**). The model projects that 12% of workers would earn above the earnings base for between one and five years over the course of their working lives. Few individuals sustain the high earnings for long periods in their careers. The model estimates that only 5% of workers would earn above the taxable wage base for more than five years.[13]

Few individuals have earnings higher than a level of taxable earnings that would cover 90% of aggregate earnings (the level Congress attempted to achieve when it last addressed Social Security's finances). The Dynasim model projects that roughly 1% of workers have earnings above a 90% limit each year. In other words, due to high levels of earnings inequality, roughly 1% of the population earn 10% of all the earnings.[14] Looking over the course of an individual's lifetime, the model projects that less than 4% of the population would ever earn above the 90% base and nearly all of those who do would earn above the base for less than five years (**Figure 2**).

[12] SSA Statistical Supplement, 2009.

[13] The share of the population affected by this policy is influenced by the way the Dynasim model projects an individual's earnings. There is a significant amount of year-to-year variation in the projection of each individual's earnings.

[14] The Dynasim model projections are consistent with current data on wage inequality. In 2004, the top 1% of earners were paid 11% of aggregate earnings (source: CRS analysis of the March 2005 Current Population Survey).

Impact of Raising or Eliminating the Taxable Earnings Base

Raising or removing the taxable earnings base could reduce or eliminate the long-term Social Security deficit.[15] The additional tax revenues would be substantial. However, the full impact of the policy change would depend on whether the wages above the maximum would also be counted toward benefits. Raising or eliminating the taxable earnings base while maintaining the current benefit structure, where benefits are calculated on the full contribution base, would lead to higher monthly Social Security checks for individuals who earned more than the taxable wage base during their careers. These higher benefit payments would lead to greater program outlays, although these expenditures would be more than offset by greater tax revenues. While the solvency impact would be improved to a greater degree if the cap on taxes was eliminated and the cap on benefits was retained, the traditional link between contributions and benefits would be broken.

Rather than eliminate the taxable wage base, policymakers could set it to cover a constant share of aggregate earnings. As described previously, the portion of Social Security covered earnings subject to the payroll tax has fluctuated since its inception. Rising inequality—primarily increases in the earnings of the highest paid individuals—has led to a decline in the share of U.S. earnings that is taxed. The proportion of earnings that is taxed is projected to continue to fall. Maintaining a consistent tax base would increase revenue and help to improve the system's solvency. Some have proposed raising the taxable earnings base to consistently tax 90% of aggregate U.S. earnings—restoring it to roughly the level in 1982 when Congress last addressed Social Security's finances. The Social Security Administration and the Joint Committee on Tax have also used this benchmark to analyze the impact of raising the base on the Social Security trust funds and the budget.

The following sections examine the impact of raising or eliminating the taxable wage base on individuals, the Social Security trust funds, on federal revenue, and on workers' and employers' behavior.

Impact on Individuals' Lifetime Payroll Taxes and Social Security Benefits if the Taxable Wage Base Were Eliminated

To estimate how much individuals' taxes and benefits would rise if the wage base were eliminated, CRS has used the Dynasim microsimulation model to look at Social Security beneficiaries in the year 2035. The estimates assume the taxable wage base would be completely eliminated starting in 2013 for calculating both the payroll taxes and future Social Security benefits. The following sections detail the impact of eliminating the base on beneficiaries based on their income and gender.[16]

[15] There is precedent for this proposal. When the hospital insurance (HI) tax was levied in 1966 the maximum taxable amount was set the same as for Social Security. As part of the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66), the HI base was removed.

[16] CRS estimates of the impact of this and other reform proposals, including raising the base to cover 90% of taxable earnings, are also available based on beneficiaries' socioeconomic status (including ethnicity, education, and marital (continued...)

Aggregate Changes

If the base were removed, the majority of beneficiaries would pay no additional taxes compared with current law, as fewer than 8% of workers are projected to earn above the taxable wage base each year. Examining the impact on individuals receiving Social Security benefits in 2035, roughly one in five beneficiaries (21%) would have paid any additional taxes over their lifetimes compared with current law (**Figure 3**). For most of these affected individuals, the increase would be moderate. Roughly 16% of all beneficiaries would see their lifetime tax payments increase by less than 10%. However, 3% of all beneficiaries would have their tax payments increase by 10% to 19%, and 2% would have tax increases of 20% or more.

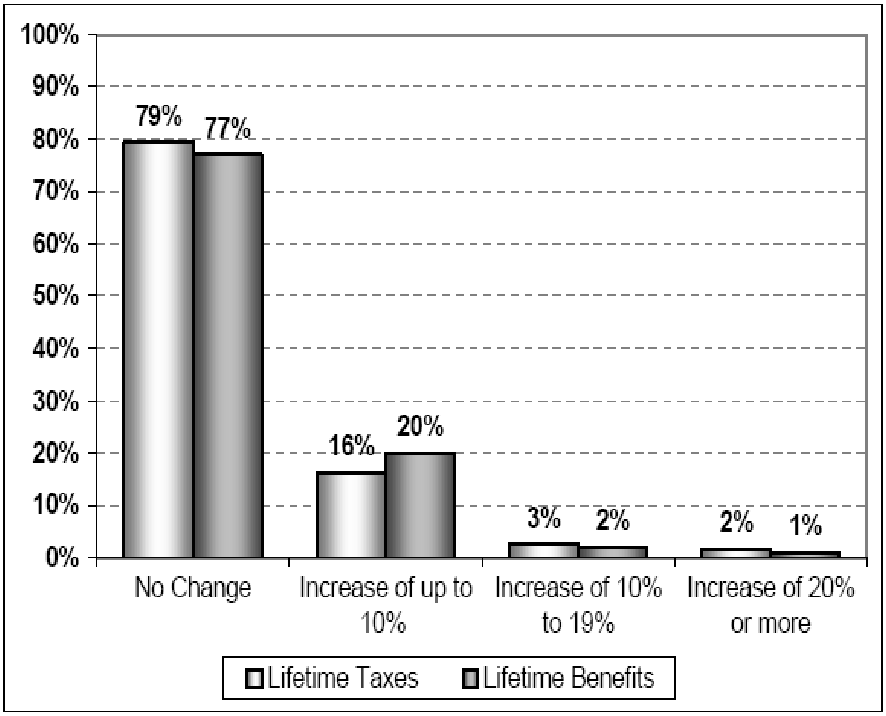
To maintain the traditional link between contribution and benefits, policymakers could choose to calculate benefits based on a worker's total earnings, including those above the taxable wage base. Under this option, some beneficiaries would receive higher Social Security benefits. CRS estimates that 23% of beneficiaries in 2035 would have higher benefits than under current law. This share of beneficiaries who receive higher benefits is greater than the share of individuals who pay higher taxes because some low earners receive benefits based on their spouses' higher earnings. Most of the affected beneficiaries (20%) would see their benefits increase by less than 10% relative to current law. Only 3% of beneficiaries would see their benefits increase by 10% or more.

Although 21% of beneficiaries in 2035 would pay some additional payroll taxes over the course of their lifetimes if the base were removed, the average change in taxes and benefits would be small. Looking *only* at individuals who would pay higher taxes over the course of their lifetimes, at the median, total lifetime tax payments would rise by 3% and benefits would increase by 2% relative to current law.

(...continued)

status). (CRS Report RL33841, *Options to Address Social Security Solvency and Their Impact on Beneficiaries: Results from the Dynasim Microsimulation Model—Detailed Distributional Tables*, by (name redacted) et al.)

Figure 3. Share of Beneficiaries in 2035 with Tax and Benefit Increases Compared with Current Law If the Taxable Earnings Base Is Eliminated, by Level of Increase



Source: CRS calculations using the Urban Institute's Dynasim microsimulation model.

Note: Lifetime taxes include both individual and employer OASDI contributions or self-employment contributions throughout the individual's entire career.

Changes by Income Group

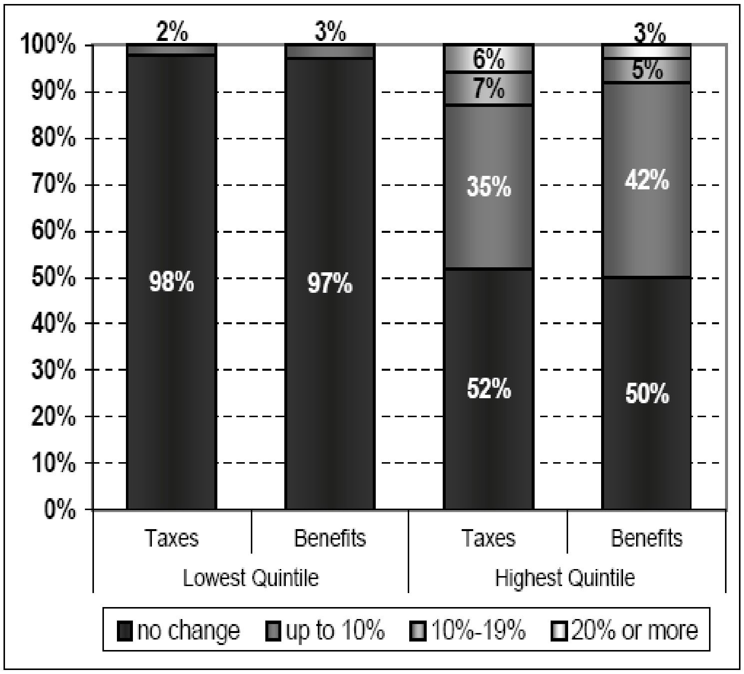
The impact of eliminating the taxable wage base on payroll taxes paid varies significantly by income group.[17] The overwhelming majority (98%) of beneficiaries in 2035 in the lowest income quintile would pay no additional taxes over their lifetime (**Figure 4**). Few in this group would receive benefit increases if the cap were removed. Under this proposal only 3% of beneficiaries in the lowest income category would receive benefit increases, and the increase would be for less than 10%.

The story is different for higher-income beneficiaries. Roughly one-half of those in the highest income quintile are estimated to have had tax increases over their lifetimes relative to current law. Whereas 35% of beneficiaries in the top quintile would see their lifetime taxes rise by less than 10%, some (7%) would see their taxes rise between 10% and 19% and some (6%) would see their taxes rise 20% or more. Beneficiaries in the highest income groups would also see the largest change in their benefits if the taxable wage base were removed. One-half of beneficiaries in the top fifth of the income distribution in 2035 would have an increase in benefits relative to current law. In this highest quintile, 42% would have benefit increases of less than 10%, some (5%)

[17] Note that the income groups are defined in 2035 using family income after an individual claims disability, retirement, survivor, or spousal benefits. Thus, some low income beneficiaries are affected by the policy if they earned above the taxable wage base at any point in their careers.

would have benefit increases of 10%-19% and a few (3%) would have benefit increases of 20% or more.

Figure 4. Share of Beneficiaries in 2035 with Higher Payroll Taxes or Benefits Compared with Current Law If the Taxable Earnings Base Is Eliminated, by Highest and Lowest Quintile

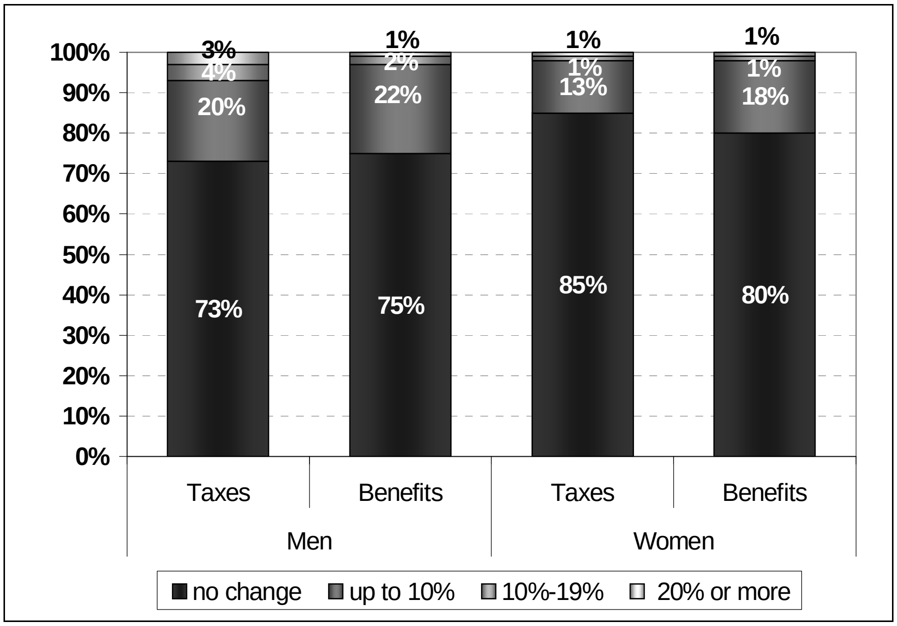


Source: CRS calculations using the Urban Institute's Dynasim microsimulation model.

Changes by Gender

Because the majority of workers who earn above the taxable wage base in a given year are men (**Table A-3** and described above), men would be more likely to pay higher payroll taxes than women if the taxable wage base were eliminated. Among men who receive benefits in 2035, more than one in four would pay higher payroll taxes over the course of their lifetimes (**Figure 5**). Twenty percent of male beneficiaries would have a tax increase of less than 10%, but 7% would see their lifetime tax contributions increase by more than 10%. If the taxable earnings base was removed, one in four men would receive higher benefits. The majority of the men affected (22% of all male beneficiaries) would see a small increase in benefits, but 3% of all men would have benefits increase by more than 10%. In contrast, only 15% of women who receive benefits in 2035 would have paid any additional payroll taxes over the course of their lives. Of these women, only 2% would have an increase of more than 10%. Because many women receive benefits based on their spouses' earnings, the share of women who would see a rise in benefits is higher than the share that would pay additional taxes. Although the benefits of one in five female beneficiaries in 2035 would rise, for most it would be a small increase of less than 10%.

Figure 5. Share of Male and Female Beneficiaries in 2035 with Higher Payroll Taxes or Benefits Compared with Current Law If the Taxable Earnings Base Is Eliminated, by Gender



Source: CRS calculations using the Urban Institute's Dynasim microsimulation model.

Impact on the Social Security Trust Funds

Under the assumptions of the 2009 Trustees Report, the actuaries at the Social Security Administration calculate that it would take an immediate increase in combined payroll taxes of 2.0% of taxable payroll (from 12.40% to 14.40%) to achieve solvency over the next 75 years.[18] Without this increase or other changes to the system, the 2009 Trustees Report projected that the OASDI Trust Funds would be exhausted in 2041. The actuaries at SSA have estimated the impact on the Trust Funds of three options to change the benefit and contribution base which are described below.

[18] The projections in this section were done using the assumptions of the 2005 Trustees Report to match the estimates in Table 4, which are the most recent estimates available for these options.

Table 2. Impact on the Social Security Trust Funds of Raising or Eliminating the Social Security Taxable Earnings Base

	Year the Trust Funds Are Exhausted	75-Year Actuarial Balance (as % of taxable payroll)	Percentage of 75-Year Shortfall Met
No change to current law	2041	-1.92	
Option 1: Make 90% of the earnings subject to the payroll tax and credit them for benefit purposes (phased in 2006-2015)	2044	-1.09	43%
Option 2: Make all earnings subject to the payroll tax and credit them for benefit purposes (beginning in 2006)	na[a]	-0.10	95%
Option 3: Make all earnings subject to the payroll tax but retain the cap for benefit calculations (beginning in 2006)	na[a]	0.28	115%

Sources: Social Security Administration, Memorandum, dated August 10, 2005.

Notes: All calculations use the intermediate assumptions of the 2005 Trustees Report.

a. Solvent beyond 75-year estimate.

Option 1: Cover 90% of Earnings and Pay Higher Benefits

One proposal would slowly raise the taxable wage base for both employers and employees to cover 90% of all earnings and credit these taxes to allow individuals to receive correspondingly higher benefits. In 2006, it was estimated that a cap of $171,600 would roughly cover 90% of wages.[19] Under this option, benefits at retirement for high earners would also rise. These changes would have a net positive impact on the Social Security Trust Funds (**Table 2**). Raising the wage base to 90% would eliminate 43% of the long-range financial shortfall—extending the Trust Funds' exhaustion date to 2044. To achieve solvency for the full 75-year projection period under this option, the total payroll tax rate would have to be raised by an additional 1.09 percentage points (from 12.40% to 13.49%) or other policy changes would have to be made to cover the shortfall.[20]

Option 2: Cover All Earnings and Pay Higher Benefits

If the earnings base was completely eliminated for both employers and employees so that all earnings were taxed, 95% of the projected financial shortfall in the Social Security program would be eliminated. To achieve solvency for the full 75-year projection period under this option, the total payroll tax rate would have to be raised by an additional 0.1 percentage points (from 12.4% to 12.5%) or other policy changes would have to be made to cover the shortfall.

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[19] Social Security Administration, *Estimated Financial Effects of "A Nonpartisan Approach to Reforming Social Security - A Proposal Developed by Jeffrey Liebman, Maya MacGuineas and Andrew Samwick"—INFORMATION,* Memorandum, dated November 17, 2005, http://www.ssa.gov/OACT/solvency/Liebman_20051117.pdf.

[20] Social Security Administration, *Estimated OASDI Long-Range Financial Effects of Several Provisions Requested by the Social Security Advisory Board,* Memorandum, dated August 10, 2005, available at http://www.ssa.gov/OACT/solvency/provisions/index.html.

Under this scenario high earners would pay higher taxes but also receive higher benefits. However, the net benefit to the Trust Funds is positive as $5 in additional revenue would provide only $1 in additional benefits (on average over their 75-year valuation period). Annual Social Security benefit payments would be much higher than today's maximum of $25,440. A worker who paid taxes on earnings of $400,000 each year would get a benefit of approximately $6,000 a month or $72,000 a year—a replacement rate of 18%—while someone with lifetime earnings of $1 million a year would get a monthly Social Security benefit of approximately $13,500 a month or $162,000 a year—a replacement rate of 16.2%.[21]

Option 3: Cover All Earnings and Pay No Additional Benefits

Finally, if the base was completely eliminated for both employers and employees so that all earnings were taxed, but those earnings did not count toward benefits, solvency would be restored to Social Security. The increased revenue would eliminate 115% of the projected shortfall and the program would have a projected surplus equal to .28% of taxable payroll. Under this scenario, the payroll tax rate could be immediately *lowered* from 12.40% to 12.12% and the system would remain solvent for the next 75 years. However, the traditional link between the level of wages that is taxed and the level of wages that counts toward benefits would be broken.

Impact on Federal Revenue

Raising the taxable earnings base would lead to an increase in total federal revenues. The Joint Committee on Taxation has estimated that raising the wage base to 90% of earnings, to $186,000 in 2008, would generate $221 billion in additional revenue over the five-year budget window of 2008-2012 (**Table 3**).[22] Over 10 years, the policy would generate more than $524 billion. Raising the payroll tax base to cover an additional 1%-2% of income (above the 90% level) would generate $32 billion-$64 billion more over five years and $80 billion-$158 billion more over 10 years.

Table 3. Revenue Impact of Raising the Social Security Taxable Earnings Base

	Taxable Wage Base (dollars)	Total Change in Revenues (billions of dollars)	
Year	**2008**	**2008-2012**	**2008-2017**
Tax 92% of earnings	250,000	+284.7	+682.7
Tax 91% of earnings	214,000	+253.5	+604.3
Tax 90% of earnings	186,000	+221.1	+524.4

Source: Joint Committee on Taxation 2007.

[21] Calculations are for 2005 from Reno and Lavery, *Options to Balance Social Security Funds*, February 2005. Benefits this high would be extremely rare as few individuals earn above the taxable wage base for their entire career.

[22] Congressional Budget Office, *Budget Options, Revenue Option 39: Increase the Upper Limit for Earnings Subject to the Social Security Payroll Tax*, February 2007, at http://www.cbo.gov. Note that the estimates by the actuaries at the Social Security Administration (SSA) and the Joint Committee on Taxation (JCT) differ slightly due to different assumptions. SSA assumes the maximum wage base will be adjusted each year to keep taxable wages at a constant percent of wages whereas the JCT assumes it will be a one-time increase with adjustments only for inflation thereafter. JCT estimates also account for the effects on all sources of revenue, including changes to income taxes and Medicare taxes.

Impact on Workers' and Employers' Behavior

The reaction of high-earning workers and their employers to raising or removing the taxable earnings base is unknown and was not taken into consideration in the above estimates of the distributional, trust fund, and revenue impacts.

Workers who earn more than the cap would have a reduced incentive to work as their after-tax earnings will fall.[23] However, whether these individuals would significantly reduce the amount they work is a matter of debate.[24] Each worker would face a decision between the reduced earnings and the additional leisure time, based on the worker's individual preferences. Workers who have earnings above the current base would also have an incentive to change the form of their compensation (e.g., from earnings to fringe benefits) to avoid paying additional payroll taxes.[25]

The impact of raising the base on employers of high-income earners is also unknown. Employers contribute 6.2% of workers' wages up to the taxable wage base toward Social Security. If employers are unable to pass along the higher tax costs to workers in the form of reduced earnings, their overall labor costs will increase. Employers may react by raising prices to consumers, reducing other non-wage forms of compensation such as health benefits or pensions, or reducing the number of workers.

Arguments For and Against Raising or Eliminating the Base

Some of the general arguments for and against changing the Social Security taxable earnings base follow.

Arguments For

The major critique about the Social Security base is that it creates a regressive tax structure. Workers earning less than the base have a greater proportion of earnings taxed than workers whose earnings exceed it. In 2008, someone with annual earnings of $30,000 pays $1,860 in Social Security taxes, or 6.2% of his or her earnings (ignoring the employer share of the tax). However, because the tax is levied on only the first $106,800 in earnings, someone earning $200,000 a year pays $6,622 or 3% of his or her earnings.

Supporters of changing the wage base point out that only 6% of workers have earnings above the base in any given year. However, because of rising earnings inequality, the amount of their earnings that escapes taxation has risen from 12% to 15% since 1991, and is projected to continue to rise through 2014. They therefore contend that the current tax structure favors a small group of the more well-off workers in society.

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[23] The response by high earners may depend on whether the wage base is raised slightly or completely eliminated.

[24] For a more detailed discussion of this debate, see CRS Report RL33943, *Increasing the Social Security Payroll Tax Base: Options and Effects on Tax Burdens*, by (name redacted).

[25] See Martin Sullivan, "Budget Magic and the Social Security Tax Cap," *Tax Notes*, March 14, 2005.

They also point out that the overall employee tax rate rose from 6.13% in 1980 to 7.65% in 1990 (counting the Medicare portion)—or by 25%—and assert that this increase is one of the main reasons for a disproportionate rise in the aggregate federal tax burden on lower- and middle-income people over that decade.[26] They further maintain that for most workers, Social Security and Medicare taxes (counting the employer share, which they view as foregone wages) are now greater than their income taxes.

Supporters argue that subjecting a larger percentage of earnings to the payroll tax would also adjust for the higher life expectancies of high earners.[27] On average, people with more education and higher earnings live longer than those with lower earnings and less education and this difference has been growing over time. The impact on the Social Security program is that these individuals receive benefits for more years over their lifetimes making the system less progressive.[28] They claim that raising the taxable wage base would make a reasonable adjustment for the faster-than-average life expectancy gains among high earners.

Thus, supporters of changing the base argue that raising or eliminating the base not only would be more fair, but also that Social Security's projected long-range financing problems could be substantially alleviated or, alternatively, that the payroll tax rate could be reduced without causing a loss of revenue to the system. It is estimated that almost $100 billion in revenue to the Social Security program would be generated annually by taxing all earnings, and if such revenues were not used to lower the tax rate, they would reduce the government's outstanding debt and eliminate about 95% of Social Security's long-range deficit.

Among supporters of changing the current base, there is disagreement regarding how high the base should be raised or if other changes should be made to tax income above the base. Several proposals would not eliminate the base entirely but raise it to cover 90% of taxable wages, restoring the level that was set in the 1977 amendments to the Social Security Act. Others have claimed that increasing the base to 90% would be a large tax increase for those who earn between the current base and the new level, but would have little impact on the share of taxes paid by individuals with the highest earnings.[29] Other options would be to remove the cap completely over the base, but lower the tax rate on those higher earnings[30] or tax employers and employees at different rates above the current base. Others have called for broadening the sources of income that are taxed beyond earnings.[31] Proponents of these ideas argue that they would close a significant portion of Social Security's long-range deficit without subjecting upper-middle income individuals to sizeable increases in their marginal tax rates.

[26] See CRS Report RL32693, *Distribution of the Tax Burden Across Individuals: An Overview*, by (name redacted).

[27] See Peter A. Diamond and Peter R. Orzag, *Saving Social Security: A Balanced Approach*, Brookings Institution, 2004.

[28] The Social Security benefit formula is thought to be progressive in that the monthly benefits of low-wage earners replace a greater proportion of their earnings than do the monthly benefits of high-wage earners.

[29] For a study of how the effective tax rates paid by different income groups would change under such a proposal, see CRS Report RL33943, *Increasing the Social Security Payroll Tax Base: Options and Effects on Tax Burdens*, by (name redacted).

[30] Robert C. Posen, "PIN Money," *Wall Street Journal*, January 9, 2007.

[31] Citizens for Tax Justice, *An Analysis of Eliminating the Cap on Earnings Subject to the Social Security Tax and Related Issues*, November 30, 2006, at http://www.ctj.org/pdf/socialsecuritytaxearningscapnov2006.pdf.

Arguments Against

Those who support keeping the base as it is point out that while the structure of the payroll tax may be regressive, it is offset by the progressive calculation of benefits.

They further maintain that its critics fail to take into account the effect of other tax and transfer programs targeted to low-earners. They point out that mitigating the Social Security tax bite was part of the motivation for creating the earned income tax credit (EITC), which provides an income tax credit on earnings up to $41,646 in 2008 for married workers with two or more children (up to $15,880 for married workers without children). They also point out that low-income families receive a greater share of government transfer payments that are not subject to Social Security payroll taxes. They argue that the combination of these factors mitigates the flat-rate nature of the tax at lower earnings levels, and that for most other workers the tax is proportional (because it is flat-rate). It is only at the upper end of the income spectrum that it takes on a regressive appearance.

Critics also argue that raising the cap will serve as a disincentive to work and could serve as a drain on the economy.[32] Because additional work effort would generate less after-tax income, supporters claim that workers faced with this higher marginal rate would either reduce their hours or avoid the tax by changing the form of their compensation.

From another perspective, some—who might otherwise espouse progressive taxation—support raising the base but not eliminating it. Having a cap makes Social Security seem less like general purpose taxation. They argue that the system needs support from people of all earnings levels, and that the larger benefits that high earners would receive would represent a poor return for the higher taxes they would pay. Moreover, regardless of the money's worth issue, some question the wisdom of paying large benefits to well-to-do people. They argue that the purpose of the program is to provide a floor of protection for retirement, not large benefits for those who can save on their own. They contend that eliminating the base would raise public cynicism about a publicly financed system that pays enormous benefits to people who already are well off.

[32] See D. Mark Wilson, *Removing the Social Security's Tax Cap on Wages Would Do More Harm Than Good,* The Heritage Foundation, October 18, 2001.

Appendix. Taxable Earnings Bases and Worker Income: Detailed Tables

Table A-1. Social Security and Medicare Tax Rates and Taxable Earnings Bases, 1937-2010

Year	Tax Rates: Social Security[a]	Tax Rates: HI[a]	Tax Rates: Self-employed (Social Security and HI combined)	Maximum taxable earnings for Social Security and HI	Percentage of workers with earnings below Social Security base	Percentage of covered earnings below Social Security base
1937	1.000	—	—	$3,000	96.9	92.0
1940	1.000	—	—	3,000	96.6	92.4
1945	1.000	—	—	3,000	86.3	87.9
1950	1.500	—	—	3,000	71.1	79.7
1951	1.500	—	2.25	3,600	75.5	81.1
1952	1.500	—	2.25	3,600	72.1	80.5
1953	1.500	—	2.25	3,600	68.8	78.5
1954	2.000	—	3.0	3,600	68.4	77.7
1955	2.000	—	3.0	4,200	74.4	80.3
1956	2.000	—	3.0	4,200	71.6	78.8
1957	2.250	—	3.375	4,200	70.1	77.5
1958	2.250	—	3.375	4,200	69.4	76.4
1959	2.500	—	3.75	4,800	73.3	79.3
1960	3.000	—	4.5	4,800	72.0	78.1
1961	3.000	—	4.5	4,800	70.8	77.4
1962	3.125	—	4.7	4,800	68.8	75.8
1963	3.625	—	5.4	4,800	67.5	74.6
1964	3.625	—	5.4	4,800	65.5	72.8
1965	3.625	—	5.4	4,800	63.9	71.3
1966	3.850	0.35	6.15	6,600	75.8	80.0
1967	3.900	0.5	6.4	6,600	73.6	78.1
1968	3.800	0.6	6.4	7,800	78.6	81.7
1969	4.200	0.6	6.9	7,800	75.5	80.1
1970	4.200	0.6	6.9	7,800	74.0	78.2
1971	4.600	0.6	7.5	7,800	71.7	76.3
1972	4.600	0.6	7.5	9,000	75.0	78.3
1973	4.850	1.0	8.0	10,800	79.7	81.8
1974	4.950	0.9	7.9	13,200	84.9	85.3

Year	Tax Rates			Maximum taxable earnings for Social Security and HI	Percentage of workers with earnings below Social Security base	Percentage of covered earnings below Social Security base
	Social Security[a]	HI[a]	Self-employed (Social Security and HI combined)			
1975	4.950	0.9	7.9	14,100	84.9	84.4
1976	4.950	0.9	7.9	15,300	85.1	84.3
1977	4.950	0.9	7.9	16,500	85.2	85.0
1978	5.050	1.0	8.1	17,700	84.6	83.8
1979	5.080	1.05	8.1	22,900	90.0	87.3
1980	5.080	1.05	8.1	25,900	91.2	88.9
1981	5.350	1.3	9.3	29,700	92.4	89.2
1982	5.400	1.3	9.35	32,400	92.9	90.0
1983	5.400	1.3	9.35	35,700	93.7	90.0
1984	5.700	1.3	14.0	37,800	93.6	89.3
1985	5.700	1.35	14.1	39,600	93.5	88.9
1986	5.700	1.45	14.3	42,000	93.8	88.6
1987	5.700	1.45	14.3	43,800	93.9	87.6
1988	6.060	1.45	15.02	45,000	93.5	85.8
1989	6.060	1.45	15.02	48,000	93.8	86.8
1990	6.200	1.45	15.3	51,300	94.3	87.2
1991	6.200	1.45	15.3	53,400 (HI-125,000)	94.4	87.8
1992	6.200	1.45	15.3	55,500 (HI-130,200)	94.3	86.8
1993	6.200	1.45	15.3	57,600 (HI-135,000)	94.4	87.2
1994	6.200	1.45	15.3	60,600[a] (HI-no limit)	94.6	87.1
1995	6.200	1.45	15.3	61,200 (HI-no limit)	94.2	85.8
1996	6.200	1.45	15.3	62,700 (HI-no limit)	93.9	85.7
1997	6.200	1.45	15.3	65,400 (HI-no limit)	93.8	85.1
1998	6.200	1.45	15.3	68,400 (HI-no limit)	93.7	84.5
1999	6.200	1.45	15.3	72,600 (HI-no limit)	93.9	83.9
2000	6.200	1.45	15.3	76,200 (HI-no limit)	93.8	83.2
2001	6.200	1.45	15.3	80,400 (HI-no limit)	94.0	84.7

Year	Tax Rates			Maximum taxable earnings for Social Security and HI	Percentage of workers with earnings below Social Security base	Percentage of covered earnings below Social Security base
	Social Security[a]	HI[a]	Self-employed (Social Security and HI combined)			
2002	6.200	1.45	15.3	84,900 (HI-no limit)	94.6	86.1
2003	6.200	1.45	15.3	87,000 (HI-no limit)	94.5	85.9
2004	6.200	1.45	15.3	87,900 (HI-no limit)	94.1	84.8
2005	6.200	1.45	15.3	90,000 (HI-no limit)	94.0[b]	84.2[b]
2006	6.200	1.45	15.3	94,200 (HI-no limit)	94.0[b]	83.6[b]
2007	6.200	1.45	15.3	97,500 (HI-no limit)	93.9[b]	83.1[b]
2008	6.200	1.45	15.3	102,000 (HI-no limit)	Not yet known	84.1[b]
2009	6.200	1.45	15.3	106,800 (HI-no limit)	Not yet known	Not yet known
2010	6.200	1.45	15.3	106,800 (HI-no limit)	Not yet known	Not yet known

Source: Social Security Bulletin, *Annual Statistical Supplement, 2009*, at http://www.ssa.gov/policy/docs/statcomps/supplement/2009.

a. Same for employer except 1984—employees received 0.3% credit (not reflected above). Various credits also applied to self-employed (not reflected above) for 1984-1989 period.

b. Estimates.

Table A-2. The Number and Percentage of Covered Workers with Social Security Taxable Earnings over the Taxable Earnings Base of $97,500, by State, 2007

State	Total Number of Covered Workers With Social Security Taxable Earnings	Number and Share of Covered Workers with Social Security Taxable Earnings Above the Taxable Earnings Base	
		Number of Workers	Percentage of Workers
U.S. Total	158,778,500	9,854,700	6.2
Alabama	2,347,200	92,100	3.9%
Alaska	383,100	22,100	5.8%
Arizona	3,021,600	163,300	5.4%
Arkansas	1,447,300	43,000	3.0%
California	16,831,500	1,513,000	9.0%
Colorado	2,483,000	177,200	7.1%
Connecticut	1,972,100	205,800	10.4%
District of Columbia	372,300	42,400	11.4%
Delaware	516,400	30,100	5.8%
Florida	9,241,100	438,800	4.8%
Georgia	4,693,600	260,400	5.6%
Hawaii	725,700	30,900	4.3%
Idaho	785,000	30,000	3.8%
Illinois	6,523,900	463,800	7.1%
Indiana	3,647,500	143,800	3.9%
Iowa	1,723,800	59,700	3.5%
Kansas	1,542,000	70,600	4.6%
Kentucky	2,133,700	71,900	3.4%
Louisiana	2,095,600	95,000	4.5%
Maine	761,900	26,300	3.5%
Maryland	3,165,100	294,800	9.3%
Massachusetts	3,433,200	338,100	9.9%
Michigan	5,171,500	282,700	5.5%
Minnesota	3,090,700	185,800	6.0%
Mississippi	1,378,500	38,500	2.8%
Missouri	3,097,700	133,700	4.3%
Montana	552,800	17,800	3.2%
Nebraska	1,037,800	36,000	3.5%
Nevada	1,255,500	58,900	4.7%
New Hampshire	813,500	60,000	7.4%
New Jersey	4,719,700	547,000	11.6%

State	Total Number of Covered Workers With Social Security Taxable Earnings	Number and Share of Covered Workers with Social Security Taxable Earnings Above the Taxable Earnings Base	
		Number of Workers	Percentage of Workers
New Mexico	957,700	36,200	3.8%
New York	10,003,900	855,600	8.6%
North Carolina	4,727,900	224,200	4.7%
North Dakota	389,600	11,400	2.9%
Ohio	5,769,700	276,300	4.8%
Oklahoma	1,886,300	61,000	3.2%
Oregon	1,963,200	98,600	5.0%
Pennsylvania	6,722,200	389,600	5.8%
Rhode Island	606,300	35,500	1.6%
South Carolina	2,260,900	85,300	3.8%
South Dakota	481,200	10,300	2.1%
Tennessee	3,237,300	141,800	4.4%
Texas	11,255,800	740,700	6.6%
Utah	1,329,100	56,300	4.2%
Vermont	425,600	15,100	3.6%
Virginia	4,291,900	353,800	8.2%
Washington	3,440,500	248,300	7.2%
West Virginia	867,000	26,600	3.1%
Wisconsin	3,190,300	132,600	4.2%
Wyoming	336,000	13,900	4.1%

Source: Custom tabulation based on the Continuous Work History Sample Files. Data extracted as of January 2009. Table provided by SSA, Office of Policy, Office of Research, Evaluation and Statistics.

Table A-3. Number and Percentage of Workers Above the Taxable Earnings Base of $97,500 by Type of Earnings and Sex, 2007

	Number[a] (in thousands)	Percentage of Group in Total	Percent of Group Above the Taxable Maximum
All workers	10,210	100%	6%
Men	7,813	77%	9%
Women	2,399	23%	3%
All wage and salary workers	9,420	92%	6%
Men	7,168	70%	9%
Women	2,253	22%	3%
All self-employed	790	8%	5%
Men	645	6%	6%
Women	146	2%	2%

Source: Social Security Bulletin, *Annual Statistical Supplement, 2009* at http://www.ssa.gov/policy/docs/statcomps/supplement/2009. (CRS calculations based on 2007 estimates from tables, 4.B1,4.B4, 4.B7, and 4B.9.)

a. Workers with earnings in both wage and salary employment and self-employment are counted in each type of employment but only once in the total.

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