Fiscal and Distributional Impacts of “No Tax on Social Security Benefits”

John T.H. Wong

Agenda

1. The fundamental problem of retirement spending.
2. How social security is taxed.
3. The impact of not taxing social security benefits.
   - Fiscal.
   - Distributional.
4. A proposal to "tax payroll taxes" instead, explained.
5. The impact of taxing payroll taxes.
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Takeaways

1. Not taxing social security is fiscally bad.
2. But paying for proposal is distributionally bad.

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  - **Tax revenue: 4.1% per year.**
  - Medicaid: 3.9% per year.
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- Any spending targeted at old age runs into the issue of runaway growth: this is the Fundamental Problem of Retirement Spending.

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  2. Not taxing social security is equivalent setting both of those rates to zero.

Not taxing social security: fiscal impact

The following estimates from a simulation of the US economy done with PolicyEngine, which:

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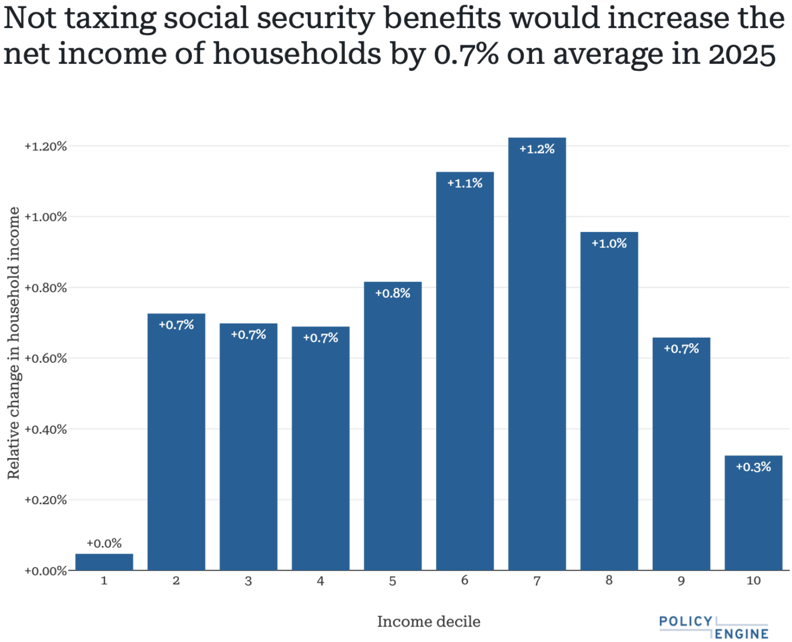
  - Which will add 6 percent to the $21 trillion of debt that the government is scheduled to borrow (over the coming decade).

Not taxing social security: distributional impact by income



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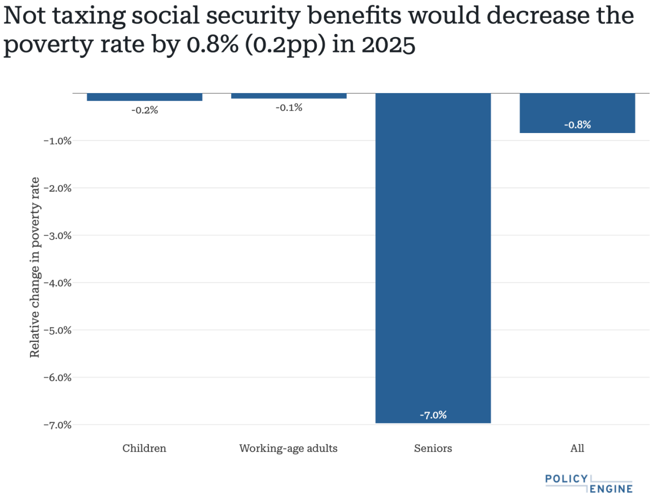

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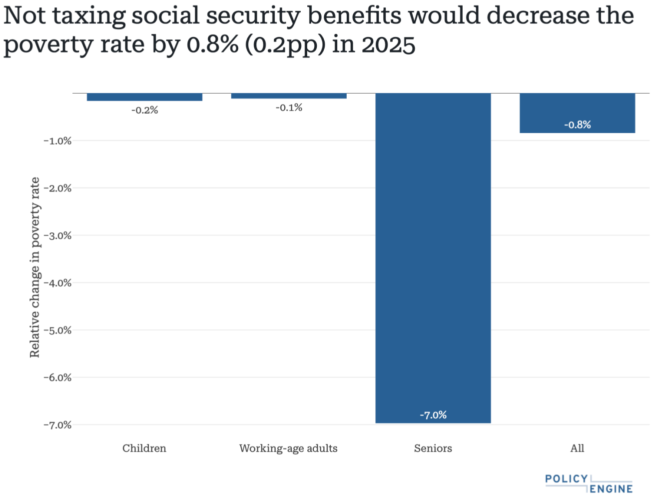

- How would you pay for it?

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  1. Tax all employer payroll contributions as employee's additional income; exempt all social security benefits from taxation.
  2. Tax only employer's *Medicare* payroll contributions as employee's additional income; set only the additional share of benefits subject to tax, to 0% (recall that it's currently at 35%, and that revenue goes to the Medicare fund).

Tax payroll not benefits: fiscal impact

Option 1 does lead to a surplus

	2025	2026	2027	2028	2029
Savings ($bn)	52	60	63	68	72

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Option 2 does not raise enough

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Savings ($bn)	-4	-8	-8	-8	-8

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- Let's focus on Option 1 to see what raising revenue looks like.

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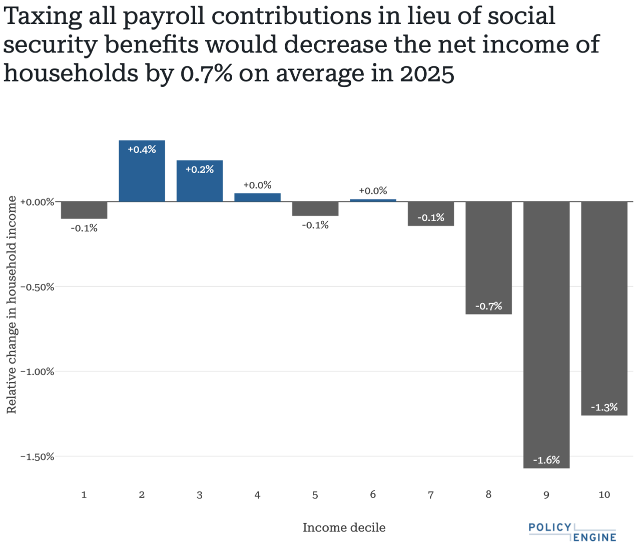

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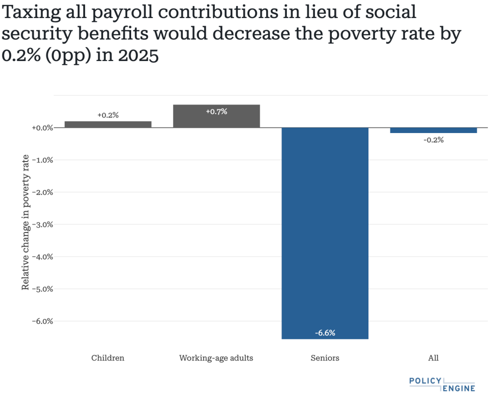

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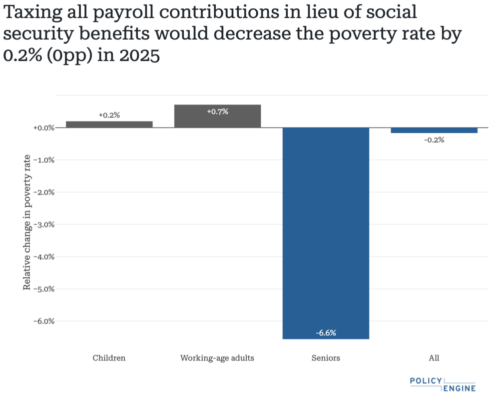

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- Distributional pattern isn't unique to taxing payroll contributions, which is akin to a generic progressive tax.[1]

[1] This is because (a) payroll contributions/income is roughly the same rate regardless of income, and (b) the proposal would tax this amount as income, which is taxed progressively.

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- Increasing net benefits alone worsens the debt problem.
- The best policy is to reject “no tax on Social Security benefits” proposals and maintain current law.

Thank you

Appendix

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- So I expect taxing payroll contributions will be very unintuitive to taxpayers, to say the least, if not very unpopular.