Is there a limit on how much income is taxed for Social Security each year? Is there a limit on how much income is taxed for Medicare each year? Check out this article: <https://www.irs.gov/taxtopics/tc751>. Do you think that these rules are fair?

#1

As you think about how you are going to respond to this question, consider this: How much money am I going to get back from Social Security during retirement?

You've probably all heard concerns about Social Security running out of money in the future. For this post, let's assume that Social Security will have ample funding throughout your retirement years.

Now, how much can you expect to get back from social security? Let's look at an example from Investopedia. For this example, imagine that you retired in 2016. (Wouldn't that be nice?!)

If you retired in 2016, the most that Social Security would pay you would be a monthly check of $2,639 (Investopedia, 2014). Note that this equates to $31,668 annually.

Now, does this mean that everyone who retired in 2016 will receive this amount in retirement? No!

There are requirements that must be met in order to receive the maximum payout from Social Security. First, you need to have worked for at least 35 years (Bieber, 2019). For example, if you started working at age 25 and you worked every year after that, you would need to have worked until at least age 60.

In my next post, we'll talk about the other major requirement for receiving the maximum payout from Social Security.

**References**

Investopedia. (2014, October). What is the maximum I can receive from my Social Security retirement benefit? Retrieved from Investopedia: <https://www.investopedia.com>

Bieber, C. (2019, April 8). Why You Should Work at Least 35 Years Before Retiring. Retrieved from The Motley Fool: <https://www.fool.com/retirement/2018/01/21/why-you-should-work-at-least-35-years-before-retir.aspx>

#2

Ok, so we know that there is a maximum monthly check that you can receive from Social Security. If you retired in 2016, that maximum check would be $2,639 (Investopedia, 2014).

But we also know that there two major requirements that you must meet in order to receive this maximum check. The first is to have worked for 35 years.

The other is to have earned A LOT of money during your working years. How much, you might ask? Let me give you an example.

If you retired at the end of 2016, you would need to have earned $118,500 that year. Wow, that's quite a salary! So, during your entire 35-year work history, do you need to have $118,500 earned each year? Almost.

Why do I say "almost"? The $118,500 requirement is increased every year to account for inflation. Therefore, in 2015 and the other years that you worked, the required amount would have been lower.

At this point, you might be asking, "But we're in 2020 now. Is the 2020 requirement higher than the 2016 requirement?" If that is what you were asking, I like your thought process! Because the requirement increases every year, it has climbed to $137,700 for 2020 (Powell, 2020).

Now, does the average person receive a monthly Social Security check of $2,639 during retirement?

Sadly, no. Instead, the average worker would receive $1,341 per month. That monthly check equates to $16,092 per year.

Now, to wrap up, be sure that you understand all of this so far. In my next post, we're going to take this analysis a step further.

**References**

Investopedia. (2014, October). What is the maximum I can receive from my Social Security retirement benefit? Retrieved from Investopedia: <https://www.investopedia.com>

Powell, R. (2020, January 17). 4 changes that could affect Social Security in 2020. Retrieved from USA Today: <https://www.usatoday.com/story/money/2020/01/17/social-security-2020-6-changes-you-should-expect-year/2827098001/>

Now consider Larry. Larry makes $40,000 per month (or $480,000 per year) for 35 years. Imagine that social security is deducted from Larry's entire salary, but the maximum benefit that he can receive back from social security is also $2,639 per month.

Do you think that it is fair for Larry, who that makes more than four times what George makes, ($480,000 compared to $118,500) to receive the same amount from social security in retirement ($31,668 per year)?

Lawmakers continue to debate this issue, and there is no easy answer upon which everyone agrees. (Liou, 2017)

References

Liou, W. (2017). Social Security: Raising or Eliminating the Taxable Earnings Base. Congressional Research Service.

It's also helpful to consider the history of the Social Security program. When President Roosevelt's Committee on Economic Security originally drafted a plan for Social Security, it was planned to be a program focused on poverty alleviation. Nonmanual laborers earning more than $250 per month (or $3,000 per year) would have been entirely exempt from the program. However, the House Ways and Means Committee decided to change it, taxing everyone on all of their earnings up to $3,000 per year (equivalent to $250 per month). This way, more taxes were coming into the program to be redistributed to lower income workers.

Why didn’t they stick with the original plan for Social Security? Well, with the original plan, one problem would have been that of how to tax workers whose earnings fluctuated above and below $3,000 per year. For example, imagine John earns $3,100 per year for three years. Under the original plan, he would not have participated in social security at all. Imagine that the following year he earns $2,900. Finally, he returns to earning over $3,000 by pulling in $3,200 the next year. Should he participate in social security or not? This type of situation would have been difficult to deal with.

Instead, the program was changed. Thus all workers participate in social security. Additionally, high wage earners do not have to pay into social security for those wages that they earn above the maximum taxable amount.

References

Whitman, K., & Shoffner, D. (2011, February). The Evolution of Social Security's Maximum. *Social Security Office of Retirement and Disability Policy Policy Brief*.

Let's look at a little more U.S. history. During World War II, Congress introduced two programs to make the collection of taxes from citizens easier. One program was payroll withholding, also known as wage withholding. The other was quarterly tax payments.

For this post, let's focus on the wage withholding program. With wage withholding, the collection of tax is easier for both the taxpayer and the IRS. However, "it also greatly reduces the taxpayer's awareness of the amount of tax being collected." This makes taxes less transparent to the taxpayer. In addition, it may make it easier for the government to raise taxes without people noticing a difference in their daily spending because one's final tax liability is calculated many months after the tax is collected.

The following taxes are collected through the wage withholding process: federal income tax, state income tax, OASDI, HI, and some other levies by a few states. ("Tax withholding in the United States", 2018)

Here are the mechanics of how it works. The employer collects the tax from the employee on each pay date. Then, the employer pays those tax funds to the federal government on either a monthly or semi-weekly basis. Beginning in 2011, the employer must pay these withholdings to the government through electronic funds transfer. In other words, the employer cannot deposit the withholdings manually.

While the employer must pay withholdings on a monthly or semi-weekly basis, it only has to file a report once per quarter. That report, called Form 941, details what the employer has withheld from its employees. Specifically, the report summarizes the federal income tax, OASDI, and HI that the employer has withheld during the quarter.

Recall that for every dollar of OASDI and HI tax withheld from an employee's paycheck, the employer also pays that amount from their own funds. Thus, the OASDI and HI tax that an employee sees on his or her paycheck constitutes only half of the total OASDI and HI tax that the employer sends to the government.

**References**

Tax withholding in the United States. (2018). Retrieved from <https://en.wikipedia.org/wiki/Tax_withholding_in_the_United_States>