Report on The Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1993

Report to The Congress,
The Secretary of Health and Human Services,
and the Railroad Retirement Board

Department of the Treasury
July 1998

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

JUL 31 1998

The Honorable Al Gore, Jr.
President of the Senate
Washington, DC 20510

Dear Mr. President:

Section 121 of the Social Security Amendments of 1983 (P.L. 98-21), directs the Secretary of the Treasury to transfer from the general fund of the Treasury to the Social Security and Railroad Retirement trust funds amounts equivalent to the tax liabilities attributable to the taxation of the Social Security and Railroad Retirement benefits. Section 121 further provides that the Secretary of the Treasury shall submit annual reports concerning (1) the transfers made that year, and the methodology used in determining the amount of such transfers and the funds or accounts to which made, and (2) the anticipated operation of these transfers during the next 5 years.

Pursuant to Section 121, I am pleased to submit the "Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1993."

This report is also being transmitted to the Speaker of the House, the Commissioner of the Social Security Administration, and the Chair of the Railroad Retirement Board.

Sincerely,

Robert E. Rubin

Robert E. Rubin

cc: The Honorable Donna E. Shalala
Secretary of the Department of Health and Human Services

The Honorable Jolene M. Molitoris
Administrator, Federal Railroad Administration

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

JUL 31 1998

The Honorable Newt Gingrich
The Speaker
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

Section 121 of the Social Security Amendments of 1983 (P.L. 98-21), directs the Secretary of the Treasury to transfer from the general fund of the Treasury to the Social Security and Railroad Retirement trust funds amounts equivalent to the tax liabilities attributable to the taxation of the Social Security and Railroad Retirement benefits. Section 121 further provides that the Secretary of the Treasury shall submit annual reports concerning (1) the transfers made that year, and the methodology used in determining the amount of such transfers and the funds or accounts to which made, and (2) the anticipated operation of these transfers during the next 5 years.

Pursuant to Section 121, I am pleased to submit the "Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1993."

This report is also being transmitted to the President of the Senate, the Commissioner of the Social Security Administration, and the Chair of the Railroad Retirement Board.

Sincerely,

Robert E. Rubin

Robert E. Rubin

TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION AND SUMMARY

I. Introduction

Since January of 1984, the Treasury Department has been required to estimate the individual income tax liabilities attributable to the inclusion of social security and railroad social security equivalent benefits in adjusted gross income (AGI) for each liability year. These estimated liabilities are transferred to the Federal Old-Age and Survivors Insurance (FOASI), Federal Disability Insurance (FDI), and Social Security Equivalent Benefit Account (SSEBA) trust funds on a quarterly basis at the beginning of each calendar quarter. The amounts transferred to the three trust funds are calculated as the difference between forecasts of tax liabilities made with and without the inclusion of forecasted levels of benefits in AGI. Both the taxation of benefits and the transfers of taxes to the trust funds are required by the Social Security Amendments of 1983 (P.L. 98-21), as amended by the Railroad Retirement Solvency Act of 1983 (P.L. 98-76), and the Consolidated Budget Reconciliation Act of 1985 (P.L. 99-272). The 1983 Act also requires that correcting adjustments be made to the amounts transferred to the trust funds if the estimates of the tax liability attributable to the benefits are subsequently shown to be incorrect.

In addition, the 1983 Act required the Treasury Department to submit annual reports to the Congress, the Secretary of Health and Human Services, and the Railroad Retirement Board containing both a description of the methodology used to estimate the transfers of income tax to the trust funds and a forecast of transfers over the five subsequent years. The Treasury Department's Office of Tax Analysis (OTA) is responsible for preparing these annual reports, as well as for estimating transfers to the trust funds and making correcting adjustments to the transfers based on actual tax return data. This report describes the methodology used to determine (1) the transfers to the trust funds of calendar year 1993 income tax liability, (2) the necessary correcting adjustments to the transfers for calendar year 1993, and (3) the forecast of transfers for the 1994 to 1998 period.

To determine if any benefits were taxable in tax year 1993, taxpayers had to add both tax-exempt interest income and one-half of social security and railroad social security equivalent benefits to AGI. The augmented AGI may be referred to as provisional income. If provisional income exceeded thresholds of $25,000 for single filers and $32,000 for joint filers, taxpayers were required to include in AGI the lesser of one-half of the benefits or one-half of the excess of provisional income over the thresholds. Thus, a maximum of 50 percent of the social security and railroad social security equivalent benefits were includable in AGI.[1]

II. Summary

In calendar year 1993, total transfers of $6,137 million were made to the three trust funds. These transfers, on net, exceeded the amount of tax liability attributable to benefits calculated from actual 1993 tax return data by $582 million. Transfers to the FOASI trust fund and the

SSEBA trust fund were overstated by $574 million and $9 million, respectively. Transfers to the FDI trust fund were understated by $1 million. Correcting adjustments were made in the October 1995 trust fund transfers.

Chapter 2 presents the estimating methodology and estimates for the 1993 transfers. The correcting adjustments based on the actual liabilities are described in Chapter 3. The forecast of 1994-1998 liabilities by trust fund, including transfers to the Federal Medicare Hospital Insurance (FHI) added by OBRA 93, are presented in Chapter 4. Chapter 5 describes the distribution of taxable benefits by income class for tax year 1993. It also contains an analysis of the effect of the higher marginal tax rates resulting from the passage of OBRA 93 on taxation of social security benefits.

CHAPTER 2: METHODOLOGY AND ESTIMATES OF THE INITIAL CALENDAR YEAR 1993 TRUST FUND TRANSFERS

I. Methodology

The Office of Tax Analysis (OTA) is responsible for estimating the tax liability attributable to the social security and railroad social security equivalent benefits received by high-income beneficiaries. OTA provides the information to the Treasury Department's Financial Management Services, which has the authority to transfer funds from general revenue to the trust funds.

OTA estimated the amount of 1993 tax liability attributable to the inclusion of benefits in AGI using the OTA Individual Income Tax Model (ITM).[2] The ITM contains information from a stratified random sample of 110,000 tax returns selected from the Internal Revenue Service's Statistics of Income (SOI) file for 1989, various imputations of data not available from tax returns, and a tax calculator.[3] Records on the ITM file are extrapolated to future years. Computations based on the ITM are weighted to produce results that are representative of the entire population of taxpayers.

Tax returns alone do not provide sufficient data to estimate the revenue effects of the partial inclusion of social security and railroad retirement benefits in AGI. Therefore, an imputation is added to the ITM to compensate for the missing items, such as data on total social security and railroad retirement benefits. The Social Security Administration and the Railroad Retirement Board provide information on the total amounts of benefits paid to recipients. These amounts are distributed among appropriate taxpayers on the ITM, using as a guide two important data sources--- (1) a file of 1099-SSA and 1099-RRB information returns for tax year 1989 that are matched to the 1989 SOI file; and (2) the most recent Current Population Survey data from the Census Bureau to aid in matching benefits to recipients who are not required to file a tax return. For purposes of extrapolating the ITM, total social security and railroad social security equivalent benefits are projected to grow at the rate indicated in the most recent benefits forecast provided by the Social Security Administration and the Railroad Retirement Board.[4]

The tax calculator uses the information (including the imputations and extrapolations discussed above) for each filing unit to calculate the estimated Federal income tax liability of each taxpayer on the model. To estimate the amounts to be transferred to the trust funds, the ITM estimates tax liabilities with and without social security and railroad social security equivalent benefits included in AGI.

The ITM accounts for changes in other tax provisions indirectly affected by the inclusion of these benefits in AGI. For example, the use of deductions and credits, as well as calculations of alternative minimum tax liabilities, can be affected by the inclusion of benefits in AGI. These effects can be in opposite directions. For instance, as AGI increases, a lesser amount of medical, casualty and certain miscellaneous expenses may be deducted. On the other hand, the increased tax liability resulting from the inclusion of benefits in AGI enables some taxpayers to use tax credits that otherwise might not be usable in that year. The ITM calculates both the percentage of total benefits included in AGI as a result of the special benefit inclusion formula and the average marginal tax rates applicable to the taxable benefits.

II. Estimates of Benefit Taxation in 1993

Estimates of the additional tax liability attributable to the partial taxation of social security and railroad retirement benefits for calendar year 1993 were initially made in late 1992. The estimates were adjusted as new information was obtained throughout 1993. The total amount transferred to the trust funds each quarter equaled one-fourth of the estimated 1993 calendar year tax liability attributable to the taxation of benefits, plus adjustments for prior transfers. The transfers were allocated to the Federal Old-Age and Survivors Insurance (FOASI), Federal Disability Insurance (FDI), and Social Security Equivalent Benefit Account (SSEBA) trust funds on a pro-rata basis.

Table 1 compares the assumptions used to estimate the initial transfers for calendar year 1993 with the actual amounts. The top section of the table shows that it was initially estimated that 9.81 percent of the estimated $267,488 million of FOASI benefits paid out in 1993 would be included in AGI at an average marginal tax rate of 22.17 percent, resulting in a transfer of $5,816 million.

Recipients of social security disability insurance benefits have on average lower incomes than social security retirees. Therefore, the estimated inclusion rates for benefits in AGI and average marginal tax rates for FDI beneficiaries are lower than for FOASI recipients. Initially, 4.03 percent of the estimated $34,216 million in FDI benefits was estimated to be included in AGI at a 19.34 percent average marginal tax rate, resulting in a transfer of $268 million.

Railroad retirees on average have incomes that are slightly lower than social security retirees, but higer than disability insurance recipients. Initially, 5.54 percent of the estimated $4,761 million paid out in railroad social security equivalent benefits was estimated to be included in AGI at a 20.34 percent average marginal tax rate. Allowing for rounding of each quarterly transfer, this yielded a $56 million transfer to the SSEBA trust fund.

TABLE 1

Comparison of Assumptions Used to Estimate Initial Trust Fund Transfers for Calendar Year 1993 with Actual Amounts 1/

Trust Fund	Total Benefits Paid ($millions)	Benefits Includable in AGI (percent)	Tax Rate on Benefits Includable in AGI (percent)	Transfer Amount ($millions)
		Initial Transfer Assumptions 2/		
Federal Old-Age and Survivors Insurance	267,488	9.81	22.17	5,816
Federal Disability Insurance	34,216	4.03	19.34	268
Railroad Social Security Equivalent Benefits	4,761	5.54	20.34	56
Total	306,465	9.10	22.01	6,140
		Actual Amounts 3/		
Federal Old-Age and Survivors Insurance	267,231	8.75	22.41	5,242
Federal Disability Insurance	34,587	4.05	19.21	269
Railroad Social Security Equivalent Benefits	4,779	4.90	20.10	47
Total	306,597	8.16	22.21	5,558

Department of the Treasury
Office of Tax Analysis

1/ Different assumptions were used for each quarterly transfer. This table presents a weighted average of these quarterly transfer assumptions. Rounding of results may prevent exact matching of total. Benefits paid to non-resident aliens are not included in the FOASI or FDI benefits paid figures.

2/ Source: The total benefits paid data were estimates provided by the Social Security Administration and the Railroad Retirement Board; the other data came from the Individual Income Tax Model of the Office of Tax Analysis.

3/ Source: The total benefits paid data are from the 1996 Annual Statistical Supplement to the Social Security Bulletin, the Social Security Administration and the Railroad Retirement Board; the other data come from the Internal Revenue Service's Individual Master File.

CHAPTER 3: ADJUSTMENTS TO TRANSFERS FOR ACTUAL 1993 TAX RETURN INFORMATION

I. Tax Return Data

The Social Security Amendments of 1983 require adjustments to the trust funds if actual tax return data subsequently reveal that the initial transfers were incorrect. To calculate the actual additional tax liability for calendar year 1993 resulting from partial taxation of social security and railroad social security benefits, the IRS created a data file based on Form 1040 records. All filers who reported taxable social security or railroad social security equivalent benefits on their Form 1040 in 1993 are included in this data file. Although the Form 1040 provides information on the total amount of benefits includable in taxable income, it does not indicate whether the filer received FOASI, FDI, or SSEBA benefits. Such information is needed to allocate revenues accurately to the trust funds. To obtain this information, the Form 1040 records belonging to those beneficiaries who reported taxable benefits were matched to the Form 1099 records provided by the Social Security Administration and the Railroad Retirement Board. (The actual Forms 1099-SSA sent to taxpayers do not disclose whether the amounts shown are for retirement or disability benefits; however, the Form 1099-SSA records provided by the Social Security Administration to the IRS do include the source of benefits.)

Using this matched file of Form 1040 and Form 1099 records, the IRS calculated for each benefit type: (1) the number of tax returns with benefits that are includable in AGI, (2) the gross dollar amount of benefits paid to beneficiaries who filed tax returns and had benefits included in AGI, and (3) the amount of taxable benefits. Next, for each taxpayer on the file, taxable income and tax liability were computed with and without taxable benefits. The amount of revenue attributable to the taxation of benefits is the difference in actual tax liabilities and tax liabilities estimated with taxable benefits excluded from taxable income.

II. Actual Income Tax Liabilities in 1993

The lower section of Table 1 shows the additional tax liability attributable to partial inclusion of social security and railroad social security benefits calculated from actual 1993 tax returns. In 1993, the Social Security Administration and the Railroad Retirement Board paid out $306,597 million in FOASI, FDI, and SSEBA benefits. The actual amount of FOASI benefits paid was $267,231 million, of which 8.75 percent was included in AGI. FOASI recipients with taxable benefits faced an average marginal rate of 22.41 percent. The increase in tax liability due to the inclusion of FOASI benefits in AGI was $5,242 million. For FDI, actual total benefits paid were $34,587 million. The actual inclusion rate in AGI for FDI benefits was 4.05 percent, on which recipients faced an average marginal tax rate of 19.21 percent. The actual additional tax liability for FDI benefits was $269 million. The actual SSEBA benefits paid totaled $4,779 million. SSEBA recipients included 4.90 percent of their benefits in AGI. The average marginal tax rate on SSEBA benefits in AGI was 20.10 percent, yielding additional tax liability of $47 million. As a result of the Social Security Amendments of 1983, total additional 1993 tax liability was $5,558 million. For all trust funds, initial transfers exceeded final liability by $582 million.

As a result of the reconciliation of estimated and actual 1993 tax liability, the October 1, 1995 transfer included a total net adjustment of -$582 million to the FOASI, FDI, and SSEBA trust funds. The adjustments to the FOASI, FDI, and SSEBA trust funds were -$574 million, $1 million, and -$9 million respectively (see Table 2).

TABLE 2

Adjustments to Trust Funds for Calendar Year 1993 Based on Comparison of the Initial Transfers With Actual Amounts
($ millions)

Trust Fund	Initial Transfer	Actual Amount	Adjustment (Change from Initial Transfer)
Federal Old-Age and Survivors Insurance	5,816	5,242	-574
Federal Disability Insurance	268	269	1
Railroad Social Security Equivalent Benefits	56	47	-9
Total	6,140	5,558	-582

Department of the Treasury
Office of Tax Analysis

CHAPTER 4: FORECAST OF TRANSFERS TO TRUST FUNDS FOR 1994-1998

I. Estimated Transfers Due to the Social Security Amendments of 1983

The Social Security Amendments of 1983 requires that the annual report include a forecast of transfers to the trust funds for the next five years. The forecast was produced using the ITM. Records on the ITM are extrapolated to future years. Computations based on the ITM are weighted to produce results that are representative of the entire population of taxpayers.

As noted in Chapter 2, tax returns alone do not provide sufficient data to estimate the revenue effects of the partial inclusion of social security and railroad retirement benefits in AGI. The ITM was modified to include the total amount of social security and railroad retirement benefits paid in 1989, which were provided by the Social Security Administration and the Railroad Retirement Board, respectively. These amounts were distributed among appropriate recipients on the ITM by using a sample of 1099-SSA and 1099-RRB information returns that were matched to the tax returns in the 1989 SOI file and the most recent Current Population Survey data from the Census Bureau as a guide to the non-filing population.

The Social Security Administration and the Railroad Retirement Board also provided forecasts of the total amounts of benefits expected to be paid in future years. The percent of aggregate retirement benefits includable in AGI and marginal tax rates are obtained by extrapolating the ITM in accordance with the Administration's budget forecasts. In addition, the forecast of future transfers reflects the information obtained from the IRS computation of marginal tax rates and benefits includable in AGI reported on tax returns for calendar year 1993.

The estimated transfers for calendar years 1994-1998 are presented in Table 3. The transfers made in calendar year 1994 include actual adjustments for 1992 liabilities. The transfers made in calendar year 1995 include the adjustment for calendar year 1993 liabilities, as described in Chapter 3. The transfers made in calendar year 1997 include the adjustment for calendar year 1994 liabilities. It is estimated that the 1983 Act will result in $33,909 million being transferred from general revenues to the FOASI, FDI, and SSEBA trust funds in calendar years 1994-1998.

TABLE 3

Forecast of Transfers, Net of Adjustments, to the FOASI and FDI for Calendar Years 1994-98 Due to the Social Security Amendments of 1983
($ millions)

	Transfers Completed 1/				Estimated Transfers	Total Transfers
Trust Fund	1994	1995	1996	1997	1998	1994-98
Federal Old-Age and Survivors Insurance	4,915	5,355	6,279	7,227	7,908	31,684
Federal Disability Insurance	307	334	364	461	493	1,959
Railroad Social Security Equivalent Benefits	50	41	57	57	61	266
Total	5,272	5,730	6,700	7,745	8,462	33,909

Department of Treasury
Office of Tax Analysis

.1/ Estimates for 1994-1998 were made using the 1989 Office of Tax Analysis' Individual Tax Model. Transfers for 1994-1997 have already been made. Transfers for 1994, 1995, and 1997 include adjustments for prior year transfers based upon actual tax return data The estimate for SSEBA includes Office of Tax Analysis' estimates of taxes attributable to railroad social security equivalent benefits received by non-resident aliens.

II. Estimated Transfers Due to the Omnibus Budget and Reconciliation Act of 1993

The Omnibus Budget and Reconciliation Act of 1993 (OBRA 93) expanded the taxation of benefits for the highest income beneficiaries, and provided that the additional revenue be transferred to the Federal Medicare Hospital Insurance Fund (FHI) trust fund. For tax years beginning January 1, 1994, the provisional income (AGI plus tax exempt interest income plus one half of social security and SSEBA Tier 1 benefits) thresholds of $25,000 for single filers and $32,000 for joint filers remain in effect for calculating benefit inclusion in AGI. However, secondary provisional income thresholds will increase the benefit inclusion in AGI for higher income beneficiaries. For beneficiaries with provisional incomes above $34,000 for single filers and $44,000 for joint filers, adjusted gross income includes the lesser of :

(1) 85 percent of the recipient's social security or railroad retirement Tier I benefit or

(2) the sum of

(a) the smaller of (i) the amount included under the lower thresholds or (ii) $4,500 (for single filers) or $6,000 (for joint filers)[5]

plus

(b) 85 percent of the excess of the recipient's provisional income over the applicable secondary provisional income threshold.

Certain married beneficiaries not filing joint returns have a provisional income threshold of zero. The adjusted gross income of these individuals includes the lesser of 85 percent of the beneficiary's social security or Railroad Retirement Tier 1 benefit or 85 percent of the recipient's provisional income.

Tax liability attributable to additional benefits included in AGI as a result of OBRA 93 is transferred to the Federal Medicare Hospital Insurance (FHI) trust fund. Table 4 shows the estimates of the additional revenues to be transferred to the FHI trust fund.

TABLE 4

Forecast of Transfers, Net of Adjustments, to the FHI Trust Fund for Calendar Years 1994-98 Due to the Omnibus Budget and Reconciliation Act of 1993

($ millions)

	Completed Transfers			Estimated Transfers		Total Transfers
Trust Fund	1994	1995	1996	1997	1998	1994-98
Federal Health Insurance	3,897	3,961	4,079	4,291	5,169	21,397

Department of Treasury
Office of Tax Analysis

1/ The estimated transfer for 1997 includes an adjustment for CY 1994 liabilities.

CHAPTER 5: ANALYSIS OF TAXABLE SOCIAL SECURITY BENEFITS IN CALENDAR YEAR 1993

I. Distribution of Taxable Social Security Benefits by Family Economic Income Class

This section presents a distributional analysis of taxable social security and SSEBA Tier 1 benefits. The tabulations are based on the ITM and are for calendar year 1993. The ITM uses information provided by the Social Security Administration and the Railroad Retirement Board on benefits paid, as well as data from the Current Population Survey and other sources (see Chapter 2).[6] These data are statistically matched to create a file that represents both beneficiaries with taxable benefits and the recipient population that (1) is not required to file tax returns or (2) files tax returns but has insufficient income to require the inclusion of benefits in AGI.

The matched file can be used to create families by grouping related taxpayers. Income received by families that may not be recorded on tax returns, such as means-tested transfer payments and employer-provided fringe benefits, can also be computed using the matched file. The total income of families computed on the ITM, "Family Economic Income," is used to classify families in distributional tables by their economic well-being.

Table 5 summarizes the benefit inclusion rates and average marginal tax rates on benefits for families with taxable benefits. On average, families with taxable benefits in 1993 included 38 percent of their benefits in AGI. The overall average marginal tax rate on taxable benefits was 22 percent.

II. Comparison of Income Sources for Tax Years 1992 and 1993

Based on the matched Form 1040 and Form 1099 data described in Chapter 3, the amount of benefits in AGI grew by about 7 percent from 1992 to 1993 ($23,383 billion to $25,031 billion). Tax liability attributable to the inclusion of security benefits in AGI grew by an almost identical amount---nearly 6.95 percent ($5,197 billion to $5,558 billion).

Table 6 shows the sources of income for taxpayers with taxable social security income in tax years 1992 and 1993 as a percent of AGI. The data in table 6 are from the 1992 and 1993 SOI files. Several interesting patterns emerge. First, taxpayers with taxable social security benefits in 1992 and 1993 have similar income profiles. The two largest income sources combined---taxable pension income and wages---account for about 43 percent of AGI in both years. However, from 1992 to 1993, there is a switch in the relative importance of interest income (both taxable and tax-exempt) and equity income (dividends and capital gains). In 1992, interest income for taxpayers with taxable social security benefits totaled $82.1 billion, which was 25 percent of AGI. Equity income was $66.5 billion, or 20.3 percent of AGI. In 1993, interest income for these taxpayers fell to $72.5 billion, or 21.3 percent of

AGI, while equity income rose to $76.7 billion, or 22.5 percent of AGI.

Closer inspection shows, however, that nearly all of the change in holdings of debt and equity income from 1992 to 1993 occurred for taxable interest income and capital gains, rather than for tax-exempt interest and dividends. The fall in debt income in 1993 is caused by a decline in taxable interest income of more than $10 billion from its 1992 level (from $54.9 billion to $44.5 billion) for taxpayers with taxable social security benefits. This is an almost 19 percent drop in taxable interest income. In contrast, tax-exempt interest remained at nearly the same percentage of AGI in 1992 and 1993 (8.2 percent and 8.3 percent, respectively).

The rise in equity income from 1992 to 1993 is driven by a sizeable increase in net positive capital gains realizations in AGI for taxpayers with taxable social security benefits. From 1992 to 1993, all taxpayers increased their realizations of net positive gains in AGI from $126.7 billion and $152.3 billion, an increase of 20.2 percent. The growth in capital gains was even greater for the subset of taxpayers with taxable social security benefits. Capital gains realizations for these taxpayers rose from $32 billion in 1992 to $40.9 billion in 1993, an increase of 27.6 percent. In contrast, dividends earned by taxpayers with taxable social security benefits (the other component of equity income) remained the same percentage of AGI in 1992 and 1993 (10.5 percent).

III. Effect of OBRA 1993 Tax Rate Changes on Taxable Social Security Benefits

The passage of OBRA 93 added two new statutory tax rates for high income taxpayers. For tax year 1993, a 36 percent marginal rate applied to taxable income in excess of $140,000 for joint returns and surviving spouses, $127,500 for heads of households, $115,000 for single individuals, and $70,000 for married individuals filing separately. A 39.6 percent marginal rate applied to taxable income in excess of $250,000 ($125,000 for married individuals filing separately).

The alternative minimum tax (AMT) calculation was also altered in OBRA 93 for tax year 1993 and beyond. The tentative minimum tax changed from a top marginal rate of 24 percent to 26 percent of the first $175,000 ($87,500 for married individuals filing separately) of alternative minimum taxable income in excess of the applicable exemption amount, and 28 percent of any additional alternative minimum taxable income. However, the amount of alternative minimum taxable income exempt from the alternative minimum tax was raised from $40,000 to $45,000 for married taxpayers filing jointly and for surviving spouses. The exempt amount for single individuals and heads of households was raised from $30,000 to $33,750.

Using the 1993 SOI data, we estimate that the tax rate changes affected about 188,500 returns with taxable social security benefits and generated approximately $62.5 million in additional tax revenue from social security benefits. Of the 188,500 returns, approximately 168,500 had tax increases which totaled $67.3 million. About 20,000 returns had tax decreases which totaled $4.8 million. The increase in the alternative minimum taxable income exemption accounts for the small number of higher income returns with taxable social security benefits that experienced a tax decrease in 1993 due to OBRA 93.

TABLE 5

Distribution of Taxable Social Security and Railroad Retirement Benefits and Tax Liability Due to Taxable Benefits in Calendar Year 1993 By Family Economic Income Class 1/

Family Economic Income ($ thousands)	Families 2/ (000)	Total Benefits Amount ($ millions)	Amount of Benefits Included in AGI ($ millions)	Benefit Inclusion Rate in AGI (percent)	Tax Liability due to Inclusion of Benefits in AGI ($ millions)	Tax Rate on Benefits in AGI (percent)
under 20	40	256	81	0.32	15	0.18
20-30	139	1,106	308	0.28	58	0.19
30-50	962	8,365	2,081	0.25	380	0.18
50-75	1,668	18,147	5,896	0.32	1,050	0.18
75-100	1,041	12,437	5,092	0.41	1,049	0.21
100-200	1,221	15,208	6,954	0.46	1,654	0.24
> 200	595	9,586	4,619	0.48	1,353	0.29
Total	5,666	65,105	25,031	0.38	5,559	0.22

Department of the Treasury
Office of Tax Analysis

1/ Family Economic Income (FEI) is calculated as AGI plus: IRA and Keogh deductions; nontaxable transfer payments, such as social security benefits and Aid to Families with Dependent Children; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders and of borrowers are subtracted and added to economic income, respectively. There is also an adjustment for accelerated depreciation of non-corporate businesses. FEI is shown on a family rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

2/ About 40,000 families have FEI of $20,000 or less but pay tax on their social security benefits. A small number of these families represent married recipients who do not file jointly; these taxpayers face zero provisional income thresholds and automatically include 50 percent of their benefits in AGI. The majority of these families, however, have lower FEI than AGI largely because their accrued capital gains, adjusted for inflation, are less than their realized (nominal) capital gains.

TABLE 6

Income Sources of Beneficiaries With Taxable Benefits

	Returns with Taxable Benefits in 1992		Returns with Taxable Benefits in 1993	
	Amount 1/ ($ millions)	Percent of AGI	Amount 1/ ($ millions)	Percent of AGI
AGI	328,421		339,881	
Sources of AGI				
Pensions	71,502	21.8	75,755	22.3
Wages and Salaries	70,562	21.5	73,776	21.7
Interest	54,912	16.7	44,544	13.1
Dividends	34,493	10.5	35,817	10.5
Net Capital Gains	32,048	9.8	40,908	12.0
Income Sources not in AGI				
Tax-Exempt Interest	27,197	8.3	28,009	8.2

Department of the Treasury
Office of Tax Analysis

1/ Income sources total differs from AGI by the amount of adjustments to income, such as the deduction for one-half of self-employment tax paid, and by other income sources, such as partnership and other Schedule E income.

ENDNOTES

1. The Omnibus Budget and Reconciliation Act of 1993 changed the method for calculating taxable benefits for the highest income beneficiaries. Beginning in tax year 1994, some beneficiaries must include up to 85 percent of their benefits in AGI. See Chapter 4, Section I for details.

2. A detailed description of the Individual Income Tax Model can be found in Cilke (1994).

3. OTA does not estimate the liability attributable to the receipt of FOASI and FDI benefits by non-resident aliens. Prior to tax year 1995, one-half of any social security benefit received by a non-resident alien was subject to a 30 percent tax rate, and this amount was automatically withheld by the Social Security Administration. According to P.L. 103-465, 85 percent of any social security benefit received by a non-resident alien is subject to a 30 percent tax rate for tax year 1995 and after.

   Each month, the Social Security Administration sends a certification of the amount withheld to the Treasury Department's Financial Management Services, and the transfer of the withheld amount from the FOASI and FDI trust funds to general revenues and back again to the FOASI and FDI trust funds is made. Since the Social Security Administration has information on the actual amounts withheld, OTA does not estimate these withheld amounts.

   Similarly, the Railroad Retirement Board automatically withholds taxes on railroad social security equivalent benefits received by non-resident aliens. However, a different procedure is used to transfer these amounts to the SSEBA. OTA includes an estimate of the withheld amounts in its initial transfers to the trust funds and subsequently verifies these estimates with the Railroad Retirement Board. In 1993, $1.6 million in withheld taxes were transferred to the SSEBA.

   The tables in the report do not include FOASI or FDI benefits received by non-resident aliens or the taxes attributable to these benefits. However, the tables show the railroad social security equivalent benefits received by non-resident aliens.

4. These forecasts for FOASI and FDI do not include benefits received by non-resident aliens.

5. For single filers, $4,500 represents one-half of the difference in the first and second provisional income thresholds ($25,000 and $34,000). For joint filers, $6,000 represents one-half of the difference in the first and second provisional income thresholds ($32,000 and $44,000).

6. The SOI sample excludes beneficiaries who live in institutions and who do not earn sufficient income to file a return. The benefit figures from SSA and RRB are adjusted for these non-filers.

BIBLIOGRAPHY

Cilke, James C. "The Treasury Individual Income Tax Simulation Model." mimeo. Department of the Treasury. Office of Tax Analysis. April 1994.

Economic Report of the President. Washington, D.C.: Government Printing Office. February 1997.

U.S. Department of Health and Human Services. Social Security Administration. 1996 Annual Statistical Supplement to the Social Security Bulletin. Washington, D.C.: Government Printing Office, September 1996.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1984. March 1987.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1985. August 1987.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1986. February 1989.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Years 1987 and 1988. March 1991.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1989. March 1992.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1990. January 1993.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1991. September 1994.

U.S. Department of the Treasury. Office of Tax Analysis. Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Year 1992. January 1997.