Social Security: Temporary Payroll Tax Reduction

Dawn Nuschler
Specialist in Income Security

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Summary

In December 2010, Congress approved a temporary 2 percentage point reduction in the Social Security payroll tax rate for employees and the self-employed in 2011 as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). The Social Security payroll tax rate in 2011 was 4.2% for employees and 10.4% for self-employed workers. The law made no changes to the Social Security payroll tax rate for employers (6.2%) or to the amount of wages and net self-employment income subject to the Social Security payroll tax ($106,800 in 2011). An individual's future Social Security benefit amount is not affected.

The temporary reduction in the payroll tax for employees and the self-employed in 2011 was intended to provide an economic stimulus by increasing workers' take-home pay. For example, the annual Social Security withholding for a worker earning the average wage in 2011 (an estimated $44,687) was lower by about $894. The annual Social Security withholding for a worker earning the maximum taxable wage ($106,800 in 2011) was lower by $2,136.

P.L. 111-312 provided general revenue transfers to the Social Security trust funds to make up for the loss of payroll tax revenues. In August 2011, the Congressional Budget Office estimated that these general revenue transfers to the Social Security trust funds would total $111 billion.

In late 2011, the House and Senate considered several bills to extend and expand the payroll tax reduction in 2012. On December 23, 2011, a measure to extend the payroll tax reduction for workers for two months (through the end of February 2012) was passed by the House and the Senate and signed into law by President Obama (H.R. 3765, P.L. 112-78). In early 2012, a conference committee is expected to consider a full-year extension of the payroll tax reduction.

The temporary reduction in the Social Security payroll tax for employees and the self-employed has drawn mixed reactions from policymakers. Some observers express concern about the potential impact of the payroll tax reduction on Social Security's long-term finances, despite the general revenue transfers to protect the trust funds from a loss of payroll tax revenues. These observers point out that, although the payroll tax reduction is temporary, the possibility remains that Congress could continue to extend the payroll tax reduction or make the payroll tax reduction permanent in response to political or other pressures. In addition, they maintain that the general revenue transfers to the Social Security trust funds introduce an element of general revenue financing to the Social Security program, signaling a departure from the self-financing mechanism that has been in place since the program's enactment in the 1930s that could jeopardize the future of the program.

Others support the payroll tax reduction on the basis that it will stimulate economic recovery and create jobs at a time when the United States continues to experience high rates of unemployment. They maintain that the immediate increase in take-home pay will spur additional consumer spending, increasing the demand for products and services, which in turn will increase production and employment. Supporters point to the payroll tax exemption for *employers* in 2010 for hiring certain unemployed workers as a precedent. They also point out that temporarily reducing Social Security payroll taxes is a policy option that has been advanced in various forms by recent deficit reduction commissions, among others, as an effective way to stimulate economic growth and job creation consistent with long-term fiscal discipline.

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Introduction

Social Security is a self-financed program that provides benefits to retired or disabled workers and their family members and to the family members of deceased workers. Social Security is financed by payroll taxes paid by covered workers and their employers. Employees and employers each pay 6.2% of covered earnings up to an annual limit; self-employed individuals pay 12.4% of net self-employment income up to an annual limit.[1] Social Security is also credited with tax revenues from the federal income taxes paid by some beneficiaries on a portion of their benefits. In addition, Social Security receives interest income from Social Security trust fund investments. Social Security income and outgo are accounted for in two separate trust funds authorized under Title II of the Social Security Act: the Federal Old-Age and Survivors Insurance (OASI) trust fund and the Federal Disability Insurance (DI) trust fund.[2]

In March 2010, Congress approved a temporary payroll tax exemption for *employers* as part of the Hiring Incentives to Restore Employment Act (HIRE Act; P.L. 111-147).[3] In 2010, employers were exempt from the employer's share of the payroll tax (6.2%) if they hired an individual who had not been employed for more than 40 hours during the preceding 60-day period. The employee's share of the payroll tax was not affected. The payroll tax exemption for employers expired on December 31, 2010. The law provided general revenue transfers to the Social Security trust funds in amounts needed to protect the trust funds from a loss of payroll tax revenues due to the temporary exemption.

In December 2010, Congress approved a temporary 2 percentage point reduction in the Social Security payroll tax rate for *employees and the self-employed* in 2011 as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).[4] The employer's share of the payroll tax was not affected. The law provided general revenue transfers to the Social Security trust funds in amounts needed to protect the trust funds from a loss of payroll tax revenues.

In late 2011, the House and Senate considered several bills to extend and expand the payroll tax reduction in 2012. On November 28, 2011, Senator Harry Reid announced that the Senate would take up legislation to extend and expand the payroll tax reduction in 2012 (S. 1917). On November 30, 2011, Senate Republicans offered an alternative proposal that would extend the payroll tax reduction for employees and the self-employed in 2012 (S. 1931). On December 1, 2011, both measures failed in the Senate on procedural votes. On December 5, 2011, Senate Democrats introduced a revised proposal to extend and increase the payroll tax reduction for workers in 2012 (S. 1944). On December 8, 2011, S. 1944 failed in the Senate on a procedural vote, and S. 1931 failed in the Senate a second time on a procedural vote. On December 9, 2011, House Republicans introduced a broad measure that includes a provision to extend the payroll tax reduction for workers for one year (H.R. 3630). On December 13, 2011, H.R. 3630 was passed by

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[1] Congress has increased the Social Security payroll tax rate many times over the program's history. The payroll tax rate under current law (12.4%) was established by P.L. 98-21 (the Social Security Amendments of 1983). P.L. 98-21 increased the payroll tax rate gradually from 11.4% in 1984 to 12.4% in 1990.

[2] In this report, the OASI and DI trust funds are referred to on a combined basis as the Social Security trust funds.

[3] See Title I, §101 (Payroll Tax Forgiveness for Hiring Unemployed Workers) of P.L. 111-147, available at http://www.gpo.gov/fdsys/pkg/PLAW-111publ147/pdf/PLAW-111publ147.pdf.

[4] The temporary reduction in the Social Security payroll tax is also referred to as a "payroll tax holiday."

the House by a vote of 234-193. On December 17, 2011, the Senate passed H.R. 3630, as amended, by a vote of 89-10. H.R. 3630, as amended, would extend the payroll tax reduction for workers for two months through the end of February 2012. On December 20, 2011, the House voted 229-193 to disagree with the Senate-passed version of H.R. 3630 and request a conference with the Senate to resolve differences between the House- and Senate-passed versions of H.R. 3630 regarding an extension of the payroll tax reduction for workers. On December 23, 2011, House Republicans introduced a measure to extend the payroll tax reduction for workers for two months through the end of February 2012 (H.R. 3765). The same day, H.R. 3765 was passed by the House and the Senate and signed into law by President Obama (P.L. 112-78). In early 2012, a conference committee is expected to meet in an effort to resolve differences between the House- and Senate-passed versions of H.R. 3630.

This report discusses Social Security policy considerations related to temporary payroll tax reductions. For a discussion of economic stimulus considerations related to temporary payroll tax reductions, see CRS Report R42103, *The Temporary Payroll Tax Reduction: A Brief Description and Economic Analysis*, by Donald J. Marples.

How the Social Security Program Is Financed

The Social Security program is financed primarily by revenues from Federal Insurance Contributions Act (FICA) taxes and Self Employment Contributions Act (SECA) taxes. FICA taxes are paid by both employers and employees, but it is employers who remit the taxes to the U.S. Treasury. Employers remit FICA taxes on a regular basis throughout the year (for example, weekly, monthly, quarterly or annually), depending on the employer's level of total employment taxes (Social Security, Medicare and federal individual income tax withholding).

The FICA tax rate of 7.65% each for employers and employees has two components: 6.2% for Social Security and 1.45% for Medicare Hospital Insurance (HI). Under current law, employers and employees each pay 6.2% of wages up to an annual limit ($110,100 in 2012) in Social Security payroll taxes. The SECA tax rate is 15.3% for self-employed individuals, with 12.4% for Social Security and 2.9% for Medicare HI. Self-employed individuals pay 12.4% of net self-employment income up to an annual limit ($110,100 in 2012) in Social Security payroll taxes. One-half of the SECA taxes are allowed as a deduction for federal income tax purposes.[5] SECA taxes are normally paid once a year as part of filing an annual individual income tax return.[6]

In addition to Social Security payroll taxes, the Social Security program has two other sources of income. Certain Social Security beneficiaries must include a portion of Social Security benefits in taxable income for the federal income tax, and the Social Security program receives part of those taxes.[7] In addition, the Social Security program receives interest from the U.S. Treasury on its investments in special U.S. government obligations.

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[5] Self-employed individuals are required to pay Social Security payroll taxes if they have annual net earnings of $400 or more. Only 92.35% of net self-employment income (up to the annual limit) is taxable.

[6] The limit on wages and net self-employment income subject to the Social Security payroll tax (the taxable wage base) is adjusted annually based on average wage growth, if a Social Security cost-of-living adjustment (COLA) is payable. Because no COLA was payable in 2010 and 2011, the taxable wage base remained $106,800 from 2009 to 2011. The Medicare HI component of the FICA and SECA tax is levied on total wages.

[7] The taxes associated with including Social Security benefits in federal taxable income go to the Social Security trust (continued...)

As the Managing Trustee of the Social Security trust funds, the Secretary of the Treasury is required by law to invest Social Security revenues in interest-bearing federal government securities (special issues) held by the trust funds.[8] The revenues exchanged for the federal government securities are deposited into the general fund of the U.S. Treasury and are indistinguishable from revenues in the general fund that come from other sources. Because the assets held by the trust funds are federal government securities, the trust fund balance represents the amount of money owed to the Social Security trust funds by the general fund of the U.S. Treasury. Funds needed to pay Social Security benefits and administrative expenses come from the redemption or sale of federal government securities held by the trust funds.[9]

Based on the program's current financing and benefit structure, the Social Security Board of Trustees projects that Social Security expenditures will exceed *tax revenues* each year from 2011 to 2085 (i.e., the program will operate with annual cash-flow deficits). When interest income to the trust funds is taken into account, the trustees project that the Social Security trust funds will have a total surplus each year from 2011 to 2022 (i.e., total income—tax revenues plus interest income—will exceed Social Security expenditures). As a result, the balance in the Social Security trust funds (the amount of assets held by the trust funds in the form of federal government securities) is projected to increase each year from 2011 to 2022. Beginning in 2023, however, trust fund reserves will begin to be drawn down to help pay benefits and administrative expenses.

Over the long run, the trustees project that Social Security expenditures will exceed income by 14% on average over the next 75 years, and that trust fund assets will be exhausted in 2036. Social Security benefits scheduled under current law can be paid in full until trust fund assets are exhausted (2036). After the trust funds are exhausted, annual Social Security revenues are projected to cover about three-fourths of benefit payments scheduled under current law.[10]

Temporary Payroll Tax Reduction for Workers in 2011

As noted above, the Social Security payroll tax rate is 6.2% for employers and employees (each) and 12.4% for the self-employed. On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). Title VI of the law provided a temporary 2 percentage point reduction in the payroll tax rate for employees and the self-employed in 2011.[11] The Social Security payroll tax rate in 2011 was 4.2% for employees and 10.4% for the self-employed.[12] P.L. 111-312 made no changes to the

(...continued)

funds and the Medicare HI trust fund. See CRS Report RL32552, *Social Security: Calculation and History of Taxing Benefits*, by Christine Scott.

[8] Social Security Act, Title II, §201(d).

[9] Social Security Administration, *Trust Fund FAQs*, http://www.socialsecurity.gov/OACT/ProgData/fundFAQ.html.

[10] Projections are based on the intermediate assumptions of The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, May 13, 2011, available at http://www.socialsecurity.gov/OACT/TR/2011/. For more information on the trust fund projections, see CRS Report RL33028, *Social Security: The Trust Fund*, by Dawn Nuschler and Gary Sidor.

[11] The temporary reduction in the payroll tax rate also applied to railroad workers. For more information, see CRS Report RS22350, *Railroad Retirement Board: Retirement, Survivor, Disability, Unemployment, and Sickness Benefits*, by Alison M. Shelton.

[12] The temporary reduction in the payroll tax rate did not affect the amount of payroll taxes that self-employed individuals may deduct for federal income tax purposes.

Social Security payroll tax rate for employers (6.2%) or to the amount of annual wages and net self-employment income subject to the Social Security payroll tax ($106,800 in 2011). The reduction in the Social Security payroll tax does not affect the amount of an individual's future Social Security benefit.[13]

The temporary reduction in the payroll tax for employees and the self-employed in 2011 was intended to provide an economic stimulus by increasing workers' take-home pay. For example, the annual Social Security withholding for a worker earning the average wage in 2011 (an estimated $44,687)[14] was lower by about $894. The annual Social Security withholding for a worker earning the maximum taxable wage ($106,800 in 2011) was lower by $2,136.

To protect the Social Security trust funds from a loss of payroll tax revenues resulting from the temporary reduction in the payroll tax rate for employees and the self-employed, P.L. 111-312 appropriated to the Social Security trust funds amounts equal to the reduction in payroll tax revenues to the Treasury. The law specified that these appropriated amounts "shall be transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers which would have occurred to such Trust Fund had such amendments not been enacted."[15] In August 2011, the Congressional Budget Office estimated that general revenue transfers to the Social Security trust funds as a result of the temporary payroll tax reduction in 2011 would total $111 billion.[16]

Senate Democratic Proposal to Extend and Expand the Payroll Tax Reduction in 2012 (S. 1917)

On November 28, 2011, Senator Harry Reid announced that the Senate would take up legislation to extend and expand the Social Security payroll tax reduction in 2012 (S. 1917, the Middle Class Tax Cut Act of 2011, introduced by Senator Robert Casey). S. 1917 would provide a 3.1 percentage point reduction in the payroll tax for workers in 2012 (the worker's share of the payroll tax would be reduced from 6.2% to 3.1%). In addition, the measure would provide a 3.1 percentage point reduction in the payroll tax for employers (from 6.2% to 3.1%) on the first $5 million of taxable payroll for 2012.

The measure also would eliminate the Social Security payroll tax for employers on the first $12.5 million of increased wages paid by the employer for the fourth quarter of 2011, and on the first $50 million of increased wages paid by the employer for 2012 (i.e., increased wages attributed to new hires or higher wages paid to current workers).

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[13] An individual's Social Security benefit is based on his or her average lifetime earnings subject to the Social Security payroll tax, indexed to account for changes in average wages over time. Because P.L. 111-312 did not affect the amount of wages and net self-employment income subject to the Social Security payroll tax, it does not affect the amount of an individual's future Social Security benefit.

[14] Social Security Administration, *2011 Social Security/SSI/Medicare Information*, December 22, 2010, available at http://www.socialsecurity.gov/legislation/2011factsheet.pdf (hereinafter cited as SSA 2011 Fact Sheet).

[15] The text of P.L. 111-312 is available at http://www.gpo.gov/fdsys/pkg/PLAW-111publ312/pdf/PLAW-111publ312.pdf. See Title VI, Temporary Employee Payroll Tax Cut.

[16] Congressional Budget Office, Combined OASDI Trust Funds, August 2011 Baseline, available at http://www.cbo.gov/budget/factsheets/2011c/OASDITrustFund.pdf.

S. 1917 would provide general revenue transfers to the Social Security trust funds to make up for the loss of payroll tax revenues.

A preliminary estimate by the Joint Committee on Taxation shows that the payroll tax provisions in S. 1917 would cost $265 billion.[17] To offset the cost of the measure, S. 1917 would impose a 3.25% surtax on modified adjusted gross income in excess of $1 million for single filers and married couples filing jointly, effective for taxable years beginning after December 31, 2012.[18]

On December 1, 2011, S. 1917 failed in the Senate on a 51-49 procedural vote.

Senate Republican Proposal to Extend the Payroll Tax Reduction in 2012 (S. 1931)

On November 30, 2011, Senator Dean Heller introduced legislation (S. 1931, the Temporary Tax Holiday and Government Reduction Act) to extend the temporary 2 percentage point reduction in the Social Security payroll tax for workers, set to expire at the end of calendar year 2011, in 2012. S. 1931, offered as an alternative to the Senate Democratic proposal, would not provide a payroll tax reduction for employers. The measure would provide general revenue transfers to the Social Security trust funds to make up for the loss of payroll tax revenues.

Among other provisions, S. 1931 would offset the cost by extending the current federal employee pay freeze for an additional three years and reducing the size of the federal workforce. The measure would effectively eliminate unemployment compensation for certain individuals based on income; make certain individuals ineligible for benefits under the Supplemental Nutrition Assistance Program (formerly known as food stamps) based on income; and require certain individuals, based on income, to pay higher Medicare premiums compared with current law.[19]

On December 1, 2011, S. 1931 failed in the Senate on a 20-78 procedural vote. S. 1931 failed in the Senate a second time by a 22-76 procedural vote on December 8, 2011.

Revised Senate Democratic Proposal to Extend and Increase the Payroll Tax Reduction for Workers in 2012 (S. 1944)

On December 5, 2011, Senator Robert Casey introduced a revised Senate Democratic proposal to extend and increase the Social Security payroll tax reduction for workers in 2012 (S. 1944, the Middle Class Tax Cut Act of 2011). Among other provisions, S. 1944 would provide a 3.1 percentage point reduction in the Social Security payroll tax for workers in 2012 (the worker's share of the payroll tax would be reduced from 6.2% to 3.1%). The measure would not provide a

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[17] Joint Committee on Taxation, *Estimated Budget Effects of "The Middle Class Tax Cut Act of 2011,"* November 28, 2011.

[18] A summary document released by the Democratic Policy and Communications Center on November 28, 2011, is available at http://www.cq.com/pdf/govdoc-3988932.

[19] See the November 30, 2011, press release on Senator Dean Heller's website at http://www.heller.senate.gov/public/index.cfm/2011/11/heller-offers-bill-to-extend-temporary-payroll-tax-cut. In addition, see Congressional Budget Office, *Budgetary Effects for S. 1931, the Temporary Tax Holiday and Government Reduction Act, as introduced on November 30, 2011*, December 1, 2011, at http://cbo.gov/ftpdocs/125xx/doc12578/s1931.pdf.

payroll tax reduction for employers. S. 1944 would provide general revenue transfers to the Social Security trust funds to make up for the loss of payroll tax revenues.

To offset the cost of the measure, S. 1944 would impose a temporary 1.9% surtax on modified adjusted gross income in excess of $1 million for single filers and married couples filing jointly, effective for taxable years beginning after 2012 and before 2022. In addition, the measure would increase the fees that Fannie Mae and Freddie Mac charge mortgage lenders to guarantee repayment of new mortgage loans. S. 1944 would effectively eliminate unemployment compensation for certain individuals based on income and make certain individuals ineligible for benefits under the Supplemental Nutrition Assistance Program (formerly known as food stamps) based on income.[20]

On December 8, 2011, S. 1944 failed in the Senate on a 50-48 procedural vote.

House Republican Proposal to Extend the Social Security Payroll Tax Reduction for Workers in 2012 (H.R. 3630)

On December 9, 2011, Representative Dave Camp introduced H.R. 3630, the Middle Class Tax Relief and Job Creation Act of 2011. Among other provisions, the broad (369-page) measure would extend for one year the 2 percentage point reduction in the Social Security payroll tax for workers. The measure would not provide a payroll tax reduction for employers. H.R. 3630 would provide general revenue transfers to the Social Security trust funds to make up for the loss of payroll tax revenues.[21]

Among other provisions, H.R. 3630 would offset the cost of the bill by extending the current pay freeze for federal employees and making changes to civilian federal pension benefits. The measure would effectively eliminate unemployment compensation for certain individuals based on income; make certain individuals ineligible for benefits under the Supplemental Nutrition Assistance Program (formerly known as food stamps) based on income; and require certain individuals, based on income, to pay higher Medicare premiums compared with current law.[22]

On December 13, 2011, H.R. 3630 was passed by the House by a vote of 234-193.

Senate Proposal to Extend for Two Months the Social Security Payroll Tax Reduction for Workers (H.R. 3630, As Amended)

On December 17, 2011, the Senate passed H.R. 3630, with an amendment in the nature of a substitute (S.Amdt. 1465), by a vote of 89-10. Among other provisions, the Senate-passed version of H.R. 3630 (renamed the Temporary Payroll Tax Cut Continuation Act of 2011) would extend

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[20] See the December 5, 2011, press release on Senator Robert Casey's website at http://www.casey.senate.gov/newsroom/press/release/?id=bc7ab64b-e999-4d86-b980-cd555e4b56e0.

[21] The Congressional Budget Office estimates that the general revenue transfers to the Social Security trust funds to make up for the loss of payroll tax revenues would total $121.223 billion. See CBO's Letter to the Honorable Dave Camp, Table 2, *Effects on Revenues and Direct Spending of H.R. 3630, the Middle Class Tax Relief and Job Creation Act of 2011, as Introduced on December 9, 2011*, at http://www.cbo.gov/ftpdocs/126xx/doc12609/hr3630.pdf.

[22] See the December 9, 2011, press release on Representative Dave Camp's website at http://camp.house.gov/News/DocumentPrint.aspx?DocumentID=271961.

the payroll tax reduction for workers *for two months* (i.e., for January and February 2012). Under H.R. 3630, as amended, the reduced 4.2% payroll tax rate for workers would apply to the first $18,350 of covered wages (an amount equal to two-twelfths of the 2012 taxable wage base of $110,100).

On December 20, 2011, the House voted 229-193 to disagree with the Senate-passed version of H.R. 3630 and request a conference with the Senate to resolve differences between the House- and Senate-passed versions of H.R. 3630 regarding an extension of the payroll tax reduction for workers.

House and Senate Agreement on a Two-Month Extension of the Social Security Payroll Tax Reduction for Workers (H.R. 3765)

On December 23, 2011, Representative Dave Camp introduced H.R. 3765, the Temporary Payroll Tax Cut Continuation Act of 2011. Among other provisions, the measure extends the 2 percentage point reduction in the Social Security payroll tax for workers for two months (i.e., through February 29, 2012). The reduced payroll tax rate (4.2%) applies to the first $18,350 of covered wages (an amount equal to two-twelfths of the 2012 taxable wage base of $110,100).

On December 23, 2011, H.R. 3765 was passed by the House and the Senate and signed into law by President Obama (P.L. 112-78).

Social Security Policy Considerations

The temporary reduction in the payroll tax for employees and the self-employed has drawn mixed reactions from policymakers. The following section presents key policy considerations raised by opponents and supporters of the temporary payroll tax reduction.[23]

Views Among Opponents

Despite the general revenue transfers to protect the trust funds from a loss of payroll tax revenues, some observers have expressed concern about the potential impact of the temporary reduction in the payroll tax for employees and the self-employed on Social Security's long-term finances. These observers point out that, although the payroll tax reduction is temporary, the possibility remains that Congress could continue to extend the payroll tax reduction or make the payroll tax reduction permanent in response to political or other pressures without providing transfers from general revenues. In addition, restoring the 2 percentage points of the employee's share of the payroll tax (from 4.2% to 6.2%) could be viewed by the public as a 50% increase in Social Security payroll taxes.

Opponents maintain that the general revenue transfers to the Social Security trust funds introduce an element of general revenue financing to the Social Security program, signaling a departure from the self-financing mechanism that has been in place since the program's enactment in the

[23] For information on administrative issues associated with the temporary reduction in the Social Security payroll tax in 2011, see *Social Security Tax Holiday Has Payroll Managers Scrambling*, Tax Notes, January 3, 2011, p. 26.

1930s. They believe that, without a dedicated revenue source, the future of the program could be in jeopardy if, like other federal programs, Social Security must rely on general revenues for part of its funding. Moreover, they point out that using general revenues to partially fund benefits breaks the traditional link between payroll tax contributions and benefits, weakening the fundamental earned-right nature of the program which in turn could affect public support for the program. Finally, some argue that using general revenues to partially fund Social Security benefits is unfair because not all taxpayers participate in the Social Security system.[24]

Some observers believe that other policy options, such as an extension of the Making Work Pay (MWP) refundable tax credit, would be more effective as an economic stimulus measure than a temporary reduction in the employees' share of the payroll tax.[25] The MWP tax credit was authorized by the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) and expired on December 31, 2010. It provided workers with a federal income tax credit of 6.2% of wages, up to a maximum credit of $400 ($800 for married couples filing jointly), in tax years 2009 and 2010. The MWP tax credit was phased out for workers with incomes above $75,000 ($150,000 for married couples filing jointly). It was implemented during the tax year by lowering the amount of federal income taxes withheld from workers' paychecks.[26]

Some observers favor the MWP tax credit over a reduction in the Social Security payroll tax because it was available to all workers (not just those covered by Social Security).[27] Moreover, the MWP tax credit was more favorable to workers earning less than $20,000, compared to the payroll tax reduction. For a worker earning $20,000, the value of the MWP tax credit and the payroll tax reduction is the same ($400).[28] At earnings levels above $20,000, the value of the payroll tax reduction is relatively greater.[29] At earnings levels below $20,000, the value of the MWP tax credit is relatively greater.[30]

Because the refundable MWP tax credit was more generous to lower-wage workers compared to the payroll tax reduction (which provides an increasingly larger dollar benefit for workers with higher earnings), and lower-wage earners are believed to be more likely to spend the additional take-home pay compared with middle- and higher-wage earners, the MWP tax credit is considered by some to be a more effective economic stimulus measure. As a result, some observers recommend adding a "hold harmless" provision for lower-wage workers so that these

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[24] On a related point, the temporary payroll tax reduction has been criticized by some observers because it does not benefit individuals who work in jobs that are not covered by Social Security (such as some state and local government employees). For more information, see The National Committee to Preserve Social Security and Medicare (NCPSSM), *Reps. Doggett, Chu, DeFazio, Deutch, Holt, and the National Committee to Preserve Social Security and Medicare Call Payroll Tax Holiday Bad Break for Families*, December 15, 2010, available at http://www.ncpssm.org/news/archive/opposing_payroll_tax_cut/. See also NCPSSM, *Social Security Experts Detail Why Payroll Tax "Holiday" is No Gift to Americans*, December 10, 2010, available at http://www.ncpssm.org/news/archive/payroll_tax_holiday_press_release/.

[25] For more information, see Center for Budget and Policy Priorities (CBPP), *Payroll Tax Holiday a Poor Stimulus Idea, "Making Work Pay" Credit a Better-Targeted Alternative*, January 26, 2009, available at http://www.cbpp.org/cms/index.cfm?fa=view&id=2264.

[26] For information on the MWP tax credit, see CRS Report R40969, *Withholding of Income Taxes and the Making Work Pay Tax Credit*, by John J. Topoleski.

[27] An estimated 7% of workers in paid employment or self-employment are *not* covered by Social Security. See SSA 2011 Fact Sheet available at http://www.socialsecurity.gov/legislation/2011factsheet.pdf.

[28] MWP tax credit = $20,000 * 6.2% (up to $400) = **$400**; payroll tax reduction = $20,000 * 2% = **$400**.

[29] MWP tax credit = $21,000 * 6.2% (up to $400) = **$400**; payroll tax reduction = $21,000 * 2% = **$420**.

[30] MWP tax credit = $19,000 * 6.2% (up to $400) = **$400**; payroll tax reduction = $19,000 * 2% = **$380**.

workers would be no worse off under the payroll tax reduction compared with the MWP tax credit.[31]

Views Among Supporters

Some observers support the temporary reduction in the Social Security payroll tax on the basis that it will stimulate economic recovery and create jobs at a time when the United States continues to experience high rates of unemployment. They maintain that the immediate increase in take-home pay will spur additional consumer spending, increasing the demand for products and services, which in turn will increase production and employment.

A temporary reduction in the Social Security payroll tax is not without precedent. As noted previously, in 2010, Congress approved a temporary exemption from the payroll tax for *employers* who hired certain unemployed persons, as part of the HIRE Act of 2010 (P.L. 111-147). Temporarily reducing Social Security payroll taxes is a policy option that has been advanced in various forms by recent deficit reduction commissions, among others, as an effective way to stimulate economic growth and job creation consistent with long-term fiscal discipline.[32]

In testimony before the Senate Budget Committee in September 2010 on the potential impact of various fiscal policy options on the economy, CBO Director Douglas W. Elmendorf stated:

> A temporary reduction in payroll taxes—especially in the share of taxes paid by employers—would also have a significant positive short-term effect on the economy. This approach would boost output and employment both by increasing demand for goods and services and by providing an incentive for additional hiring.[33]

CBO estimated that reducing Social Security payroll taxes for *employees* would raise output cumulatively over a five-year period by $0.30 to $0.90 per dollar of total budgetary cost. In comparison, CBO estimated that reducing Social Security payroll taxes for *employers* would have a somewhat larger effect, raising output by $0.40 to $1.20 per dollar of total budgetary cost.[34]

In November 2010, the Bipartisan Policy Center's deficit reduction commission co-chaired by former Senator Pete Domenici and Dr. Alice Rivlin recommended a one-year suspension of the Social Security payroll tax for employers and employees. The commission recommended that

[31] For example, see Economic Policy Institute, *Any payroll tax cut should be designed not to hurt lower-income workers*, December 15, 2010, available at http://www.epi.org/analysis_and_opinion/entry/any_payroll_tax_cut_should_be_designed_not_to_hurt_lower-income_workers/.

[32] For example, see CBO, *Information on Reducing Payroll Taxes to Encourage Employment*, Letter to the Honorable Robert P. Casey Jr., February 3, 2010, available at http://www.cbo.gov/ftpdocs/110xx/doc11042/02-03-CaseyLetter.pdf. See also CBO, *Policies for Increasing Economic Growth and Employment in 2010 and 2011*, January 2010, available at http://www.cbo.gov/ftpdocs/108xx/doc10803/01-14-Employment.pdf.

[33] CBO, *The Economic Outlook and Fiscal Policy Choices*, Testimony by CBO Director Douglas W. Elmendorf before the Senate Committee on the Budget, September 28, 2010, p. 3, available at http://www.cbo.gov/ftpdocs/118xx/doc11874/09-28-EconomicOutlook_Testimony.pdf. (Hereafter cited as CBO Testimony before the Senate Budget Committee, September 28, 2010.)

[34] CBO Testimony before the Senate Budget Committee, September 28, 2010, pp. 21-22. In this analysis, CBO noted that the largest effect on the economy per dollar of budgetary cost would result from a temporary increase in aid to the unemployed. P.L. 111-312, which provided the temporary payroll tax reduction for employees and the self-employed in 2011, also extended the temporary Emergency Unemployment Compensation (EUC08) program until December 31, 2011.

employers and employees be exempt from the 12.4% payroll tax in 2011, and that the Social Security trust funds be reimbursed in full from general revenues. The commission stated that the proposal would cost an estimated $650 billion and would create between 2.5 million and 7 million new jobs (based on CBO assumptions).[35]

In December 2010, the National Commission on Fiscal Responsibility and Reform established by President Obama recommended a "temporary suspension of one side of the Social Security payroll tax, financed by transfers from general revenue." The commission stated that the proposal would cost an estimated $50 billion to $100 billion in lost revenues, depending on the design, and that CBO found it would result in "significant short-term economic growth and job creation."[36]

Author Contact Information

Dawn Nuschler
Specialist in Income Security
dnuschler@crs.loc.gov, 7-6283

[35] Bipartisan Policy Center, *Restoring America's Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-Growth Tax System*, The Debt Reduction Task Force, Senator Pete Domenici and Dr. Alice Rivlin, Co-Chairs, November 2010, pp. 10 and 16, available at http://bipartisanpolicy.org/sites/default/files/FINAL%20DRTF%20REPORT%2011.16.10.pdf. For more information, see estimates of the OASDI financial effects and benefit illustrations under the plan prepared by the Office of the Chief Actuary, Social Security Administration, available at http://www.ssa.gov/OACT/solvency/index.html.

[36] *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, December 1, 2010, p. 43, available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf. For more information, see estimates of the OASDI financial effects and benefit illustrations under the plan prepared by the Office of the Chief Actuary, Social Security Administration, available at http://www.ssa.gov/OACT/solvency/index.html.