**IRET Congressional Advisory**

**March 4, 2000 No. 100**

# REPEAL OF THE EARNINGS TEST: A GREAT FIRST STEP

The House of Representatives has unanimously passed a proposal by Representative Sam Johnson (R-TX) to repeal the notorious Social Security earnings test for beneficiaries age 65 through age 69. (The earnings test does not apply to people age 70 or older.) The Senate should act at once to eliminate this punitive provision. If the Congress passes a clean bill, President Clinton has promised to sign it. The bill is an excellent first step toward removing a major obstacle to the financial well-being of seniors. As the good results from this initiative become apparent, it may also pave the way for additional steps that need to be taken.

***The bill is an excellent first step toward removing a major obstacle to the financial well-being of seniors.***

## Repealing the earnings test for older seniors

Under current law, seniors ages 65 through 69 who continue to work and have wage and salary income over $17,000 lose $1 in Social Security retirement benefits for every $3 in wages over the threshold. The earnings test is an implicit 33-1/3% add-on tax rate on earnings over the threshold. These seniors also face a payroll tax rate of 15.3% and an income tax rate of 15%, for a combined federal tax rate in excess of 60% on earnings from working. If they are also subject to income taxation of their Social Security benefits, triggered by earning additional wages, the implicit federal tax rate on the added wage income can range from 68% to nearly 91%. These provisions practically force seniors out of the work force, depriving the economy of their skills and output. Moreover, the Social Security earnings penalty reduces federal tax revenue on the lost earnings, offsetting most if not all of the trivial saving in lower Social Security benefits.

***The earnings test should also be repealed for the younger seniors. In addition, something must be done about the taxation of Social Security benefits.***

The earnings threshold for this age group is already being boosted under provisions of the Senior Citizens' Right to Work Act of 1996 to $30,000 by 2002; it will then resume normal annual adjustment for average wage growth. But even the augmented $30,000 threshold for these seniors is an unwarranted infringement on the freedom to work, and complete repeal is the right course. It could not come at a better time. Millions of jobs are going begging, and there is a serious shortage of the skills that older workers possess.

## Still to be done — ending the test for younger seniors and fixing taxation of benefits

The House bill does not repeal the earnings test applied to younger seniors ages 62 through 64 (those below the Social Security normal retirement age). The younger seniors face a steeper earnings test, losing $1 in benefits for every $2 in wages above a lower threshold, $10,800 in 2000. The threshold for these younger seniors was not given a boost in the 1996 Act, and only rises with average wages. For the younger seniors, the earnings test is a 50% add-on implicit

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tax rate, which boosts their combined tax rate on additional wages to more than 80%. If they are also subject to income taxation of their Social Security benefits, triggered by earning additional wages, the implicit federal income and payroll tax rates on the added wage income can reach 85% to nearly 110%.

Furthermore, the repeal for the older seniors only affects beneficiaries above the normal Social Security retirement age, and that is scheduled to rise. The normal retirement age is currently 65, but will increase to age 66 by 2 months a year for people who reach age 62 between 2000 and 2005. By 2009, people age 65 will be completely shifted into the young seniors group, subject to the earnings test again, and at the higher \$1 for \$2 rate now imposed on the younger group. The retirement age is scheduled to rise again by 2 months a year, to age 67, for people who reach age 62 between 2017 and 2021; by 2027, people age 66 will all be back under the test too.

The earnings test should also be repealed for the younger seniors. In addition, something must be done about the taxation of Social Security benefits. Up to 50% or 85% of benefits become taxable as other retirement income exceeds certain thresholds. Tying the taxability of benefits to the amount of a person's other income implicitly taxes wages, pensions, interest, dividends, and capital gains at enormously punitive rates. The tie-in should be eliminated. Half of benefits should simply be taxable, with some floor amount made tax free to protect lower income recipients. (The employer half of the payroll tax is deductible, the employee half not; so, only half of benefits should be taxable.)

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