Taxable Social Security Benefits

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Before 1984, Social Security benefits were exempt from income tax. As part of the Greenspan Commission reforms intended to bolster Social Security's finances, up to 50 percent of Social Security benefits became subject to tax in that year, with the proceeds from the income tax allocated to the Social Security Trust Fund. In 1993, a higher inclusion rate up to 85 percent was enacted with the additional revenue allocable to the Medicare Trust Fund. Peter Orszag estimates that the tax on benefits will account for almost 8 percent of Social Security Trust Fund revenue by 2080.[1]

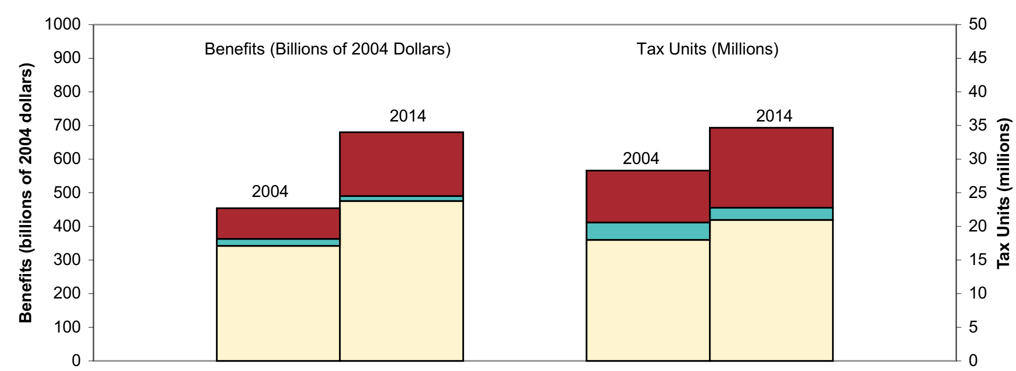
The 50 percent taxation of Social Security benefits phases in starting at an expanded income of $32,000 for joint returns and $25,000 for singles and heads of household.[2] The 85 percent inclusion rate begins at expanded income of $44,000 and $34,000, respectively. The thresholds are not indexed for inflation, so each year more and more older Americans pay tax on a portion of their Social Security benefits, and the total tax paid increases as a share of total benefits.

In 2004, we estimate that there are more than 28 million households receiving Social Security benefits. Only 36 percent of them are taxed on those benefits in 2004, but 40 percent are in 2014. (See Figure 1.) The percentage of benefits that are taxable increases from 25 percent in 2004 to 30 percent in 2014. Among those who are taxed, most are in the 85 percent inclusion range because the 50 percent inclusion bracket is very narrow and shrinking in real terms over time. One-quarter of the taxable returns are in the 50 percent range in 2004; by 2014, this category shrinks to 13 percent.

[1]Peter R. Orszag, "Tax on Social Security Benefits Providing More Trust Fund Revenue," *Tax Notes*, December 9, 2002, p. 1359.

[2]Expanded income equals adjusted gross income plus tax-exempt bond interest and one-half of Social Security benefits.

Figure 1
Social Security Benefits by Income Tax Status



	Benefits 2004	Benefits 2014	Tax Units 2004	Tax Units 2014
Nontaxable	$342	$475	18	21
50% Taxable	20	15	3	2
85% Taxable	91	189	8	12
Total	454	680	28	35

Up to 85% Taxable
Up to 50% Taxable
Untaxed

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0304-2).

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