



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

March 18, 2014

The Honorable Joseph R. Biden
President of the Senate
Washington, DC 20510

Dear President Biden:

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 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 of accounts to which made, and (2) the anticipated operation of the transfers during the next five years.

Pursuant to Section 121, enclosed is the "Report on the Taxation of Social Security and Railroad Retirement Benefits in Calendar Years 2005 through 2009."

Sincerely,

Alastair M. Fitzpayne
Assistant Secretary for Legislative Affairs

Enclosure



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WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

March 18, 2014

The Honorable John A. Boehner
Speaker of the House
U.S. House of Representatives
Washington, DC 20515

Dear Speaker Boehner:

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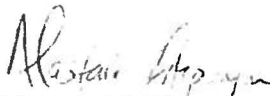
The Honorable Kathleen Sebelius
Secretary
Department of Health and Human Services
200 Independence Avenue SW
Washington, DC 20201

Dear Secretary Sebelius:

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 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 of accounts to which made, and (2) the anticipated operation of the transfers during the next five years.

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ASSISTANT SECRETARY

March 18, 2014

The Honorable Carolyn W. Colvin
Commissioner
Social Security Administration
Altmeyer Building
6401 Security Blvd.
Baltimore, MD 21235

Dear Commissioner Colvin:

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 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 of accounts to which made, and (2) the anticipated operation of the transfers during the next five years.

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The Honorable Michael S. Schwartz
Chairman
Railroad Retirement Board
1310 G Street NW
Washington, DC 20005

Dear Chairman Schwartz:

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ASSISTANT SECRETARY

March 18, 2014

The Honorable Joseph C. Szabo
Administrator
Federal Railroad Administration
1200 New Jersey Avenue SE
Washington, DC 20590

Dear Administrator Szabo:

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Report on the Taxation of
Social Security and Railroad Retirement Benefits
in Calendar Years 2005 through 2009

**Report to the Congress,
the Secretary of Health and Human Services,
the Social Security Administration,
the Railroad Retirement Board,
and the Federal Railroad Administration**

February 2014

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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 (Federal Old Age and Survivors and Federal Disability Insurance) and Railroad Social Security Equivalent benefits in adjusted gross income (AGI) for each liability year. These estimated tax liabilities are transferred from the general fund to the Federal Old Age and Survivors Insurance (FOASI), Federal Disability Insurance (FDI), and Railroad Social Security Equivalent Benefit Account (SSEBA) trust funds on a quarterly basis. Since 1994, transfers have also been made to the Federal Hospital Insurance (Medicare) trust fund (FHI). The amounts transferred to these 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 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), the Consolidated Budget Reconciliation Act of 1985 (P.L. 99-272), and the Omnibus Budget and Reconciliation Act of 1993 (OBRA 93) (P.L. 103-66). P.L. 98-21 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 differ from final amounts.

In addition, P.L. 98-21 requires 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 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 estimating the original transfers to the trust funds, calculating the correcting adjustments when final amounts of liability become available, and preparing these mandated reports. This report covers a five year period, and describes (1) the original liability estimates and transfers to the trust funds for calendar years 2005 through 2009, (2) the necessary correcting adjustments to the transfers for those same calendar years, and (3) the forecast of liability and transfers for calendar years 2010 through 2014.¹

To determine if any benefits were taxable in calendar years 2005 through 2009, taxpayers had to add both tax-exempt interest income and one-half of Social Security and Railroad Social Security Equivalent benefits to AGI. This augmented AGI is 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. If provisional income exceeded \$34,000 for single filers and \$44,000 for joint filers, taxpayers were required to include in AGI the lesser of:

1. 85 percent of the recipient's Social Security or Railroad Social Security Equivalent 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)

plus

- b. 85 percent of the excess of the recipient's provisional income over the applicable second provisional income threshold.²

None of the provisional income thresholds are indexed for inflation. Certain married beneficiaries not filing joint returns had a provisional income threshold of zero. The AGI of these individuals included the lesser of 85 percent of the beneficiary's Social Security or Railroad Social Security Equivalent benefit or 85 percent of the recipient's provisional income. Overall, for the highest income beneficiaries, a maximum of 85 percent of Social Security or Railroad Social Security Equivalent benefits was includable in AGI.

For beneficiaries whose provisional incomes are above the first threshold but below the second threshold, the tax liabilities attributable to the included benefits are transferred to the FOASI and FDI (Social Security) trust funds and the Railroad Social Security Equivalent benefit trust fund. For beneficiaries whose provisional incomes are above the second threshold, the tax liabilities attributable to the additional included benefits are transferred to the FHI (Medicare) trust fund.

To summarize, the Office of Tax Analysis estimates the income tax liability attributable to the partial inclusion of FOASI, FDI and SSEBA benefits in adjusted gross income and estimates the amounts to be transferred to the corresponding trust funds plus the FHI (Medicare) trust fund.³ Subsequently, OTA makes adjustments to correct the amounts put into each fund. Throughout the report, some tables will show benefits and/or tax liability by income source (FOASI, FDI or SSEBA benefits) while others will show the amounts transferred to the various trust funds (FOASI, FDI, SSEBA or FHI).

II. Summary

The Summary Table shows OTA's original tax liability estimates by benefit source and the transfers made to the trust funds based on those estimates, the adjusting transfers subsequently made, and the resulting net amounts transferred to each trust fund for each calendar year. For example, for calendar year 2005, OTA initially estimated that the tax liability attributable to partial inclusion of Social Security and Railroad Social Security Equivalent benefits was \$24,237 million. Of this amount, \$22,456 million was attributable to the inclusion of FOASI benefits, \$1,604 million was attributable to the inclusion of FDI benefits, and \$177 million was attributable to the inclusion of SSEBA benefits.

Based on these estimates, transfers of \$13,698 million, \$1,068 million, \$9,354 million, and \$117 million were made from the general fund to the FOASI, FDI, FHI, and SSEBA trust funds, respectively. OTA subsequently determined that the amount of tax liability calculated from actual 2005 tax return data was \$653 million less than the amount originally transferred. Transfers to the FOASI, FDI, and FHI trust funds were overstated by \$64 million, \$323 million, and \$274 million respectively, while transfers to the SSEBA trust fund were understated by \$8 million. Correcting adjustments to the FOASI, FDI, and SSEBA trust funds were made in April 2009 and October 2011. Correcting adjustments to the FHI trust fund were made in June 2009 and January 2012.⁴ The resulting net amount transferred for calendar year 2005 liability was

\$23,584 million. Of this amount, \$13,634 was transferred to the FOASI trust fund, \$745 million was transferred to the FDI trust fund, \$9,080 was transferred to the FHI trust fund, and \$125 million was transferred to the SSEBA trust fund.

This report provides the detail supporting the tax liability and transfer amounts. Chapter 1 presents OTA's methodology for estimating the tax liability attributable to the inclusion of benefits in AGI and presents a comparison of estimates to actual amounts of income tax liability calculated from tax return data for calendar years 2005 through 2009. Chapter 2 presents the methodologies for estimating the initial amounts to be transferred to the trust funds and the subsequent correcting adjustments. The chapter also presents those initial transfer amounts and the correcting adjustments for 2005 through 2009 liabilities. Chapter 3 presents the forecast of transfers of estimated amounts to the trust funds for calendar years 2010 through 2014.

Summary Table

	Calendar Years; Millions of Dollars				
	2005	2006	2007	2008	2009
Original Liability Estimate Attributable To					
FOASI Benefits	22,456	24,896	28,057	29,425	32,304
FDI Benefits	1,604	1,837	2,081	2,427	2,708
SSEBA Benefits	177	190	207	217	228
Total Original Liability Estimates	24,237	26,923	30,345	32,069	35,240
Original Transfers Made To					
FOASI Trust Fund	13,698	15,437	17,047	18,564	19,778
FDI Trust Fund	1,068	1,253	1,389	1,598	1,916
FHI Trust Fund	9,354	10,108	11,774	11,763	13,402
SSEBA Trust Fund	117	125	135	144	144
Total Original Transfers	24,237	26,923	30,345	32,069	35,240
Subsequent Correcting Adjustments Made To					
FOASI Trust Fund Transfers	-64	438	987	-683	-2,357
FDI Trust Fund Transfers	-323	-401	-420	-594	-870
FHI Trust Fund Transfers	-274	618	598	425	-1,497
SSEBA Trust Fund Transfers	8	24	35	24	20
Total Trust Fund Transfers	-653	679	1,200	-828	-4,704
Net Amounts Transferred To					
FOASI Trust Fund	13,634	15,875	18,034	17,881	17,421
FDI Trust Fund	745	852	969	1,004	1,046
FHI Trust Fund	9,080	10,726	12,372	12,188	11,905
SSEBA Trust Fund	125	149	170	168	164
Total Net Amounts	23,584	27,602	31,545	31,241	30,536

Department of the Treasury
Office of Tax Analysis

CHAPTER 1: METHODOLOGY AND ESTIMATES OF THE TAX LIABILITY ATTRIBUTABLE TO THE TAXATION OF BENEFITS FOR CALENDAR YEARS 2005 THROUGH 2009

I. Methodology for Estimating Tax Liability

The Office of Tax Analysis (OTA) is responsible for estimating the annual tax liability attributable to the partial inclusion of Social Security and Railroad Social Security Equivalent benefits received in AGI, making quarterly transfers from the general fund to the trust funds based on these estimates, and calculating correcting adjustments to amounts initially transferred. OTA provides this information to the Treasury Department's Bureau of the Fiscal Service, which has the authority to transfer funds between the general revenue fund and the trust funds as necessary.

OTA estimated the amount of tax liability attributable to the inclusion of Social Security benefits in AGI for each of the years 2005 through 2009 using results from OTA's Individual Income Tax Model (ITM).^{5, 6} The ITM is OTA's primary tool for preparing revenue estimates and analyzing taxpayer behavior. For this application, the ITM was used to account fully for changes in all individual income tax provisions resulting from the inclusion of benefits in AGI. That is, in addition to the direct effect on tax liability of including benefit income, the use of deductions and credits, as well as the calculations of alternative minimum tax liabilities, can be affected by the inclusion of benefits in AGI.⁷

The ITM is built on a stratified random sample of individual income tax returns contained in the Internal Revenue Service's Statistics of Income (SOI) file. ITM computations are weighted to produce results that are representative of the entire population of taxpayers. Tax returns alone, however, do not provide sufficient data to estimate the tax liability effects of the partial inclusion of Social Security and Railroad Social Security Equivalent benefits in AGI. Therefore, imputations are added to the ITM to compensate for the missing data. 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 Form SSA-1099 and Form RRB-1099 information returns that are matched to the SOI file; and (2) Current Population Survey data from the Census Bureau to aid in matching benefits to recipients who were not required to file a tax return. Records on the ITM are extrapolated to future years in accordance with the Administration's macroeconomic forecast in use at the time of the extrapolation. In general, the ITM is extrapolated twice per calendar year: once as part of the production of the Administration's budget, submitted to Congress each February, and once as part of the production of the Administration's mid-session review, submitted to Congress each summer. As part of each extrapolation, total Social Security and Railroad Social Security Equivalent benefits are projected to grow at the rates indicated in benefits forecasts provided by the Social Security Administration and the Railroad Retirement Board.

The base year for the ITM extrapolation is updated approximately every three years. Estimates for calendar years 2005 and 2006 were made using a 2001-based ITM. That is, OTA extrapolated sample tax returns, SSA-1099 forms, RRB-1099 forms, and CPS data for 2001.

Estimates for 2007, 2008, and 2009 were made using a 2004-based ITM. OTA extrapolated sample tax returns, SSA-1099 forms, RRB-1099 forms and CPS data for 2004.

The ITM uses the tax return information, the imputations, and extrapolations to estimate the amount of Social Security and Railroad Social Security Equivalent benefits included in AGI and the Federal income tax liability attributable to the inclusion of those benefits for all of the filing units in the model. To do this, each tax unit's liability is estimated with and without the inclusion of benefits received by that tax unit. The difference between those two levels of income tax liability equals the tax liability attributable to the inclusion of benefits. The ITM results are used to calculate both the percentage of total benefits included in AGI and the average effective marginal tax rates applicable to the taxable benefits. Final estimates of tax liability attributable to the partial inclusion of benefits are produced using a spreadsheet-based model. This model blends the estimates of the percent of benefits in AGI and the average effective marginal tax rates with more recent tax return information (not available when the ITM is extrapolated) and the most current tax collection information. As will be discussed in Chapter 2, Section I, these liability estimates are transferred to the FOASI, FDI, FHI, and SSEBA trust funds.

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 determine if adjustments are required, it is necessary to determine the actual tax liability attributable to the inclusion of benefits in AGI. To calculate this actual tax liability, the IRS created data files based on Form 1040 records for each of the calendar years 2005 through 2009. All filers who reported taxable Social Security or Railroad Social Security Equivalent benefits on their Form 1040 were included in these data files (as opposed to the data used to determine the original transfer estimates, which are sample data). The methodology for determining the adjustments to the estimated transfers is discussed in Chapter 2, Section II.

II. Estimates of Tax Liability Attributable to the Taxation of Benefits in Calendar Years 2005 to 2009

Tables 1.A through 1.E compare the assumptions and parameters used to determine the estimates of tax liability with the parameters calculated from actual tax return and benefit data for each calendar year from 2005 to 2009. As noted above, the parameters used in the estimates are determined from a base year of SOI sample data, other data sources, and an extrapolation algorithm while the parameters used to calculate actual liabilities are based on IRS population data.

For example, the top section of Table 1.A shows that OTA estimated that \$123,409 million of \$521,090 million in total benefits (23.68 percent) would be included in AGI for calendar year 2005. The estimated tax liability attributable to those benefits was \$24,237 million, for an average effective marginal tax rate of 19.64 percent. The bottom section of the table shows that, based on calendar year 2005 tax return and benefits data, \$123,583 million of \$525,649 million in total benefits (23.51 percent) were included in AGI. The actual tax liability attributable to those benefits was \$23,584 million, for an average effective marginal tax rate of 19.08 percent.

Continuing the example, the total liability estimate for calendar year 2005 was the sum of the estimates of the tax liability attributable to the partial inclusion of FOASI, FDI, and SSEBA benefits. The top section of Table 1.A shows that OTA estimated that \$113,271 million of \$433,007 million in FOASI benefits (26.16 percent) would be included in AGI. The estimated tax liability attributable to those benefits was \$22,456 million, for an average effective marginal tax rate of 19.83 percent. The bottom section of the table shows that, based on calendar year 2005 tax return and benefits data, \$115,530 million of \$434,803 million in FOASI benefits (26.57 percent) were included in AGI. The actual tax liability attributable to those benefits was \$22,221 million, for an average effective marginal tax rate of 19.23 percent.

In 2005, the estimated inclusion rates for benefits in AGI and average effective marginal tax rates for FDI beneficiaries are lower than those for FOASI recipients. The top section of Table 1.A shows that OTA estimated that \$9,135 million of \$82,617 million in FDI benefits (11.06 percent) would be included in AGI. The estimated tax liability attributable to those benefits was \$1,604 million, for an average effective marginal tax rate of 17.56 percent. The bottom section of the table shows that, based on calendar year 2005 tax return and benefits data, \$6,953 million of \$85,376 million in FDI benefits (8.14 percent) were included in AGI. The actual tax liability attributable to those benefits was \$1,172 million, for an average effective marginal tax rate of 16.86 percent.

Also in 2005, the estimated inclusion rates for benefits in AGI and average effective marginal tax rates for Railroad SSEBA beneficiaries are slightly lower than for FOASI beneficiaries but higher than for FDI recipients. The top section of Table 1.A shows that OTA estimated that \$1,003 million of \$5,466 million in SSEBA benefits (18.35 percent) would be included in AGI. The estimated tax liability attributable to those included benefits was \$177 million, for an average effective marginal tax rate of 17.65 percent. The bottom section of the table shows that, based on calendar year 2005 tax return and benefits data, \$1,100 million of \$5,470 million in SSEBA benefits (20.12 percent) were included in AGI. The actual tax liability attributable to included SSEBA benefits was \$191 million, for an average effective marginal tax rate of 17.36 percent.

Table 1.A
Comparison of Parameters Used to Estimate Tax Liability Attributable to the
Partial Inclusion of Benefits In AGI with Parameters Calculated from Actual Amounts
Calendar Year 2005 /1

Benefit Source	Total Benefits Paid /2	Benefits Includable in AGI /2	Percent of Total Benefits Includable in AGI	Tax Liabilities on Benefits Includable In AGI /2	Average Effective Marginal Tax Rate on Benefits Includable In AGI
Estimate Parameters /3					
Federal Old-Age and Survivors Insurance	433,007	113,271	26.16%	22,456	19.83%
Federal Disability Insurance	82,617	9,135	11.06%	1,604	17.56%
Railroad Social Security Equivalent Benefits	5,466	1,003	18.35%	177	17.65%
Total	521,090	123,409	23.68%	24,237	19.64%
Actual Parameters /4					
Federal Old-Age and Survivors Insurance	434,803	115,530	26.57%	22,221	19.23%
Federal Disability Insurance	85,376	6,953	8.14%	1,172	16.86%
Railroad Social Security Equivalent Benefits	5,470	1,100	20.12%	191	17.36%
Total	525,649	123,583	23.51%	23,584	19.08%

Department of the Treasury
Office of Tax Analysis

1/ Estimated tax liabilities were updated on a semi-annual basis to conform with updates to the Administration's macroeconomic forecast.
The table compares the parameters used in the final estimates of tax liability with the parameters derived from actual tax return and benefits data.
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/ Benefits amounts and tax liabilities in millions of dollars, excluding benefits paid to non-resident aliens.

3/ The total benefits paid data are estimates provided by the Social Security Administration and the Railroad Retirement Board; the other data are estimated from the Office of Tax Analysis Individual Income Tax Model.

4/ The total benefits paid data are derived from the 2010 Annual Statistical Supplement to the Social Security Bulletin and information supplied by the Railroad Retirement Board; the Benefits in AGI and tax liability data are derived from the Internal Revenue Service's Individual Masterfile.

Table I.B
Comparison of Parameters Used to Estimate Tax Liability Attributable to the
Partial Inclusion of Benefits in AGI with Parameters Calculated from Actual Amounts
Calendar Year 2006 /1

Benefit Source	Total Benefits Paid /2	Benefits Includable in AGI /2	Percent of Total Benefits Includable in AGI	Tax Liabilities on Benefits Includable in AGI /2	Average Effective Marginal Tax Rate on Benefits Includable in AGI
Estimate Parameters /3					
Federal Old-Age and Survivors Insurance	461,365	125,369	27.17%	24,896	19.86%
Federal Disability Insurance	91,535	10,357	11.31%	1,837	17.74%
Railroad Social Security Equivalent Benefits	5,627	1,066	18.94%	190	17.83%
Total	558,528	136,791	24.49%	26,923	19.68%
Actual Parameters /4					
Federal Old-Age and Survivors Insurance	459,897	132,521	28.82%	26,023	19.64%
Federal Disability Insurance	92,368	8,033	8.70%	1,348	16.78%
Railroad Social Security Equivalent Benefits	5,672	1,322	23.30%	231	17.48%
Total	557,937	141,875	25.43%	27,602	19.46%

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1/ Estimated tax liabilities were updated on a semi-annual basis to conform with updates to the Administration's macroeconomic forecast.
The table compares the parameters used in the final estimates of tax liability with the parameters derived from actual tax return and benefits data.
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/ Benefits amounts and tax liabilities in millions of dollars, excluding benefits paid to non-resident aliens.

3/ The total benefits paid data are estimates provided by the Social Security Administration and the Railroad Retirement Board; the other data are estimated from the Office of Tax Analysis Individual Income Tax Model.

4/ The total benefits paid data are derived from the 2010 Annual Statistical Supplement to the Social Security Bulletin and information supplied by the Railroad Retirement Board; the Benefits in AGI and tax liability data are derived from the Internal Revenue Service's Individual Masterfile.

Table I.C
Comparison of Parameters Used to Estimate Tax Liability Attributable to the
Partial Inclusion of Benefits in AGI with Parameters Calculated from Actual Amounts
Calendar Year 2007 /1

Benefit Source	Total Benefits Paid /2	Benefits Includable in AGI /2	Percent of Total Benefits Includable in AGI	Tax Liabilities on Benefits Includable in AGI /2	Average Effective Marginal Tax Rate on Benefits Includable in AGI
Estimate Parameters /3					
Federal Old-Age and Survivors Insurance	484,883	137,081	28.27%	28,057	20.47%
Federal Disability Insurance	98,910	11,581	11.71%	2,081	17.97%
Railroad Social Security Equivalent Benefits	5,725	1,151	20.11%	207	17.98%
Total	589,517	149,814	25.41%	30,345	20.26%
Actual Parameters /4					
Federal Old-Age and Survivors Insurance	485,312	151,482	31.21%	29,737	19.63%
Federal Disability Insurance	99,070	9,309	9.40%	1,542	16.57%
Railroad Social Security Equivalent Benefits	5,825	1,522	26.12%	266	17.48%
Total	590,207	162,313	27.50%	31,545	19.43%

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1/ Estimated tax liabilities were updated on a semi-annual basis to conform with updates to the Administration's macroeconomic forecast.
The table compares the parameters used in the final estimates of tax liability with the parameters derived from actual tax return and benefits data.
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/ Benefits amounts and tax liabilities in millions of dollars, excluding benefits paid to non-resident aliens.

3/ The total benefits paid data are estimates provided by the Social Security Administration and the Railroad Retirement Board; the other data are estimated from the Office of Tax Analysis Individual Income Tax Model.

4/ The total benefits paid data are derived from the 2010 Annual Statistical Supplement to the Social Security Bulletin and information supplied by the Railroad Retirement Board; the Benefits in AGI and tax liability data are derived from the Internal Revenue Service's Individual Masterfile.

Table I.D
Comparison of Parameters Used to Estimate Tax Liability Attributable to the
Partial Inclusion of Benefits in AGI with Parameters Calculated from Actual Amounts
Calendar Year 2008 /1

Benefit Source	Total Benefits Paid /2	Benefits Includable in AGI /2	Percent of Total Benefits Includable in AGI	Tax Liabilities on Benefits Includable In AGI /2	Average Effective Marginal Tax Rate on Benefits Includable In AGI
Estimate Parameters /3					
Federal Old-Age and Survivors Insurance	505,234	149,481	29.59%	29,425	19.68%
Federal Disability Insurance	103,562	12,917	12.47%	2,427	18.79%
Railroad Social Security Equivalent Benefits	5,926	1,243	20.97%	217	17.46%
Total	614,721	163,641	26.62%	32,069	19.60%
Actual Parameters /4					
Federal Old-Age and Survivors Insurance	508,483	153,559	30.20%	29,381	19.13%
Federal Disability Insurance	106,286	9,725	9.15%	1,598	16.43%
Railroad Social Security Equivalent Benefits	5,935	1,530	25.78%	262	17.12%
Total	620,704	164,815	26.55%	31,241	18.96%

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1/ Estimated tax liabilities were updated on a semi-annual basis to conform with updates to the Administration's macroeconomic forecast.
The table compares the parameters used in the final estimates of tax liability with the parameters derived from actual tax return and benefits data.
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/ Benefits amounts and tax liabilities in millions of dollars, excluding benefits paid to non-resident aliens.

3/ The total benefits paid data are estimates provided by the Social Security Administration and the Railroad Retirement Board; the other data are estimated from the Office of Tax Analysis Individual Income Tax Model.

4/ The total benefits paid data are derived from the 2010 Annual Statistical Supplement to the Social Security Bulletin and information supplied by the Railroad Retirement Board; the Benefits in AGI and tax liability data are derived from the Internal Revenue Service's Individual Masterfile.

Table 1.E
Comparison of Parameters Used to Estimate Tax Liability Attributable to the
Partial Inclusion of Benefits in AGI with Parameters Calculated from Actual Amounts
Calendar Year 2009 /1

Benefit Source	Total Benefits Paid /2	Benefits Includable in AGI /2	Percent of Total Benefits Includable in AGI	Tax Liabilities on Benefits Includable in AGI /2	Average Effective Marginal Tax Rate on Benefits Includable in AGI
Estimate Parameters /3					
Federal Old-Age and Survivors Insurance	554,003	169,952	30.68%	32,304	19.01%
Federal Disability Insurance	115,666	16,122	13.94%	2,708	16.80%
Railroad Social Security Equivalent Benefits	6,154	1,318	21.42%	228	17.30%
Total	675,822	187,392	27.73%	35,240	18.81%
Actual Parameters /4					
Federal Old-Age and Survivors Insurance	556,549	157,029	28.21%	28,613	18.22%
Federal Disability Insurance	118,314	10,404	8.79%	1,669	16.04%
Railroad Social Security Equivalent Benefits	6,308	1,558	24.69%	254	16.31%
Total	681,171	168,990	24.81%	30,536	18.07%

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1/ Estimated tax liabilities were updated on a semi-annual basis to conform with updates to the Administration's macroeconomic forecast.
The table compares the parameters used in the final estimates of tax liability with the parameters derived from actual tax return and benefits data.
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/ Benefits amounts and tax liabilities in millions of dollars, excluding benefits paid to non-resident aliens.

3/ The total benefits paid data are estimates provided by the Social Security Administration and the Railroad Retirement Board; the other data are estimated from the Office of Tax Analysis Individual Income Tax Model.

4/ The total benefits paid data are derived from the 2010 Annual Statistical Supplement to the Social Security Bulletin and information supplied by the Railroad Retirement Board; the Benefits in AGI and tax liability data are derived from the Internal Revenue Service's Individual Masterfile.

CHAPTER 2: METHODOLOGY FOR ESTIMATING TRANSFERS AND CALCULATING ADJUSTMENTS TO TRANSFERS OF LIABILITY IN CALENDAR YEARS 2005 THROUGH 2009

I. Methodology for Estimating Quarterly Transfer Amounts

Based on the estimates of annual liability given in Chapter 1, the Department of the Treasury's Office of Tax Analysis constructed estimates of the quarterly transfers from the general fund to the FOASI, FDI, FHI, and SSEBA trust funds. Since OBRA 93 created the second thresholds for inclusion of benefits in AGI, and directed that the additional tax liability be directed to the FHI trust fund, OTA estimated the annual liability attributable to the inclusion of FOASI, FDI, and SSEBA benefits in AGI on both a pre-OBRA 93 and a post-OBRA 93 basis. The amounts of liability transferable to the FOASI, FDI, and SSEBA trust funds were the pre-OBRA 93 liability estimates. The amount of liability transferable to the FHI trust fund was taken as the difference between the post-OBRA 93 total liability estimate and the pre-OBRA 93 total liability estimate. OTA then estimated the quarterly transfer amounts associated with the current and subsequent calendar years. Separate methodologies were used to transfer the pre-OBRA 93 and post-OBRA 93 quarterly amounts due to differences in statutory requirements.

With respect to pre-OBRA 93 transfers, statutory requirements dictate that liability should be transferred quarterly as it accrues. Therefore, the quarterly transfers are made on the first day of the calendar quarters beginning with the months of January, April, July, and October. As noted in Chapter 1, Section I, the ITM generally is re-extrapolated twice per year, thus for a given liability year, the total amounts transferable to the FOASI, FDI, or SSEBA trust funds are the amounts of liability estimated from the most recent forecast of estimated annual liability (based on the most recent extrapolation), less any amounts of liability already transferred for that year (which were based on prior extrapolations). This net difference is divided over the remaining quarters still available for transfers.

With respect to post-OBRA 93 transfers, statutory requirements dictate that liability should be transferred quarterly as it is collected. Therefore, that calendar year liability is transferred in five installments, representing four quarterly estimated payments and one final payment of liability. Transfers to the FHI trust fund are made on the fifteenth day of the quarter beginning with the months April, June, September, and January. The total April 15 transfer to the FHI trust fund always contains two installments – one estimated payment for the current year's liability and one final payment for the prior year's liability. As with the pre-OBRA 93 transfers, the total amount transferable to the FHI trust fund for a given liability year is the amount of liability estimated from the most recent forecast of estimated annual liability (again based on the most recent extrapolation), less any amounts of liability already transferred for that year (which were based on prior extrapolations). This net difference is divided over the remaining installments still available for transfers.

II. Methodology for Adjustments to Transfers of Estimated Amounts

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 tax liability for each of the calendar years 2005 through 2009 resulting from the partial taxation of Social Security and Railroad Social Security Equivalent benefits, the IRS created data files for each year based on Form 1040 records. All filers who report taxable Social Security or Railroad Social Security Equivalent benefits on their Form 1040 are included in these data files. 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 are matched to Form SSA-1099 records provided by the Social Security Administration and Form RRB-1099 records provided by the Railroad Retirement Board.⁸

Using this matched file of Form 1040, Form SSA-1099 and RRB-1099 records, the IRS calculates the tax liability attributable to the taxation of Social Security and Railroad Social Security Equivalent benefits, for both pre-OBRA 93 and post-OBRA 93 liability. For each taxpayer, the total tax liability attributable to the taxation of benefits is calculated as the difference between tax liability with and without benefits included in AGI. The pre-OBRA 93 tax liability is calculated as the difference between tax liability with benefits includable under pre-OBRA 93 law and with no included benefits. The post-OBRA 93 tax liability is the difference between the total tax liability and the pre-OBRA 93 tax liability. The total difference taken over all taxpayers equals the tax liability attributable to the taxation of benefits.

After comparing the IRS liability calculations with the OTA liability estimates, OTA calculates adjustments to the original transfers. These adjustment amounts are equal to the difference between the IRS liability calculations and OTA's original liability estimates. The adjustment amounts are included as an adjustment to the estimated liability transfers described in Section I.⁹ Thus, the net transfer for that quarter reflects the transfer for the current period liability and the adjustment to the estimate of prior period liability.

III. Transfers of Estimated Amounts and Adjustments to Transfers for Liability in Calendar Years 2005 through 2009

Table 2 shows the estimated liability amounts transferred to the FOASI, FDI, FHI and SSEBA trust funds in each calendar year from 2005 to 2009. For example, in calendar year 2005, total transfers of \$13,698 million, \$1,068 million, and \$117 million were made to the FOASI, FDI, and SSEBA trust funds, respectively, and total transfers of \$9,354 million were made to the FHI trust fund. Amounts were transferred quarterly to the FOASI, FDI and SSEBA trust funds between January 1 and October 1 of 2005. Amounts were transferred quarterly to the FHI trust fund between April 15, 2005 and April 15, 2006.

Table 2 also shows the IRS calculations of final trust fund amounts, and the resulting adjustments to the FOASI, FDI, FHI, and SSEBA trust funds due to the reconciliation of OTA estimates and IRS calculations. For example, as a result of the reconciliation of estimated and

actual 2005 tax liability, adjustments of -\$64 million, -\$323 million, -\$274 million, and \$8 million were made, for the FOASI, FDI, FHI, and SSEBA trust funds, respectively. The final column of Table 2 shows the quarter in which each adjustment was made.

Table 2
Comparison of OTA Estimated Transfers, IRS Calculated Transfers, and
Corresponding Adjustments for Calendar Years 2005 to 2009 /1

Year and Trust Fund	OTA Estimated Transfers	IRS Calculated Transfers	Adjustment Amount	Adjustment Date
CY 2005 Liability				
FOASI	13,698	13,634	-64	/2
FDI	1,068	745	-323	/2
FHI	9,354	9,080	-274	/2
SSEBA	<u>117</u>	<u>125</u>	<u>8</u>	/2
Total	24,237	23,584	-653	
CY 2006 Liability				
FOASI	15,437	15,875	438	January 1, 2012
FDI	1,253	852	-401	January 1, 2012
FHI	10,108	10,726	618	April 15, 2012
SSEBA	<u>125</u>	<u>149</u>	<u>24</u>	January 1, 2012
Total	26,923	27,602	679	
CY 2007 Liability				
FOASI	17,047	18,034	987	April 1, 2012
FDI	1,389	969	-420	April 1, 2012
FHI	11,774	12,372	598	April 15, 2012
SSEBA	<u>135</u>	<u>170</u>	<u>35</u>	April 1, 2012
Total	30,345	31,545	1,200	
CY 2008 Liability				
FOASI	18,564	17,881	-683	April 1, 2012
FDI	1,598	1,004	-594	April 1, 2012
FHI	11,763	12,188	425	April 15, 2012
SSEBA	<u>144</u>	<u>168</u>	<u>24</u>	April 1, 2012
Total	32,069	31,241	-828	
CY 2009 Liability				
FOASI	19,778	17,421	-2,357	January 1, 2013
FDI	1,916	1,046	-870	January 1, 2013
FHI	13,402	11,905	-1,497	January 15, 2013
SSEBA	<u>144</u>	<u>164</u>	<u>20</u>	January 1, 2013
Total	35,240	30,536	-4,704	

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1/ Amounts in millions of dollars.

2/ This adjustment was made in two steps. Preliminary adjustments of -\$4 million, \$35 million, and -\$8 million to the FOASI, FDI, and SSEBA trust funds, respectively, were included with the April 1, 2009 transfer. A preliminary adjustment of -\$255 million to the FHI trust fund was included with the June 15, 2009 transfer. Subsequent to these adjustments, IRS issued new totals for calendar year 2005 tax liability. Second adjustments of -\$60 million, -\$358 million, and \$16 million to the FOASI, FDI, and SSEBA trust funds, respectively, were included with the October 1, 2011 transfer. A second adjustment of -\$19 million to the FHI trust fund was included with the January 15, 2012 transfer. The total adjustments were -\$64 million, -\$323 million, -\$274 million, and \$8 million, for the FOASI, FDI, FHI, and SSEBA trust funds, respectively.

CHAPTER 3: FORECAST OF TRANSFERS TO TRUST FUNDS FOR CALENDAR YEARS 2010 TO 2014

I. Forecasting Methodology

The Social Security Amendments of 1983 require that the annual report include a forecast of transfers to the trust funds for the next five years. The forecast years are currently calendar years 2010 to 2014, since no correcting adjustments have been made to those years' liability transfers. This forecast was produced using the same methods that were used to produce the initial estimates of calendar year 2005 through 2009 liability and trust fund transfers, described in Chapters 1 and 2. The calendar year forecasts for 2010 through 2014 were produced using results from an ITM based on 2007 SOI data and imputations, similar to the 2001- and 2004-based ITMs described in Chapter 1.

As noted in Chapter 1, tax returns alone do not provide sufficient data to estimate the revenue effects of the partial inclusion of Social Security and Railroad Social Security Equivalent benefits in AGI. Therefore, imputations of total Social Security and Railroad Social Security Equivalent benefits are added to the 2007-based version of the ITM to compensate for the missing data. The total benefit amounts are distributed among appropriate recipients on the ITM using Form SSA-1099 and Form RRB-1099 information returns that are matched to the tax returns in the SOI file. As with the 2004-based ITM, the most recent Current Population Survey data from the Census Bureau is used as a guide to the non-filing population. The cross-sectional records of the ITM are extrapolated to future years in accordance with the Administration's macroeconomic forecast in use at the time of the extrapolation. As part of the extrapolation, total benefits are projected to grow at the rates indicated in the forecasts provided by the Social Security Administration and the Railroad Retirement Board.

II. Forecast of Transfers to the Trust Funds

Table 3 presents the estimates of liability incurred in calendar years 2010 through 2014 and the amounts transferred to the trust funds. The transfers of estimated liability for calendar years 2010 through 2012 have been completed and include adjustments attributable to prior years' liabilities. The FOASI, FDI, FHI, and SSEBA transfers for calendar year 2011 liability include adjustments due to the reconciliation of calendar year 2005 estimated and actual liabilities.¹⁰ The transfers for calendar year 2012 liability include adjustments due to the reconciliation of calendar years 2006, 2007 and 2008 estimated and actual liabilities. The transfers for calendar year 2013 include adjustments due to the reconciliation of calendar year 2009 estimated and actual liabilities. In total, for liability incurred in calendar years 2010 through 2014, OTA forecasts that \$122,992 million, \$9,902 million, \$84,689 million, and \$930 million will be transferred from general revenues to the FOASI, FDI, FHI, and SSEBA trust funds. The adjustments for prior period liabilities total -\$1,675 million for FOASI, -\$2,643 million for FDI, \$125 million for FHI, and \$119 million for SSEBA. The net transfer to the trust funds is estimated to be \$214,439 million.

Table 3
Forecast of Transfers, Net of Adjustments, to the FOASI, FDI, FHI and SSEB Trust Funds
for Calendar Year Liability in 2010 to 2014

Calendar Year Liability in Millions of Dollars						
Trust Fund	Completed Transfers			Estimated Transfers		Totals
	2010	2011	2012	2013	2014	2010-2014
FOASI						
Estimated Transfer /1	21,931	22,109	25,764	25,331	27,857	122,992
Prior Year Adjustment /2	0	-60	742	-2,357	0	-1,675
Net Transfer	21,931	22,049	26,506	22,974	27,857	121,317
FDI						
Estimated Transfer /1	1,848	1,935	1,994	1,972	2,152	9,902
Prior Year Adjustment /2	0	-358	-1,415	-870	0	-2,643
Net Transfer	1,848	1,577	579	1,102	2,152	7,259
FHI						
Estimated Transfer /1	14,442	15,693	16,761	17,918	19,875	84,689
Prior Year Adjustment /2	0	-19	1,641	-1,497	0	125
Net Transfer	14,442	15,674	18,402	16,421	19,875	84,814
SSEBA						
Estimated Transfer /1	159	160	194	200	217	930
Prior Year Adjustment /2	0	16	83	20	0	119
Net Transfer	159	176	277	220	217	1,049
Totals						
Estimated Transfer /1	38,380	39,897	44,713	45,421	50,101	218,513
Prior Year Adjustment /2	0	-421	1,051	-4,704	0	-4,074
Net Transfer	38,380	39,476	45,764	40,717	50,101	214,439

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Notes:

1/ Estimated Transfers are amounts transferred to the trust funds for liability incurred in the year indicated. Note that the final two estimated liability transfers to the FHI trust fund for a given year occur in January and April of the following year.

2/ Prior Year Adjustments are amounts transferred to or from the trust funds that correct the original estimated liabilities transferred for prior years. Because the final two estimated liability transfers to the FHI trust fund for a given year occur in January and April of the following year, a Prior Year Adjustment to a given year's FHI estimated transfer may occur in the next calendar year.

Adjustments made in CY 2011 were for liability incurred in CY 2005. Subsequent to making original adjustments in CY 2009, the IRS reported new CY 2005 liability totals. The second correcting adjustments to the FOASI, FDI, and SSEBA trust funds were made in October 2011. The second correcting adjustment to the FHI trust fund was made in January 2012.

Adjustments made in CY 2012 were for liability incurred in CY 2006, CY 2007 and CY 2008. Adjustments to the FOASI, FDI, and SSEBA trust funds were made in January 2012 (for CY 2006 liability) and April 2012 (for CY 2007 and CY 2008 liability). Adjustments to the FHI trust fund were made in April 2012 (for CY 2006, CY 2007 and CY 2008 liability).

Adjustments made in CY 2013 were for liability incurred in CY 2009. Adjustments to the FOASI, FDI, FHI, and SSEBA trust funds were made in January 2013.

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ENDNOTES

1. This report covers a five year period due to certain delays in determining the final levels of benefits in AGI and final tax liability for calendar years 2005 and 2006. The IRS updated the systems and programs used to determine the final levels and there were delays in transitioning to the new methods. While the report covering 2005 and 2006 was in production, final levels of benefits in AGI and final tax liabilities for calendar years 2007, 2008, and 2009 became available. Therefore the five calendar years have been combined into one report.
2. The \$4,500 and \$6,000 amounts represent half the distance between the first and second provisional income thresholds for single and joint filers, respectively (\$25,000 and \$34,000 for singles, \$32,000 and \$44,000 for joints). The second provisional thresholds and the associated benefits-in-AGI inclusion rule were enacted as part of OBRA 93 and apply to all calendar years beginning on or after January 1, 1994. OBRA 93 also stipulated that the additional tax liability arising from those provisions be directed to the FHI trust fund.
3. Liability estimates and the associated transfers are updated semi-annually (in December and May) to conform with updates to the Administration's macroeconomic forecast. All transfers are made using the most recently created forecast.
4. In June 2008, the IRS provided OTA with preliminary totals of tax liability with and without the inclusion of Social Security benefits for calendar year 2005. The April and June 2009 correcting adjustments were made based on these totals. In September 2011, the IRS provided OTA with revised totals for calendar year 2005. The second correcting adjustments made in October 2011 and January 2012 were based on these totals.
5. A detailed description of the Individual Income Tax Model can be found in Cilke (1994).
6. OTA does not estimate the liability attributable to the receipt of FOASI and FDI benefits by non-resident aliens. Prior to calendar 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. For calendar years 1995 and after, the portion of benefits subject to withholding is raised to 85 percent (P.L. 103-465).

Each month, the Social Security Administration sends a certification of the amount withheld to the Treasury Department's Bureau of the Fiscal Service. The withheld amount is transferred to general revenues and then back to the FOASI and FDI trust funds. 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 estimates of transfers to the trust funds and subsequently verifies these estimates with the Railroad Retirement Board.

The tables in this report do not include FOASI or FDI benefits received by non-resident aliens or the taxes attributable to these benefits. However, the tables do show the Railroad Social Security Equivalent benefits received by non-resident aliens.

7. For example, as AGI increases, the amount of deductible medical, casualty and certain miscellaneous expenses may change. Similarly, the increased income tax liability resulting from the inclusion of benefits in AGI may enable some taxpayers to use tax credits that otherwise might not be usable in that year due to

insufficient income tax liability.

8. The Form SSA-1099 records provided to the IRS distinguish between retirement and disability benefits, even though the Form SSA-1099s sent to taxpayers do not include this information.
9. The April 1, 2012 and April 15, 2012 liability transfers both included adjustments for multiple prior years because the adjustments for those years were determined over a short time span. The April 1, 2012 transfer included adjustments for CY 2007 and CY 2008. The April 15, 2012 transfer included adjustments for CY 2006, CY 2007 and CY 2008.
10. The adjustments for Calendar Year 2005 liability were made in two steps. In June 2008, the IRS provided OTA with preliminary totals of tax liability with and without the inclusion of Social Security benefits for calendar year 2005. The estimated liability transfers for calendar year 2009 included these correcting adjustments. In September 2011, the IRS provided OTA with revised totals for calendar year 2005. The estimated liability transfers for calendar year 2011 included these second correcting adjustments. See also endnote 4 and the notes to Tables 2 and 3.