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Social Security Is in Trouble: Not Taxing Benefits Isn't the Solution

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KEY FINDINGS

- Recent proposals to end the taxation of Social Security benefits are misguided. These taxes provide an essential source of funding for the cash-strapped program while simultaneously improving its overall progressivity.
- Many object that taxing benefits is a form of double taxation. In fact, employee contributions typically comprise no more than 15% of the total benefits they receive, leaving the other 85%—the maximum taxable share—fair game for taxation.
- Rather than accelerating Social Security's quickly approaching insolvency or blowing a \$1 trillion hole in the deficit, lawmakers would be wise to maintain taxes on benefits and to quickly pass the reforms needed for ensuring Social Security's fiscal stability.

ABSTRACT

Social Security faces looming solvency challenges due to demographic shifts, with projections indicating it will be able to meet only a portion of its promised benefits within the next decade. Recently, President Donald Trump has proposed eliminating federal income taxes on Social Security benefits, a move that would bring forward the date of insolvency by two years to 2032. Ending the taxation of Social Security benefits would (a) introduce distortions between Social Security and pension income, which the current tax system treats similarly; (b) weaken system financing to the tune of \$1 trillion over the next decade; and (c) disproportionately favor high-income retirees while offering minimal relief to lower-income beneficiaries. Rather than exacerbating the program's existing challenges, we argue that lawmakers could instead forgo their proposed \$4.5 trillion tax cut package, which is almost exactly size of the investment needed to make Social Security solvent in perpetuity.

Donald Trump has repeatedly advocated eliminating federal income taxes on Social Security benefits (Duehren 2024). At first, this strikes many as a commonsense idea. After all, people generally understand that they pay into Social Security via payroll taxes throughout their working lives and are therefore confused about why they may have to pay taxes again when they receive their benefits after retiring. But the commonsense response is also simple: A significant share of benefits comes from sources other than the employee's contribution—in particular, from the employer's contribution and other factors—and thus has never been taxed. Moreover, a closer look at the history and structure of the program reveals that taxing a share of benefits reduces differences in the taxation of private and pension income, increases progressivity, and slows the program's approaching insolvency.

Social Security does more than any other program to keep Americans out of poverty. In 1934, more than half of elderly Americans could not support themselves financially (Social Security Administration, n.d.). Today, the poverty rate for adults

older than 65 is just 10%, with Social Security keeping millions of Americans out of poverty (Romig 2025).

Social Security is financed by matching employer and employee contributions—currently, each party pays 6.2% of the employee's wages on the first \$176,100 of earnings (which covers all earnings for most Americans). The self-employed pay both sides of the tax.

These contributions enter the Social Security trust fund, which pays benefits to current retirees (and survivors), generating the expectation that the next generation will do the same. Although this system could, in principle, run forever, population aging—because of more retirees and lower birth rates—has reduced the ratio of workers to retirees. As a result, under current law, the Social Security Administration estimates that the program will be able to meet only 83% of scheduled benefits starting in 2035 (and falling to 73% by 2098). This gap will lead to a projected unfunded obligation equal to 3.32% of taxable payroll or 1.2% of GDP.

The taxation of benefits was instituted in the 1983 reforms, when the program faced similar (though smaller) funding challenges. A large share of revenue from benefit taxation goes into the Social Security Trust Fund and thus improves system financing.

Taxing benefits also increases the progressivity of the Social Security program. Currently, the IRS uses Modified Annual Gross Income (MAGI), which adds half of Social Security benefits received to taxpayers' other income, to determine the share of benefits subject to taxation. Taxpayers with MAGI below \$25,000 (\$32,000 for couples filing jointly) do not owe any tax on their benefits, representing about half of all Social Security recipients (Sears 2024). Individuals and couples earning up to \$34,000 and \$44,000, respectively, pay income tax on half of their benefits; those making more face taxation on 85% of their benefits. This limit of 85%—Congress's estimate of the share of benefits not coming directly from an employee's own lifetime contributions—helps align taxation of benefits more closely with the taxation of private pension income. Those retirees facing taxation on the full 85% of their benefits are also the ones most likely to have other sources of retirement income from savings or pensions. In short, by providing a nearly universal benefit but taxing back some of the benefit from high earners, Social Security remains relatively easy to administer while more efficiently directing funds to those who rely on it most.

Making benefits tax-free would cost about \$1 trillion or more over the next 10 years (Committee for a Responsible Federal Budget 2024b; Van de Water 2025). This action would both move forward the date of trust fund exhaustion to 2032 from 2034 and increase the subsequent required benefit cut or payroll tax increase at that time (Reichling and Shin 2025). Likewise, it would raise the 75-year shortfall by about 0.9% of payroll (Committee for a Responsible Federal Budget 2024a). Although eliminating income taxes on benefits would offset some of the required Social Security adjustments for middle- and upper-income households, most low-income retirees would face the full effect. A Tax Policy Center (2024) analysis shows that only 0.1% of tax units in the bottom quintile would see a tax cut from exempting benefits, averaging just \$250. On the other hand, the wealthiest Americans would see a much larger benefit, with households in the top quintile who receive a tax cut getting back an average of \$7,250—and the top 1% receiving more than \$12,230 on average. Just as Trump's proposed adjustments to the rest of the tax code would help transfer money from the poor to the rich, so too would these changes to Social Security (Gale 2025).

This change also would generate a significant intergenerational transfer toward current and soon-to-be retirees. High-income retirees would see a net benefit ranging from \$11,100 to as much as \$134,400, whereas those born today would lose as much as \$14,100 in lifetime welfare, with losses reaching \$22,000 for those not yet born. Although some people argue that eliminating these taxes might encourage

certain beneficiaries to work more, the Penn Wharton Budget Model estimates that lower savings, higher debt, and the resulting reduction in capital stock will ultimately reduce wages, thereby leading to a slight decline in hours worked by 2054 (Reichling and Shin 2025). Moreover, even if labor supply gains are to be had, there are more targeted and efficient ways to achieve this goal (Rubin and Tergesen 2024).

There may be procedural hurdles to exempting benefits from income taxes. To avoid the 60-vote threshold required for overcoming a filibuster in the Senate, Republicans will use the Budget Reconciliation process to pass their upcoming tax law, which allows certain bills to pass with only 50 votes. One of the limits on this process, however, is that reconciliation bills cannot change Social Security. Therefore, a bill directly ending taxation of benefits would likely not meet the requirements of reconciliation. If Republicans want to use reconciliation, they may need to be creative—for example, they could overrule the Senate Parliamentarian, if need be, or establish a new income tax credit, equal to the amount paid on Social Security benefits. Although this would limit the impact on Social Security's solvency, it would be as regressive and fiscally damaging as explicitly exempting benefits from income tax.

Rather than adding to the financial stress of either Social Security or the federal budget, lawmakers would be wise to take the program's funding challenges seriously, acting now in order to stave off more pain down the line. One option would be to either increase or fully repeal the income cap on payroll taxes, increasing program revenues. Or, even more simply, Republicans could forgo \$4.5 trillion in tax cuts for the rich, which, coincidentally, is almost exactly the size of the investment needed to make Social Security solvent in perpetuity (Gale and Thorpe 2025). There are many suggestions on the right way to proceed, but eliminating taxes on benefits is the wrong one.

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