

OASDI BENEFITS AND EMPLOYEE TAX CONTRIBUTIONS

Social security benefits are not includable in taxable income on the basis of an administrative ruling of the Internal Revenue authorities. Appendix I hereof presents some views and discussion regarding the origin of this ruling. It appears that there is a difference of opinion between a member of the Committee on Ways and Means and a Treasury official and even differences of opinion within the Treasury Department. There is agreement that the Congress, by appropriate legislation, could make social security benefits includable in taxable income.

The application of the lifetime income spreading principle to the OASDI system would call for the tax deductibility of employee tax contributions along with the inclusion of benefits in taxable income. If the occasion arises when serious consideration is being given by the Congress to general revenue support for the OASDI system, such tax treatment, aside from its own real merits, deserves first consideration as an appropriate liberalization that is a strain on general revenues but is more logical than direct general revenue support.

If this change in the tax treatment of OASDI benefits and employee tax contributions were made at a time of a modest increase in gross tax contributions and a general increase in benefits, employee net tax contributions could remain substantially unchanged and the increase in benefits would make the taxation of benefits more acceptable (or less unacceptable) to those who have been receiving tax-free benefits. For example, if an added 0.6 percent of taxable payrolls for employees and for employers were made effective, an additional \$3.5 billion to \$4 billion would be available for increased benefits—about a 15-percent increase. About \$1.75 billion to \$2 billion would come from employers which would be tax deductible, employees' net tax contributions would be a little less than presently scheduled and net contributions from general revenues of \$2 billion to \$3 billion would result after taking account of added revenue from taxable benefits and the effects of the slightly lower net employee tax contributions.

Under this proposal, the employee should have a specific deduction of the amount of tax contribution similar to regular exemptions; for example, the deduction would appear as an additional \$150 to \$400 deductive amount, depending upon gross earnings rate and the higher social security tax rates adopted. For persons who have no taxable income from which to deduct the social security tax contribution, an actual tax credit should be provided based on the initial marginal tax rate, now 14 percent. When a taxpayer must identify in his tax return the exact amount of social security tax contribution in order to get the deduction, he will be much more aware of its magnitude than under the present automatic payroll deduction practice. A real cost consciousness results. This tax-deductible arrangement is more favorable, of course, at the higher levels of earnings than at the lower levels because of the progressive income tax rates. Those in the higher income brackets, however, would be those persons, generally, who would, in fact, pay a tax on their social security benefits when received, thus producing a substantial order of equity.