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Taxing Social Security Benefits: A Page of Logic and Volumes of History

For the first forty-some years of the existence of Social Security, Social Security benefits were exempt from federal income taxation–by reason of administrative fiat, in the absence of any legislative directive. That changed in 1983, when Congress subjected to income tax half of benefits received by taxpayers with incomes above a statutory threshold. Legislation enacted in 1993–and still in effect today–requires taxation of half of benefits for taxpayers with incomes above one statutory threshold, and of 85% of benefits for taxpayers with incomes above a second higher threshold. During his successful 2024 presidential campaign, Donald Trump called for the elimination of all income taxation of Social Security retirement benefits. Although Congress in 2025 delivered on most of Trump's tax-related campaign promises, it did not change the income tax treatment of Social Security benefits. The One Big Beautiful Bill's additional $6,000 deduction for taxpayers 65 or older, touted by the White House as the functional near-equivalent of tax exemption for Social Security benefits, is in fact no such thing. As retirees (and future retirees) become more aware of the gap between what Trump promised and what Congress delivered, there is a good chance in the next few years that Congress will reconsider the income tax treatment of Social Security benefits. This article reviews the historical development of the income tax treatment of benefits, as well as the development of the income tax treatment of private forms of retirement savings. It concludes that the structural logic of the current income tax–as reflected in its treatment of individual retirement accounts, 401(k)s, and other forms of private retirement savings–provides a clear answer to the question of how Social Security benefits should be taxed. For all recipients, regardless of income level, half of benefits should be taxable and half should be tax-free. Thus, current law is both too generous in excluding 100% of benefits for some recipients, and too harsh in taxing 85% of benefits of some other recipients.

Introduction

Over the decades since the payment of the first Social Security benefits in the late 1930s, the income tax treatment of benefits has ranged from exclusion by way of administrative fiat in the absence of any express legislative directive (from 1938 to 1983),[1] to taxation of 50% of benefits for taxpayers with incomes above a statutory threshold (from 1983 to 1993),[2] to taxation of 50% of benefits for taxpayers with incomes above one statutory threshold and of 85% of

[1]See Part III of this article.

[2]See Part IV of this article.

benefits for taxpayers with incomes above a second higher threshold (from 1993 to now).[3]

During his successful 2024 presidential campaign, Donald Trump called for the elimination of all income taxation of Social Security retirement benefits.[4] Although Congress in 2025 delivered on most of Trump's tax-related campaign promises, it did not change the income tax treatment of Social Security benefits–apparently out of legislators' concern that a change in the income tax treatment of benefits might not be permitted in legislation passed using the filibuster-proof reconciliation process.[5] The so-called "One Big Beautiful Bill" (the legislation has no official name) features a $6,000 increase in the standard deduction for taxpayers 65 or older–effective for only 2025 through 2028, and phased out for higher-income retirees–in lieu of a change in the tax status of Social Security benefits.[6] Although the Trump administration has

[3]See Part V of this article.

[4]Andrew Duerhren, Trump Dangles New Tax Act Proposals with Real Political Appeal, New York Times, August 7, 2024.

[5]According to the relevant statute, reconciliation cannot be used with respect to any bill or resolution "contain[ing] recommendations with respect to the old age, survivors, and disability insurance program established under title II of the Social Security Act." 2 U.S.C. § 641(g). It is not altogether obvious that this prohibition applies to legislation affecting only the income tax treatment of Social Security benefits, especially if (a) the change in the income tax treatment is favorable to recipients of benefits, and (b) the legislation fully compensates the Trust Funds for the loss of dedicated revenues from the current partial taxation of benefits. Nevertheless, the proponents of the 2025 Ways and Means bill evidently decided avoiding a debate over the scope of 2 U.S.C. § 641(g) was the better part of valor.

[6]Pub. L. No. 115-97, § 70103, __ Stat. __. __ (codified at IRC § 151(d)(5)(C)). The $6,000 amount is decreased by 6% of the excess of a taxpayer's modified adjusted gross income (MAGI) over $75,000 ($150,000 in the case of a joint return). Thus, an unmarried taxpayer with MAGI of $175,000 or more is not entitled to the increased deduction in any amount.

attempted to frame the provision as almost completely delivering on Trump's campaign pledge,[7] in fact a $6,000 standard deduction increase is a very poor proxy for exemption of all benefits,

[7]In an email sent in early July to Social Security recipients across the country, and in a post on the Social Security Adminstration's (SSA) website, the SSA claimed, "The bill ensures that nearly 90% of Social Security beneficiaries will no longer pay federal income taxes on their benefits." Social Security Applauds Passage of Legislation Providing Historic Tax Relief for Seniors, blog.ssa.gov/social-security-applauds-passage-of-legislation-providing-historic-tax-relief-for-seniors (July 3, 2025). The "nearly 90%" claim appears to have been based on a June 2025 analysis by the White House's Council of Economic Advisors, concluding that "88% of seniors receiving Social Security benefits will pay no tax on their benefits under the OBBB as a result of their total deductions exceeding their taxable Social Security benefits." Council of Economic Advisors, The One Big Beautiful Bill Delivers on President Trump's Promise of No Tax on Social Security (June 2025). Under the Council's analysis, a Social Security recipient is considered to owe no tax on benefits if the taxable portion of benefits (reflecting the 50% and 85% inclusion rules of IRC §86) did not exceed the $23,750 sum of the taxpayer's regular standard deduction under the OBBB ($15,750 for an unmarried taxpayer), the $2,000 existing senior standard deduction (IRC § 63(f), as adjusted for inflation), and the new $6,000 deduction. As an example, the Council offers an unmarried senior receiving Social Security benefits of $24,000, with enough additional income that the statutory maximum of 85% of the benefits–$20,400–is includable in taxable income. Because $20,400 is less than $23,750, the Council views this taxpayer as owing no tax on Social Security benefits. But this is mere sleight-of-hand; the trick is assuming (contrary to anything in the Internal Revenue Code) that standard deduction amounts are first applied against taxable Social Security benefits. The good news for the taxpayer under the Council's analysis is offset by the bad news that the taxpayer has only $3,350 ($23,750 - $20,400) of standard deduction remaining to offset against all the taxpayer's other income. Contrary to the Council's assertion, the $6,000 of additional standard deduction is not nearly as valuable to the taxpayer as being able to exclude from income another $20,400 of benefits (in addition to the $3,600 excluded under current law). Suppose, for example, the taxpayer has $100,000 of income from other sources. Under the OBBB, the taxpayer has taxable income of $120,400 - $23,750 = $96,650. If, instead, Congress had fulfilled Trump's campaign pledge by excluding all Social Security benefits from income (and had not created a new $6,000 senior standard deduction), the taxpayer would have had taxable income of only $100,000 - $17,750 = $82,250. The $14,400 difference between the two results is, of course, simply the difference between excluding $20,400 from income and allowing $6,000 deduction. And yet the Council offers this hypothetical taxpayer as an example of a taxpayer for whom the OBBB is as good as income tax exemption of 100% of benefits! One can only agree with the comment of Martha Shedden, president of the National Association of Registered Social Security Analysts, that "[i]t is discouraging to see such misrepresentation by the administration and the Social Security Administration." Tara Seigel Bernard, Social Security Sends Misleading Email Claiming to Eliminate Taxes, New York Times, July 6, 2025.

given that annual benefits average about $24,000[8] and can exceed $60,000[9]; it is an even poorer proxy once the deduction's income-based phaseout and temporary status are taken into account. Because income tax exemption for all Social Security benefits may have enough bipartisan appeal to be passed under regular rules as stand-alone legislation (despite the threat of filibuster), the issue is likely to resurface in the reasonably near future–certainly as the temporary deduction approaches its scheduled expiration date, and possibly sooner.

In all three eras of the income tax treatment of benefits (complete exemption for all, 50% inclusion for some, and 85% inclusion for some), those responsible for the rules–the Bureau of Internal Revenue (BIR) in the first era, and Congress in the second and third eras–have invoked income tax logic as the justification for their chosen rules. To be sure, income tax logic is not the only relevant consideration. Even if a move from the 50%/85% inclusion regime back to complete exemption (as urged by Trump) comported with income tax logic, it might still be inadvisable because of its adverse effects on the Social Security and Hospital Insurance Trust Funds (or on the overall federal budget deficit, if general revenues were used to hold harmless the Trust Funds), and for its regressive distributional impact among Social Security beneficiaries (with no increase in after-tax benefits for lower-income beneficiaries not currently taxed, and

[8]Social Security Administration, Monthly Statistical Snapshot, April 2025, ssa.gov/policy/docs/quickfacts/stat_snapshot/ (reporting an average monthly benefit paid to retired workers in April 2025 of $1,999.97).

[9]In 2025 the maximum monthly benefit for a worker retiring at age 70 is $5,108, resulting in annual benefits of $61,296. Social Security Administration, Workers with Maximum Taxable Earnings, ssa.gov.oact/cola/examplemax.html.

five-figure increases in after-tax benefits for some higher-income beneficiaries).[10]

This article, however, sets aside revenue and distributional concerns, in order to explain and evaluate the arguments based on income tax logic that have been offered, at various times, in favor of all three historical approaches. Part I is purely descriptive; it briefly reviews the current income tax treatment of Social Security benefits. Part II of the article is analytical; it explains why a 50% inclusion–and *only* a 50% inclusion–is consistent with the overall structure of our hybrid income-consumption tax. Although 50% inclusion may seem like nothing more than a Goldilocks-style compromise between a too-hard 85% or 100% inclusion, and a too-soft 100% exclusion, in fact it is the only approach consistent with the income tax's well-established treatment of other forms of retirement savings. The remainder of the article offers historical perspectives on the issue. Part III describes and critiques the Bureau of Internal Revenue's early rulings excluding all benefits from gross income. Part IV describes how the National Commission on Social Security Reform (better known as the Greenspan Commission) and Congress in 1983 reached the correct result of a 50% inclusion (albeit on grounds of rough justice rather than of theoretical correctness). Part V describes and critiques Congress's move to an 85% inclusion rule for higher-income beneficiaries in 1993. Part VI briefly concludes.

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[10]Consider, for example, a married couple in 2025, each receiving a near-maximum benefit of $60,000, for a total of $120,000. If the couple's MAGI is sufficient that the 85% inclusion rule applies to their entire benefits, $102,000 of their benefits is taxable under current law. If their marginal tax rate under IRC § 1 is 32%, their income tax on benefits is $32,640. And, of course, complete exemption of those benefits would increase their after-tax benefits by that amount. More generally, estimates by the Penn Wharton Budget Model support both of the critiques mentioned in the text. According to the Budget Model, eliminating income taxes on benefits would "reduce revenues by $1.5 trillion over 10 years and increase federal debt by 7 percent by 2054," while "primarily benefit[ting] high-income households near or in retirement." Penn Wharton Budget Model, Eliminating Income Taxes on Social Security Benefits (February 10, 2025).

I. The Current Rules–85% Inclusion for Some

Under the rules for income taxation of benefits set forth in IRC §86, the single taxpayer and joint return thresholds for purposes of the 50% inclusion (which are *not* adjusted for inflation) are $25,000 and $32,000. If the sum of a taxpayer's modified adjusted gross income (MAGI) and half of the taxpayer's Social Security benefits exceeds the threshold, the taxpayer must include in income the lesser of half of the benefits or half of the amount by which the above-described sum exceeds the threshold.[11] For example, an unmarried taxpayer with MAGI of $15,000 and benefits of $30,000 would have MAGI-plus-half-of-benefits equal to $30,000, which is $5,000 above the threshold. The inclusion would be $2,500: the lesser of $15,000 (half of benefits received) or $2,500 (half of the above-the-threshold amount of $5,000). The single taxpayer and joint return thresholds for purposes of the 85% inclusion (also not inflation-adjusted) are $34,000 and $44,000. The rules governing the interaction between the two thresholds are maddeningly complex–particularly for rules applicable to millions of taxpayers, many of whom lack tax sophistication–although of course the rules can be handled with ease by tax-return preparation software. Imagine an unmarried taxpayer with MAGI of $40,000 and benefits of $30,000. The sum of the taxpayer's MAGI and half of benefits is $55,000, which is $21,000 above the threshold for 85% inclusion. This taxpayer must include in income $17,850 (85% of $21,000), plus $4,500 (half of the difference between the $34,000 and $25,000 thresholds), for a total inclusion of $22,350.[12] The income tax revenue produced by the 50% and 85% inclusions are

[11]IRC § 86(a)(1). Social Security benefits are not included in MAGI. IRC § 86(b)(2).

[12]IRC § 86(a)(2). The inclusion cannot exceed 85% of Social Security benefits, but that ceiling does not come into play in this example because $22,350 is less than $30,000 x 0.85 = $25,500.

earmarked, respectively, for the Social Security Trust Fund and the Hospital Insurance Trust Fund.[13]

In form, the 50% and 85% provisions of IRC § 86 are *inclusion* rules. Nothing in IRC § 86, or in any other Code section, specifies that benefits not included by IRC § 86 ($27,500 for the first hypothetical taxpayer, and $7,650 for the second) are not within the scope of the definition of gross income in IRC § 61. Rather, a 1970 revenue ruling concluding (without explanation or analysis) that Social Security benefits are not includible in gross income continues to apply to benefits that escape taxation under IRC § 86.[14]

II. The Case for a 50% Inclusion

The primary sources of funding for Social Security benefits are the twin payroll taxes: a 6.2% tax imposed on employees on their wages,[15] and a 6.2% tax imposed on employers on wages paid.[16] Both taxes are imposed on wages paid by a particular employer to a particular employee only up to the "contribution and benefit base."[17] The inflation-adjusted base for 2025 is $176,000.[18] The benefit amount to which a retiree is entitled is a function of the retiree's history of taxed wages, and thus (indirectly) a function of payroll taxes paid by the retiree and by the

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[13]Social Security Amendments of 1983, Pub. L. No. 98-21, § 121(e), 97 Stat. 65, 84-85; Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13215(c), 107 Stat. 312, 476.

[14]Rev. Rul. 70-217, 1970-1 C.B. 12.

[15]IRC § 3101(a).

[16]IRC § 3111(a).

[17]IRC § 3121(a)(1).

[18]Social Security Administration, Fact Sheet: 2025 Social Security Changes (October 10, 2024).

retiree's employer(s) on the retiree's wages. The statutory formula produces a monthly benefit equal to the sum of (1) 90% of the first tranche of a retiree's "averaged indexed monthly earnings" (AIME), (2) 32% of the next tranche, and (3) 15% of remaining AIME up to the contribution and benefit base.[19] For an individual who first becomes eligible for benefits in 2025, the 90% wage replacement rate applies to the first $1,226 of AIME, the 32% rate to AIME above $1,226 up to $7,391, and the 15% rate to AIME over $7,391.[20]

Although a history of wages subject to the twin payroll taxes gives rise to the right to retirement benefits, only in a loose sense are benefits a return on investments made through payment of payroll taxes. For one thing, the bulk of current payroll tax payments by this year's workers and their employers is used to pay benefits to current retirees, rather than to fund retirement benefits for this year's workers.[21] For another thing, an actual investment would not feature dramatically different rates of return on different tranches of investment dollars.

Based on these and other significant differences between Social Security taxes and private pension investments protected by contract law, both Deborah Geier and Patricia Dilley have forcefully argued that any claimed link between retirement benefits and payroll taxes should be

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[19]IRC § 415(a)(1).

[20]Social Security Administration, Primary Insurance Amount, ssa.gov/oact/COLA/piaformula.html.

[21]See, e.g., The 2024 Annual Report of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds 7 (May 7, 2024) (reporting net payroll tax contributions of $1,233.1 billion in calendar year 2023 and $1,379.3 billion of 2023 benefits payments, with the difference financed by a draw down of Trust Fund asset reserves).

rejected for purposes of policy analysis.[22] As a *legal* matter, Geier and Dilley are clearly correct. From 1935 to today, the Social Security statute has always included the declaration, "The right to alter, amend, or repeal any provision of this chapter is hereby reserved to Congress."[23] Relying in part on this provision, the Supreme Court in 1960 upheld the termination of old-age benefits payable to Ephram Nestor, following his deportation for formerly having been a member of the Communist Party.[24] In his majority opinion, Justice Harlan concluded that Nestor's "right to Social Security benefits cannot properly be" viewed as an "accrued property right," because "eligibility for benefits, and the amount of such benefits, do not in any true sense depend on contribution to the program through the payment of taxes, but rather on the earnings record of the primary beneficiary."[25] Thus, "the noncontractual interest of an employee covered by the Act cannot be soundly analogized to that of the holder of an annuity, whose right to benefits is bottomed on his contractual premium payments."[26] Harlan further observed, "To engraft upon the Social Security system a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adapting to ever-changing conditions which it demands."[27]

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[22]Deborah Geier, Integrating the Tax Burdens of the Federal Income and Payroll Taxes on Labor Income, 22 Virginia Tax Rev. 1, 30-43 (2002); Patricia E. Dilley, Taking Public Rights Private: The Rhetoric and Reality of Social Security Privatization, 41 B.C. L. Rev. 975, 1,000 (2000).

[23]42 U.S.C. § 1304.

[24]Flemming v. Nestor, 363 U.S. 603 (1960).

[25]363 U.S. at 608-09.

[26]363 U.S. at 610.

[27]Id.

So much for the legal question. For purposes of this article, however, the crucial question is not whether the payment of Social Security taxes gives rise to a legally protected right to benefits, but only whether the connection between taxes paid and benefits received is strong enough to justify harmonizing the income tax treatment of Social Security with that of true (*i.e.*, contractually protected) pensions. Consideration of that question might well begin with the dissenters in *Nestor.* Justices Black, Douglas and Brennan dissented; Black's dissent was particularly forceful. In support of his conclusion that "this action . . . takes Nestor's insurance without just compensation and in violation of the Due Process Clause of the Fifth Amendment,"[28] Black quoted Senator Walter F. George's statement in the *Congressional Record*, "Social Security is not a handout; it is not charity; it is not relief. It is an earned right based upon the contributions and earnings of the individual."[29] Scornfully quoting Harlan's majority opinion, Black commented, "People who pay premiums for insurance usually think they are paying for insurance, not for 'flexibility and boldness.'"[30]

There is a rich vein of similar comments in the historical record. Most famously, President Franklin Roosevelt remarked in 1941, "We put those payroll contributions there [in the Social Security Act of 1935] so as to give the contributors a legal, moral, and political right to collect their pensions . . . . With those taxes in there, no damn politician can ever scrap my

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[28]363 U.S. at 622.

[29]102 Cong. Rec. S-15110 (July 27, 1956).

[30]363 U.S. at 624.

social security program. Those taxes aren't a matter of economics, they're straight politics."[31]

As Roosevelt had expected, the government has historically encouraged workers to think of their payroll taxes as a form of retirement savings, rather than as true taxes. For example, the website of the Social Security Administration formerly included a "kids and family" section, which explained that "[s]ince each worker pays Social Security taxes, each worker earns the right to receive Social Security benefits without regard to need."[32] Similarly, in 2001 the President's Commission to Strengthen Social Security, despite urging reforms that would have reduced anticipated benefits for many, acknowledged that "[m]any people [incorrectly] believe that Social Security is a national pension fund in which workers make contributions to an investment account called the Trust Fund. When a worker retires, dies or becomes disabled, they believe that his contributions, plus interest, are taken out of an account to pay benefits."[33]

The following analysis is premised on the view that the analogy between (1) payroll taxes and Social Security benefits and (2) actual investments in tax-favored retirement vehicles (such

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[31]Luther Gulick, Memorandum on Conference with FDR Concerning Social Security Taxation, Summer 1941, available at https://www.ssa.gov/history/Gulick.htm. Two years later, no less a luminary than Erwin Griswold–Harvard law professor and leading tax scholar, later to serve both as Dean of Harvard Law School and as Solicitor General–analogized employees' payroll tax payments to employees' contribution to private pensions in arguing that both payroll taxes and pension contributions should be deductible by employees in calculating their taxable income (a position contrary to the then-current treatment of both employees' payroll taxes and employees' pension contributions). Erwin N. Griswold, The Tax Treatment of Employees' Contributions to Pension Plans, 57 Harv. L. Rev. 247, 248-50 (1943). Congress eventually enacted Griswold's recommendation with respect to employees' contributions to private pensions (see, e.g., IRC §§ 219, 401(k)), but not with respect to the payroll tax on employees.

[32]Social Security Administration, Frequently Asked Questions: How Does It Work?, http://www.ssa.gov/kids/workfacts.htm (accessed March 17, 2005).

[33]President's Commission to Strengthen Social Security, Interim Report (August 2001), at 10.

as individual retirement accounts (IRAs) and 401(k)s) and distributions received in retirement from those vehicles, is compelling enough for the tax treatment of those vehicles to serve as the model for the income tax treatment of Social Security benefits. I do not attempt an in-depth defense of the analogy, partly because its force strikes me (at least) as self-evident, and partly because (as will be explained later in this article) in all three eras of the income taxation of Social Security benefits, policymakers have started from the premise that the taxation of Social Security benefits should be consistent with the taxation of actual retirement savings. The only problem has been that in two of the three eras (the era of the 100% exclusion, and the era of 85% inclusion for some), the policymakers failed to apply the analogy correctly.

Applying the analogy starts with the income tax treatment of the payment of payroll taxes.[34] The payment by the employer of the employer's share of the payroll tax has no income tax consequences for the employee. Under an expansive interpretation of the definition of gross income in IRC § 61, the payment of the payroll tax could be viewed as conferring an economic benefit on the employee (in the form of the prospect of increased Social Security benefits upon retirement) sufficient to give rise to inclusion in the employee's gross income in the year in which the employer's tax is paid. Congress, however, has never expressly required such an inclusion, and the Internal Revenue Service (IRS) and its BIR predecessor have never been foolhardy enough to assert taxability.

The income tax treatment of the employee's payroll tax is very different. The portion of gross wages used to pay the employee's payroll tax is included in the employee's gross income

[34]For reasons explained below, the following analysis takes as a given the current income tax treatment of the payment of payroll taxes.

for income tax purposes, and is expressly made nondeductible by IRC § 275(a)(1)(A). All the rules described above–the bifurcation of the payroll tax into equal employee and employer taxes, the exclusion of the employer's payroll tax from the base of the employee's income tax, and the inclusion of the employee's payroll tax in the employee's income tax base–date from the creation of Social Security by the Social Security Act of 1935. Neither the bifurcation of the payroll tax nor the opposite income tax treatments of the two payroll taxes has much to commend it as a matter of logic.[35]

A review of the background of the 1935 Act suggests that the differing income tax treatments of the two payroll taxes was essentially accidental. The President's Commission on Economic Security had recommended a social security tax with equal employer and employee shares, on the grounds that a widespread sharing of the burden of providing old-age retirement income security was appropriate: "[A]n orderly system under which employers, employees, and the Government will all contribute appears to be the dignified and intelligent solution of the problem."[36]

Apart from the differing income tax treatments of the two halves of the payroll tax, the bifurcation has no economic significance; a tax on wages has the same effect whether nominally imposed entirely on the employer's payroll, the employee's wages, or half on each.[37] As it

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[35]The following three paragraphs are borrowed (slightly revised) from Lawrence Zelenak, The Income Tax and the Cost of Earning a Living, 56 Tax L. Rev. 39, 51-52 (2002).

[36]Report to the President of the Committee on Economic Security 33-34 (1935). The Report described the employee's share of the proposed payroll tax as "a self-respecting method through which workers make their own provision for old age." Id.

[37]Joel Slemrod & Jon Bakija, Taxing Ourselves 64-66 (2d ed. 2000).

happens, there is a consensus among economists that workers bear virtually the entire burden of the payroll taxes.[38] The more fundamental point, however, is that the ultimate incidence of a wage tax does not depend on whether it is *called* a tax on workers, a tax on employers, or some combination of the two. It may be that Congress in 1935 failed to understand this, and wrongly believed that a nominal sharing of the burden created a real sharing,[39] or Congress may have understood but thought the symbolism of sharing was nevertheless important.

In any event, it appears that the decision to bifurcate the base was made prior to and independently of consideration of the income tax treatment of the payroll taxes, and that the income tax treatment followed almost instinctively from the bifurcation decision. There is no discussion in either the report of the Committee on Economic Security[40] or in the congressional committee reports[41] of the exclusion of the employer's tax from the employees' income tax base. It did not seem to have occurred to anyone that there was even a decision to be made, given that the employee was never even nominally in receipt of amounts paid as employer tax. As for the employee's share, the official explanation for nondeductibility was that it was a kind of federal income tax, and federal income taxes are not deductible.[42] This explanation is based on a

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[38]E.g., id. at 67-68.

[39]See Richard A. Musgrave & Peggy Musgrave, Public Finance in Theory and Practice 264 (5th ed. 1989), speculating that the bifurcation of the tax base may have been the result of "mere stupidity."

[40]Report to the President, supra note 35.

[41]H. Rep. No. 74-615 (1935); S. Rep. No. 74-628 (1935).

[42]"Since the tax on employees is a Federal income tax, [§ 803 of the Act] makes it clear that such a tax is not deductible." H.R. Rep. No. 74-615, supra note 40, at 30.

misunderstanding. The decision whether to make *real* income tax liability deductible in computing the income tax base is simply a decision whether to have a tax with a tax-inclusive or a tax-exclusive base; although Congress wisely decided long ago (in 1917) that the income tax base should be tax-inclusive, and thus made the *income* tax nondeductible against itself,[43] that decision has no implication for whether a *payroll* tax on employees' wages should be deductible.

If today Congress were creating a retirement income security program from scratch, it might well make different decisions from those made in 1935–in particular, Congress might opt for a single (non-bifurcated) payroll tax, and for consistent income tax treatment (whether taxable or non-taxable) of the entirety of the payroll tax. But that is not where we are. As things now stand, changes in the income tax treatment of Social Security *benefits* are on the legislative agenda, but changes in the income tax treatment of the payroll *taxes* decidedly are not. The remainder of this discussion accordingly takes as a given the disparate income tax treatments of the two payroll taxes, and considers what income tax treatment of benefits should follow.

In a conceptually pure income tax, earned income saved for retirement would be taxed in the year in which it was earned and invested, and the investment return would also be taxed in later years. For many decades, however, this has not been the way the federal income tax has treated the bulk of retirement savings. Rather, most retirement savings–employer-provided defined-benefit pensions, optional employee contributions to defined-contribution plans, and contributions to individual retirement accounts (IRAs)–have been taxed under a "cash flow" consumption tax model, with no income tax imposed in the year dollars are earned and saved for

[43]For the story behind that decision, see Lawrence Zelenak, Figuring Out the Tax: Congress, Treasury, and the Design of the Early Modern Income Tax 64-79 (2018).

retirement, and no income tax imposed on investment income as it accrues, but with all distributions in retirement treated as fully taxable.[44] As an alternative to the cash-flow treatment of retirement savings, the Code offers wage tax (or "prepaid") treatment, with earnings taxed in the year they are earned and saved for retirement, but with no income tax imposed on investment income as it accrues, *and* with all distributions in retirement treated as nontaxable. The best known example is the Roth IRA,[45] but taxpayers can also opt for wage tax treatment of elective contributions to employment-based retirement plans.[46] As a consequence of these rules, the so-called "income" tax is actually a hybrid tax, with income-tax treatment of savings outside of tax-preferred qualified retirement savings vehicles, but with consumption-tax (or wage-tax) treatment of qualified retirement savings. Although the hybrid character of the tax opens it to charges of inconsistency, a strong normative case can be made in defense of the income-consumption hybrid tax base.[47]

If a taxpayer's marginal tax rate is the same in the year income is earned and saved, and in the retirement year in which a distribution is received, there is no bottom-line difference between cash-flow and wage tax treatment. If, for example, a taxpayer in the 20% bracket in both years wants to save $10,000 of this year's earnings in a tax-favored cash-flow-style retirement

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[44]IRC §§ 401-420, 457 (employment-based retirement savings); IRC § 219 (deductible IRAs).

[45]IRC § 408A.

[46]IRC § 402A (permitting taxpayers to elect Roth IRA-type treatment for contributions to plans under IRC §§ 401(k), 403(b), and 457(b).

[47]See, *e.g.,* Edward J. McCaffery, Tax Policy Under a Hybrid Income-Consumption Tax, 70 Tex. L. Rev. 1145 (1992); Lawrence Zelenak, The Reification of Metaphor: Income Taxes, Consumption Taxes and Human Capital, 51 Tax L. Rev. 1, 11-19 (1995).

account, and if the investment return triples the value of the account by the retirement year in which the taxpayer receives a $30,000 distribution, the taxpayer will pay tax of $6,000 (20% of $30,000) in the retirement year and will have $24,000 available to spend. If the taxpayer had instead opted for wage tax treatment, the taxpayer would have paid an upfront tax of $2,000 on the $10,000, leaving the taxpayer with only $8,000 to invest in the tax-prepaid retirement account. If this account also triples in value by the time of the retirement distribution, the taxpayer will receive a distribution of $24,000, free of tax–just as with the cash-flow tax regime, leaving the taxpayer with $24,000 to spend. The equivalence is explained, simply enough, by the commutative property of multiplication. That is, $10,000 x 3 x (1 - .2) in the cash flow example equals $10,000 x (1 - .2) x 3 in the wage tax example, because the product of the same three numbers is independent of the order in which the numbers are multiplied.[48] The results will differ, of course, if the taxpayer's marginal tax rates in the earning year and the distribution year are not the same. In that case, the savvy taxpayer will choose whichever tax treatment imposes the tax in the lower-rate year (although, of course, as of the earning year the rate of tax in the distribution year can never be more than an educated guess).[49]

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[48]The insight as to the equivalence (under certain conditions) of a cash-flow tax and a wage tax seems to have originated with a 1948 article–little noticed at the time, but immensely influential in later decades–by the economist E. Cary Brown. E. Cary Brown, Business-Income Taxation and Investment Incentives, in Income, Employment and Public Policy: Essays in Honor of Alvin H. Hansen 300, 309-10 (1948). For an intellectual history of what has come to be known as "the Cary Brown model," see Christopher H. Hanna, Tax Theories and Tax Reform, 59 SMU L. Rev. 435, 439-45 (2006).

[49]The results described in the text under *cash-flow* and *wage tax* treatment, although equivalent to each other (assuming the same tax rate in each relevant year), are both taxpayer-favorable compared to *income tax* treatment of retirement savings. Faced with income tax treatment, our hypothetical taxpayer would invest $8,000 for her retirement (having paid an upfront tax of $2,000 on $10,000 of earnings, as in the wage tax example). If that $8,000 triples

What are the implications of the above-described tax treatment of retirement savings for the taxation of Social Security benefits, assuming (1) one accepts the analogy of payroll taxes to retirement savings, and (2) the bifurcated income tax treatment of the twin payroll taxes is taken as a given? Simply enough, the one-half of benefits associated with the employee's payroll tax should be received free of tax, because the employee paid income tax on the wages used to pay the employee's payroll tax. Since this half of the Social Security tax-and-benefits regime was taxed on the Roth (or prepaid, or wage tax) model in the earning year, it should also be taxed (that is to say, *not* taxed) on the Roth model in the benefit year. On the other hand, the employee did not pay income tax on the employer's payroll tax, so cash-flow treatment is indicated with respect to the half of benefits associated with the employer's tax. That means, of course, that those benefits should be fully taxable when received. Putting together the analysis of the two halves of the payroll-tax-and-benefits structure leads to the conclusion that exactly half of benefits should be included in the taxable incomes of *all* recipients. Under this analysis, inclusion of 85% of benefits for some recipients is a conceptual error, as is inclusion of zero percent of

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to $24,000 by the time the taxpayer receives the retirement distribution, and if the $16,000 increase in value qualified as unrealized appreciation until the distribution year, then the taxpayer will owe tax of $3,200 (20% of $16,000) in the distribution year, and will be left with $20,800 to spend–$3,200 less than under either cash-flow or wage-tax treatment. This is basically the tax treatment provided by IRC § 72 for annuities purchased outside IRAs and qualified employer-sponsored plans. Under that provision, investments are made with after-tax dollars, increases in the value of the annuity ("inside buildup") prior to the beginning of payments is treated as unrealized appreciation, and payments are taxed to the extent they exceed the taxpayer's "investment in the contract." Of course, the application of the IRC § 72 rules is more complicated than the example in the text, because of the need for the rules to address the uncertainty with respect to the total amount of annuity payments that will be received under a longevity-dependent annuity.

benefits for low-income recipients.[50]

Although the above analysis seems to me to have an almost syllogistic force, it has had absolutely no influence on legislative deliberations concerning the tax treatment of benefits. To my knowledge, it has been previously suggested only twice in the tax policy literature–by Deborah Geier in a single footnote in a 2002 article,[51] and by me in a four-page discussion in a 2002 article primarily concerned with the tax treatment of earners rather than the tax treatment of

[50]Of course, Social Security is a kind of annuity, with beneficiaries' returns on their payroll tax "investments" varying greatly according to how long they live. In contrast, an IRA or 401(k) invested in stocks, bonds, and mutual funds does not feature investment returns dependent on the outcome of a mortality bet. It might be argued, then, that this difference undercuts this article's analogy between the actual taxation of private retirement savings and the taxation of Social Security benefits championed by this article. The response to that objection, simply enough, would be that annuities are among the permitted investments for IRAs and employer-sponsored defined contribution plans. See IRC §§ 408(b) (providing tax-favored treatment for "individual retirement annuities") and 401(a)(38)A)(i) (permitting ownership of "lifetime income investments" within defined contribution employer plans). Thus, a person who purchases an annuity within an IRA or a qualified plan has an investment the return on which depends on longevity, just as with Social Security. If that person chooses (or defaults to) cash-flow taxation, no tax is imposed when funds are contributed to the retirement savings vehicle and used to buy (or pay premiums on) an annuity, and annuity payments received in retirement are fully taxable. If, instead, the person elects Roth tax treatment, amounts are taxed when contributed and used to buy (or pay premiums on) the annuity, and all annuity payments received in retirement are tax-free. And if a person opts for cash-flow taxation of half of the annuity and Roth treatment of the other half, half of that person's contributions (the Roth half) will be taxable and half of the annuity payments received in retirement will be taxable (the cash-flow half). Thus, this article's proposed income tax treatment of Social Security benefits mirrors current law's tax treatment of annuities in private savings vehicles, whenever (as with Social Security) half of retirement contributions are taxable up front and half are not.

[51]Deborah A. Geier, Integrating the Tax Burdens of the Federal Income Tax and Payroll Taxes on Labor Income, 22 Virginia Tax Rev. 1. 45, n. 133. If it is puzzling that Geier would hide a significant insight under a proverbial bushel (Matt. 5:14-15, Mark 4:21-25, Luke 8:16-18), the two likely explanations are (1) that Geier rejects the view of payroll taxes as analogous to private retirement savings, and (2) that the focus of Geier's article is on the income tax treatment of payroll taxes, not on the income tax treatment of benefits.

retirees.[52] As far as I know, neither Geier's footnote nor my four-page discussion has ever come to the attention of tax policymakers.

As will be developed in the historical accounts in Parts III, IV and V of this article, the failure of Congress to legislate on the basis of the above analysis[53] can be explained, simply enough, by the fact that the current income taxation of private retirement savings, featuring a choice between cash-flow and prepaid tax regimes, is of fairly recent vintage. Although the cash-flow model for employer-funded pensions dates from the 1920s,[54] neither IRAs nor excludable elective employee contributions existed at the time of the introduction of Social Security in the 1930s. Not only was there no statute expressly allowing workers to deduct their retirement savings; the Bureau ruled in 1935–the very year that Congress created Social Security–that employees could not deduct their contributions to private pensions plans.[55] The deduction for IRA contributions originated in 1974,[56] and IRC § 401(k) (providing cash-flow treatment for

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[52]Lawrence Zelenak, The Income Tax and the Costs of Earning an Income, 56 Tax L. Rev. 39, 55-59 (2002).

[53]Even in the 50% inclusion era from 1983 to 1993, Congress did not arrive at the 50% figure by way of the above analysis, nor did it require 50% inclusion for *all* taxpayers receiving benefits (as would have been indicated by the above analysis). How Congress arrived at the 50% inclusion rule in 1983 is explained below, in Part IV.

[54]Revenue Act of 1926, Pub. L. No. 69-20, § 219(f), 44 Stat. 9, 33 (extending to all employer-provided pensions the tax treatment previously afforded to only stock bonus and profit-sharing plans).

[55]I.T. 2874, XIV-1 Cum. Bull. 49 (1935); I.T. 2891, XIV-1 Cum. Bull. 50 (1935).

[56]Employee Retirement and Income Security Act of 1974, Pub. L. No. 93-406, § 2002, 88 Stat. 829, 958.

elective employee contributions to qualified plans) dates from 1978.[57] Roth IRAs originated in 1997,[58] and the Roth-style option for 401(k) contributions in 2006.[59] Thus, wage tax (Roth-style) treatment of retirement savings postdates even the 1993 revision of the taxation of Social Security benefits, and so was unavailable to Congress as an analogy at the time of the most recent revision.

III. Congress is Silent on the Issue, and the Bureau Creates an Administrative Exclusion

Under the Social Security Act of 1935, payroll tax collection was to begin in 1937, and payment of monthly benefits (with eligibility for and amount of benefits dependent on retirees' taxed earnings) in 1942.[60] This did not mean, however, that Treasury and the Bureau had until 1942 to figure out the income tax treatment of Social Security benefits, because the Act also provided for small lump sum benefits beginning in 1937 to retirees whose wages subject to payroll tax were insufficient to make them "qualifying individuals" for purposes of monthly benefits.[61] The lump sum benefit was intended by Congress to compensate recipients for the payroll tax they had paid on post-1936 earnings.[62] In 1937 lump sum benefits totaling $1,278,000 were paid to 53,236 retirees, for an average benefit of $24.00; for 1938 that increased to

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[57]Revenue Act of 1978, Pub. L. No. 95-600, § 135, 92 Stat. 2763, 2768.

[58]Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 302(a), 111 Stat. 788, 825.

[59]Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 617, 115 Stat. 38, 103 (enacted in 2001, but not effective until 2006).

[60]Social Security Act of 1935, Pub. L. No. 74-271, §§ 202(a) (monthly benefits starting date), 801 (tax starting date), 49 Stat. 620, 623, 636 (1935).

[61]Social Security Act of 1935, § 204(a), 49 Stat. 624.

[62]H. R. Rep. No. 74-415, 74th Cong., 1st Sess., at 6 (1935).

$10,478,000 benefits paid to 213,670 retirees, for an average of $49.04.[63]

In both 1937 and 1938 the income tax exemption levels were $1,000 for a single taxpayer and $2,500 for a married couple.[64] Given the very small size of the lump sum payments relative to income tax exemption levels, and the fact that benefits were payable only to retirees (thus making substantial amounts of earned income unlikely), the income tax treatment of lump sum benefits could not have been of much immediate consequence. Nevertheless, the Bureau addressed the question in guidance published in 1938, declaring–with absolutely no analysis or explanation–that "lump sum payments made to individuals under section 204(a) . . . are not subject to income tax in the hands of the recipients."[65] Later in 1938 the Bureau issued a second ruling, reaching the same result with the same lack of explanation, with respect to lump sum payments made under §§ 203 and 204(b) of the Social Security Act to a deceased worker's estate.[66]

When the Social Security Amendments of 1939[67] moved the starting date for monthly payments from 1942 to 1940, the Bureau responded with a 1941 ruling–as devoid of analysis as

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[63]Social Security Administration, Social Security: A Brief History 19 (2007) (benefit amounts and beneficiary numbers; averages are author's calculation based thereon).

[64]Tax Policy Center, U.S. Individual Income Tax: Personal Exemptions and Lowest and Highest Tax Brackets, Tax Years 1913-2023 (May 11, 2023). For an explanation and discussion of the oddity of a marital exemption amount more than double the single person exemption amount, see Lawrence Zelenak, Figuring Out the Tax: Congress, Treasury and the Design of the Early Modern Income Tax 187-201 (2018).

[65]I.T. 3194, 1938-1 C.B. 114.

[66]I.T. 3229, 1938-2 C.B. 136.

[67]Pub. L. No. 76-379, § 202(a), 53 Stat. 1360, 1363-64 (1939).

its 1938 predecessors–declaring "that the sundry insurance benefit payments made to individuals under . . . the Social Security Act . . . are not subject to income tax in the hands of the recipients."[68] Although rulings without analyses have never been a feature of agency best practices, the Bureau, and later the IRS, have issued numerous such rulings over the decades. Analysis-free rulings typically appear "[w]hen the IRS believes it has good practical reasons for taking a particular position, but that the position is technically dubious (or worse)."[69]

In the ordinary course of events, later observers could only speculate on the Bureau's unstated reasons for the conclusions reached in the 1938 and 1941 rulings. The most obvious speculation would be that the Bureau thought a ruling including benefits in gross income would have been widely unpopular with both the public and Congress, but that it had no good explanation as to *why* the benefits were not within the scope of the statutory definition of gross income as including "gains, profits, and income . . . derived from any source whatever."[70]

As luck would have it, however, events from more than a decade after the issuance of the rulings trio have provided posterity with detailed information–*uniquely* detailed, compared to other tax rulings of the same era–on the agency deliberations leading to the issuance of the three rulings.

In November 1953, a Ways and Means Subcommittee chaired by Carl T. Curtis (R, Neb.)

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[68]I.T. 3447, 1941-1 C.B. 191, 192.

[69]Richard Schmalbeck, et al., Federal Income Taxation 117 (6th ed., 2024) (commenting on Rev. Rul. 57-374, 1957-2 C.B. 69, which reads, in its entirety, "Where an individual refuses to accept an all-expense paid vacation trip he won as a prize in a contest, the fair market value of the trip is not includible in his gross income for Federal income tax purposes").

[70]Internal Revenue Code of 1939, Pub. L. No. 76-1, § 22(a), 53 (Part I) Stat. 1, 9.

held widely-publicized hearings on Social Security reform.[71] Earlier in 1953 Curtis had declared, in a speech to the National Conference of Social Work, that "an irresponsible government can promise large benefits extremely far into the future," but that such promises could be "a major factor contributing to national insolvency."[72] A major focus of the hearings was the legal status of Social Security benefits–in particular, whether present and future recipient of retirement benefits had a legal entitlement to receive benefits at the level they had been told to expect, or whether Congress was always free to reduce future benefits.[73] In making his case against Social Security as a legally protected entitlement, Curtis evidently thought it would be helpful to have the leading proponent of the opposing view present and available for hostile questioning at the hearings. And so he subpoenaed–then and now, a tactic rarely used in hearings focused on policy reform rather than on legislative fact-finding–as his foil Arthur J. Altmeyer, the former long-time Social Security Commissioner, sometimes called "the father of Social Security,"[74] and the person most associated with the view of Social Security as an entitlement.

In a front-page story, the *Washington Post* characterized a "long line of questions thrown at Altmeyer by the subcommittee counsel [Robert H. Winn] as "designed to show two things: (1) that the Government had no 'contractual' obligation to pay social insurance benefits and (2) that

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[71]Analysis of the Social Security System, Hearings before a Subcommittee of the Committee on Ways and Means, House of Representatives, 83rd Cong., 1st Sess. (1953).

[72]Murray Illson, Wide Faults Seen in Social Security, New York Times, June 1, 1953, at 25.

[73]As noted earlier, the Supreme Court eventually, in 1960, decided the issue in favor of Congress's freedom to alter or eliminate benefits. Flemming v. Nestor, 363 U.S. 603 (1960).

[74]Robert C. Albright, Clash Stirs Hearing on Change in Benefits Law, Washington Post, November 28, 1953, at 1 (mentioning Altmeyer's sobriquet).

Congress could change the law as it pleased at any time."[75] Journalistic coverage of the fiery hearings extended beyond the front page of the *Post* and a lengthy story in the *New York Times*,[76] to–believe it or not–the pages of *Better Homes and Gardens.* The *Better Homes* story opened dramatically:

> Suddenly, the dull Congressional committee hearing exploded into "angry shouts, furious bangings of the gavel, heated charges and countercharges." It was, one startled Washington correspondent wrote, one of the stormiest sessions in years. Bitter, Arthur J. Altmeyer . . . hurled this accusation at [Winn]: "You are doing more to destroy the confidence of the American people in this system than anyone else–except the chairman of this committee."[77]

In the months preceding Altmeyer's compelled appearance before the Subcommittee, Curtis had engaged in an extensive correspondence with Internal Revenue Commissioner T. Coleman Andrews about the thinking behind the 1941 ruling, in the hope that the Bureau's reasoning would support Curtis's view that there was no legally protected right to receive Social Security benefits.[78] Introduced into evidence at the hearings by Winn, the file of correspondence

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[75]Id.

[76]C. P. Trussell, Pension Hearing Stirs Up Wrangle, New York Times, November 28, 1953, at 22.

[77]Henry Lee, How Secure is Our Social Security?, Better Homes and Gardens, May 1954, at 38. By "the chairman of this committee," Altmeyer clearly meant Curtis, not Ways and Means Chair Daniel Reed.

[78]Andrews had perhaps the most remarkable second act of any former Internal Revenue Commissioner. After leaving office in 1955, Andrews promptly transformed himself into a crusader for the abolition of the federal income tax. In a lengthy 1956 interview with *U.S. News & World Report*, Andrews warned that soon "[t]he Government will own everything, and we'll be forced to do the bidding of the commissars imbued with the idea that they know better how to spend our money than we, and vested with the authority to do it." Why the Income Tax is Bad, Interview with T. Coleman Andrews, Former Commissioner of Internal Revenue, U.S. News & World Report, 62, 63 (May 25, 1956). For more on Andrews as the St. Paul of the mid-century anti-tax movement, see Lawrence Zelenak, Tearing the Income Tax Out by the (Grass)Roots, 15

between Curtis and Andrews occupies more than five pages (in very small type) of the printed record of the hearings.[79]

Curtis and Winn clearly had no interest in the income tax question for its own sake–a lack of interest seemingly shared by all the participants in the hearings. Rather, their sole reason for exploring the Bureau's income tax analysis was the hope that the analysis would undermine the view of Altmeyer (and many others) of Social Security as an inviolable right. It is to this happenstance–occurring twelve years after the 1941 ruling–that we owe our knowledge of the internal agency deliberations that resulted in the three otherwise opaque rulings.

So what did Andrews tell Curtis about the genesis of the three rulings? In a letter to Curtis dated August 26, 1953, Andrews explained that there had been conflicting views within the Bureau in 1941 as to the income tax status of Social Security benefits.[80] The Social Security Act of 1935 "contained no specific prohibition against taxing the benefits and no specific mandate, as such to tax the benefits."[81] In the absence of an explicit statutory directive, some within the Bureau thought the benefits were taxable as annuities. The prevailing view, however, was that the payments were neither annuities nor deferred compensation for services, but were rather "payments made in aid of general welfare."[82] The "general welfare" language came from

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Florida Tax Rev. 649, 669-70 (2014).

[79]Hearings, supra note 68, Part 6 (November 27, 1953), at 970-75.

[80]Id. at 970-71. The information in this letter, and in Andrews' later and more detailed letter to Curtis, is based entirely on a review of the relevant files; Andrews had not been employed by the Bureau or by Treasury in the years in which the three rulings had been issued.

[81]Id. at 970-71.

[82]Id. at 971.

the Supreme Court's 1937 opinion in *Helvering v. Davis*.[83] In rejecting a constitutional challenge to the Social Security Act, the Court ruled that the Act was authorized by Article I, Section 8, of the Constitution, which empowers Congress to "provide for the . . . general Welfare of the United States." Andrews did not explain how the "general welfare" characterization of benefits led to the conclusion that they were not within the scope of the income tax's definition of gross income. He did note, however, two additional considerations in support of the 1941 ruling's non-taxable conclusion: (1) that Congress had acquiesced in the Bureau's interpretation by not disturbing the two 1938 rulings, and (2) that income taxation of benefits "would tend to defeat the underlying purposes of the Social Security Act."[84]

Although Andrews' letter made clear that the Bureau in 1941 had viewed benefits as *not* equivalent to either private annuities or deferred compensation for services, it did not indicate what the Bureau thought benefits *were* (other than, of course, non-taxable). Curtis, who must have been hoping for a statement from the Bureau that it viewed benefits as a gifts, sent Andrews a rather snippy reply: "I sought a statement of what the benefits are, rather than what they are not."[85]

Andrews responded to the rebuke by ordering his minions to take a deeper dive into the files. In a letter dated November 20, 1953–barely in time for Curtis and Winn to make use of in connection with Altmeyer's testimony–Andrews reported in detail the results of that deeper dive,

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[83]301 U.S. 619, 640 (1937).

[84]Hearings, supra note 68, at 971.

[85]Id. at 972 (letter from Curtis to Andrews, dated September 17, 1953).

with respect to the two 1938 rulings as well as the 1941 ruling.[86] In that second letter, Andrews revealed that although the 1938 rulings had not characterized the lump sum benefits in reaching the letters' unexplained conclusions, three of four Bureau attorneys who had considered the issue thought the benefits "are to be properly characterized as gifts or gratuities," and so tax-free under the predecessor of today's IRC § 102 (excluding gifts from gross income).

When the taxability of *monthly* benefits later arose, the first Bureau attorney to weigh in opined they were taxable as annuities under §22(b)(2) of the Revenue Act of 1938.[87] Andrews did not explain how taxation of benefits as annuities would have worked, but benefits would have been partially taxable if viewed as annuities. The statute allowed an annuitant to exclude from gross income, as basis recovery of invested after-tax dollars, the amount by which annuity payments received during the year exceeded 3% of aggregate premiums paid for the annuity (with the exclusion ceasing when basis had been fully recovered).[88] Other Bureau attorneys, however, disagreed with the characterization of benefits as annuity payments, and so the

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[86]Id. at 973-75.

[87]Revenue Act of 1938, Pub. L. No. 75-554, § 22(b)(2), 52 Stat. 447, 458.

[88]As an example, suppose a retiree who received $250 in Social Security benefits annually had paid a total of $500 payroll tax during his working years, and his employer had paid another $500 of payroll tax on his wages. If the employee's payroll taxes were viewed as annuity premiums but the employer's payroll taxes were not (because the employee had been subject to income tax on the wages used to pay his payroll taxes, but had not been subject to income tax on the payroll taxes paid by his employer), then the application of the annuity tax rules would have been straightforward. The employee's $500 of payroll taxes paid would give rise to $500 of basis in the annuity, but the employer's $500 would not give rise to any basis. As a result, only $15 (3% of $500) of benefits would have been taxable in each of the first two benefit years, and $235 received in each of those years would have been tax-free. In the third year, with only $30 of basis remaining, $30 of benefits would have been tax-free, and the other $220 would have been taxable. In the fourth and all later years, benefits would have been fully taxable.

Bureau's Chief Counsel tasked a staff attorney with producing a memorandum analyzing the issue in depth.

The resulting seven-page memo concluded that monthly benefits were tax-free gifts within the meaning of § 22(b)(3) of 1939 Internal Revenue Code (the predecessor of today's IRC § 102).[89] Because the published 1941 ruling on monthly benefits offered no explanation for its conclusion, Andrews could offer Curtis only a rather unsatisfying summary of the Bureau' cogitations:

> Apparently it was decided that the benefits are exempt for either one or all of the following reasons: (1) the benefits are in the nature of gratuities and are, therefore, exempt under section 22(b)(3) of the code; (2) the lump-sum benefits having been held exempt in prior rulings, Congress indicated its intent for the monthly benefits to be exempt since they were not specifically made taxable in the 1939 amendments to the Social Security Act and (3) the amounts were paid as public assistance to the general welfare and, accordingly, Congress did not intend that such benefits be reduced by subjecting them to taxation.[90]

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[89]Hearings, supra note 68, at 974.

[90]Id.

The current version of IRC § 86 applies the same partial inclusion rules to both Social Security retirement benefits and "tier 1 railroad retirement benefits" under the Railroad Retirement Act of 1974. Identical partial taxation rules for Social Security and tier 1 benefits originated with the Social Security Amendments of 1983, Pub. L. No. 98-21, § 121, 97 Stat. 65, 80. Like Social Security benefits, tier 1 benefits were not subject to income tax before 1983. Unlike Social Security benefits, however, tier 1 benefits were tax-free by reason of an express statutory exemption, rather than a debatable administrative interpretation. The Railroad Retirement Act of 1934–predating, of course, the Social Security Act of 1935–provided that "no annuity [received by a retired railroad employee under the Act] shall be assignable or subject to any tax or to garnishment, attachment, or legal process under any circumstances whatsoever." Pub. L. No. 73-485, § 11, 48 Stat. 1284, 1288. Although the quoted language strongly suggests that exemption from federal income tax was not the primary legislative concern underlying § 11 of the Act, the broad language unquestionably encompassed the federal income tax.

In one of the last gasps of the *Lochner* era, a five-to-four Supreme Court decision invalidated the 1934 Act on the grounds that the payroll tax imposed on railroads to help finance retirement benefits (along with a wage tax imposed on railroad employees) violated the railroads' due process rights. Railroad Retirement Board v. Alton Railroad Co., 295 U.S. 330 (1935).

Although benefits-as-gifts was the first rationale suggested by Andrews, this fell far short of the resounding "benefits are gifts" statement for which Curtis had been fishing. Invited to comment on the Andrews letters, an undaunted Altmeyer succinctly observed, "I thought the chairman pointed out that this is not a contractual right. It is a statutory right of the most sacred, and, I believe, sure nature that one could conceive."[91]

The first and third rationales suggested by Andrews merit further discussion on two points. *First,* although the characterization of benefits as excludable gifts is difficult or impossible to reconcile with *later* Supreme Court interpretations of the gift exclusion, in 1938 (and 1941) the characterization was not implausible. As of the 1938 Social Security lump sum

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Congress promptly responded by enacting the Railroad Retirement Act of 1935, providing for retirement benefits funded out of general revenues rather than out of railroad-specific payroll taxes. Pub. L. No. 74-399, § 3(c), 49 Stat. 967, 969. Like its 1934 predecessor, the 1935 Act provided that "no annuity . . . shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever." Id., § 11, at 1288. When Congress again revised the railroad retirement rules in 1937, it retained the same broad exemption language. Railroad Retirement Act of 1937, Pub. L. No. 75-162, § 12, 50 Stat. 307, 316.

Despite having passed three railroad retirement acts expressly conferring tax exempt status on railroad retirement benefits–the first of those acts the year before the Social Security Act of 1935, and the second just fifteen days after the Social Security Act–Congress did not address the tax status of Social Security retirement benefits. It is debatable what inference, if any, about the income tax treatment of Social Security benefits should have been drawn from the exemption provisions in the several railroad acts. On the one hand, it could have been argued that in the absence of any policy rationale for different income tax treatments of the two types of federal retirement benefits, the express inclusion in the railroad statutes should have been matched by an implied inclusion in the Social Security Act. On the other hand, it could have been argued that the railroad acts demonstrated that Congress was perfectly capable of providing a tax exemption when it desired to do so, thus undercutting the case for an implied exemption for Social Security benefits. In any event, it is surprising that nowhere in Andrews' detailed account of the Bureau's deliberations on the income tax treatment of Social Security benefits is there any indication that the Bureau's lawyers considered the implications for Social Security benefits of the express statutory exclusion for railroad retirement benefits.

[91]Id. at 975.

benefit rulings, the most recent Supreme Court interpretation of the gift exclusion was the 1937 case of *Bogardus v. Commissioner,*[92] in which a narrow five-justice majority held that bonuses, paid by an acquiring corporation in a reorganization to employees of the acquired corporation in appreciation of their work in developing the business of the acquired corporation, were excludable gifts. Although *Bogardus* has never been overruled, it was dubious at the time (as indicated by the narrow majority), and has only become more dubious in light of later Supreme Court gift cases. Today, *the* Supreme Court gloss on IRC § 102 is the statement–originally offered in *Commissioner v. LoBue,*[93] and famously quoted with approval in *Commissioner v. Duberstein,*[94]–that the gift exclusion applies only to transfers motivated by "detached and disinterested generosity." Whatever the difficulties there might be in fitting the square peg of the legislative motivation for creating Social Security benefits in the round hole of "detached and disinterested generosity," those difficulties did not face the Bureau in either 1938 or1941. If the gift exclusion was capacious enough to accommodate transfers arising out of the recipients' employment in *Bogardus*, it might also be sufficiently capacious to accommodate Social Security benefits.

Second, Andrews' suggestion that an implied exclusion for Social Security benefits might be found, not in any section of the Internal Revenue Code, but in Social Security legislation, is intriguing. Andrews was clearly correct that Congress can and occasionally does enact income tax exclusions which are effective despite not being included in the Internal Revenue Code. An

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[92]302 U.S. 314 (1937).

[93]351 U.S. 243, 246 (1956).

[94]363 U.S. 278, 285 (1960).

example in force today is the uncodified exclusion–dating from 2001–for restitution payments received by Nazi victims and their heirs.[95] But *clearly expressed* exclusions outside the Code are one thing; *implied* exclusions outside the Code are another–and considerably more dubious–thing. An exclusion cannot be implied simply on the grounds that Congress would not want to confer a benefit with one hand and then take back a portion of it as taxes. That reasoning would be inconsistent with the fact that salaries of federal employees have been subject to the federal income tax since 1913, as has interest on federal debt obligations.[96] Andrews cited nothing from the legislative history of either the 1935 or the 1939 Social Security Acts to indicate that anyone in Congress had *any* intent–one way or the other–concerning the income tax treatment of Social Security benefits, and I am unaware of any such history. If Andrews' suggestion was limited to government payments with an anti-poverty purpose, there would still be the question of why Congress would think it appropriate to provide an additional anti-poverty protection for recipients of Social Security benefits, beyond the personal exemptions available to all taxpayers.

In any event, Andrews' third suggested rationale–that Congress did not intend that

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[95]Economic Growth Tax Relief and Reconciliation Act, Pub. L. No. 107-16, § 803, 115 Stat. 38, 149.

[96]The Public Salary Tax Act of 1939, Pub. L. No. 76-32, 53 Stat. 574, first made salaries of state and local government employees subject to federal income tax (overcoming earlier concerns that such taxation might be an unconstitutional federal burden on state governments). There was no need in 1939 for a special statute subjecting salaries of federal employees to federal income tax, because the federal income tax had always applied to federal salaries. Although the tax distinction between federal and state employees disappeared long ago, the Code still exempts interest on state and local government debt obligations (IRC § 103), but contains no exemption provision for interest on federal debt.

payments in promotion of the "general welfare" be taxed[97]–turned out to be an acorn from which has grown the mighty oak of the income tax's general welfare exclusion. This exclusion had a very peculiar genesis. As a leading treatise explains,

> Without any explicit statutory authority, the Internal Revenue Service (IRS) has administratively excluded from gross income a broad range of governmental disbursements made "in the interest of the general welfare," including disaster relief, benefits to low-income families . . . , and aid to the elderly or disabled.[98]

In what is surely the definitive scholarly examination of the general welfare exclusion, Samuel D. Branson and Christian Johnson offer an in-depth account of the historical development of the doctrine, as well as a critique of the doctrine's current (uncertain) contours.[99] Because there is no mention of the general welfare doctrine in the trio of early rulings excluding Social Security benefits from gross income, no one recognized at the time that those rulings had given rise to a new income tax exclusion doctrine. Even twelve years later, when Andrews mentioned "general welfare" as a *possible* rationale for the rulings, he claimed neither that it was the *actual* rationale, nor that the Bureau had thereby created a new substantive tax law doctrine, the general welfare exclusion. Only in 1957 did an IRS ruling inform the world of the existence of the general welfare exclusion. According to the 1957 ruling, "The benefit payments which a

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[97]The "general welfare" language, of course, echoed *Helvering v. Davis*, 301 U.S. at 640, which in turn echoed Article I, section 8, of the Constitution.

[98]Boris I. Bittker, et al., Federal Income Taxation of Individuals § 9.1 (3rd ed., 2024) (citing a long list of revenue rulings, including Rev. Rul. 76-144, 1976-1 C.B. 17 (federal payments to needy disaster victims); Rev. Rul. 73-87, 1973-1 C.B. 39 (federally funded antipoverty program); Rev. Rul. 78-170, 1978-1 C.B. 24, (state-financed winter energy assistance for the low-income elderly); and Rev. Rul. 74-74, 1974-1 C.B. 18 (crime victims).

[99]Samuel D. Brunson & Christian Johnson, Good Intentions: Administrative Fiat and the General Welfare Exclusion, 100 Wash. U. L. Rev. 1411 (2023).

blind person receives from the State of Pennsylvania constitutes a disbursement from a general welfare fund in the interest of the general public. *Such payments are not includible in gross income of the recipients for Federal income tax purposes*."[100] The only authority cited by the ruling in support of its concluding sentence was the 1941 ruling excluding Social Security monthly benefits–which ruling, of course, had made no such general pronouncement. As Brunson and Johnson note, "While payment from a general welfare fund has no relevance in statutory tax law, this [1957] revenue ruling introduced the idea of the general welfare as a reason for excluding certain payments from income."[101]

Over the following decades, the IRS has issued numerous rulings–sometimes difficult to reconcile with one another–elaborating on what does and what does not constitute a payment from a "general welfare fund" made "in the interest of the general public."[102] Summarizing these developments, Brunson and Johnson aptly characterize the "reach" of the doctrine as "extraordinary."[103]

Since the enactment of the partial taxation of Social Security benefits in 1983, the income tax inclusion of benefits within the scope of IRC § 86 has been based on express legislative directive; to the extent of the statutory inclusion provisions, Congress has overruled the general welfare doctrine as applied to Social Security benefits. The general welfare doctrine remains relevant to benefits, however, as the only basis for excluding from gross income those benefits

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[100]Rev. Rul. 57-102, 1957-1 C.B. 26 (emphasis added).

[101]Brunson & Johnson, supra note 96, at 1418.

[102]Id. at 1418-42 (describing these developments in detail).

[103]Id. at 1444.

not reached by IRC §86. After all, the statute is an *in*clusion provision, and *only* an inclusion provision. By its terms, it does not provide that any benefits are outside the scope of the definition of gross income under IRC § 61. The exclusion for benefits not included in income by IRC § 86 still depends on the general welfare doctrine.[104] And so the trio of early rulings excluding Social Security benefits from income remains relevant today not only as the source of the general welfare doctrine as applied to a panoply of benefits other than Social Security, but also as the source of the continued non-taxation of a large portion of Social Security benefits.

IV. 1983: Congress Taxes (Some) Social Security Benefits

The 1979 Advisory Council on Social Security, chaired by economist Henry J. Aaron of the Brookings Institution, and "charged [by Congress] with reviewing all aspects of the social security program,"[105] recommended "including half of all social security benefits in the income of a couple or of an individual that is subject to federal income taxes."[106] The Council reached this recommendation via a somewhat circuitous route. Starting from the premise that "social security benefits should be subject to taxation in the same general way that private pension income is taxed," the Council noted that "[t]he accumulated employ*ee* tax payments of workers now entering the labor force will amount to no more than about 17 percent of the benefits that the workers can expect to receive."[107] Thus, according to the Council, "If social security benefits

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[104]Thus, the administrative exclusion for Social Security benefits expressed in Rev. Rul. 70-217, 1970-1 C.B. 12, continues to apply to benefits not taxable under IRC § 86.

[105]Reports of the 1979 Advisory Council on Social Security, 43(2) Soc. Sec. Bull. 3, 3 (1980).

[106]Id. at 5.

[107]Id. (emphasis added).

were taxed in the same way as private pensions, about 83 percent of an employee's social security benefits would be subject to taxation."[108] In income tax terminology, the Council's analysis gave an employee basis in her entitlement to benefits equal to the income tax she had paid on her share of the payroll tax, but denied her basis on account of the employer's share of the payroll tax because she had not paid income tax on that amount. The tax treatment recommended by the Council was broadly consistent with the treatment of private annuities under IRC § 72, which treated (then as now) a fraction of each year's annuity payment as a nontaxable recovery of basis, with the fraction equal to the taxpayer's "investment in the contract" (i.e., basis) divided by the "expected return" on the annuity.[109] This was almost two decades before the 1997 enactment of the Roth IRA provision introduced wage tax treatment of retirement savings,[110] so the Council cannot be faulted for failing to analogize the half of Social Security benefits attributable to the employee's payroll tax to a retirement savings vehicle not yet in existence.

The structure of the Council's analysis strongly suggests, however, that if Roth IRAs (and elective Roth-style treatment for 401(k) contributions) had existed in 1979, the Council would have drawn the analogy and recommended (1) wage tax treatment for the one-half of benefits attributable to the employee's share of the payroll tax, resulting in no tax on half of benefits, and (2) cash-flow treatment modeled on the tax treatment of regular (non-Roth) IRAs (which had

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[108]Id.

[109]The three percent rule for annuity taxation, in force at the time of the trio of early Social Security income tax rules (described supra, text accompanying note 85) was long gone by 1979.

[110]Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 302, 111 Stat. 788, 825.

been introduced by Congress five years earlier[111]), resulting in full taxability of the other half of benefits. In short, the Council would have recommended taxation of precisely half of all benefits.

As it happened, the Council recommended a 50% inclusion, despite the Council's analysis indicating that something like 83% of benefits should be taxable. The Council's choice of 50% was based not on its understanding of income tax logic, but on concerns about administrability and public acceptance: "Because of lack of necessary data, taxing social security benefits in exactly the same fashion as private pensions would be quite difficult. It would also result in taxing more of the benefit than most people would consider appropriate. There the council recommends [a 50% inclusion]."[112]

Initially, Congress declined to enact any of the reform proposals of the 1979 Council. In fact, in 1981 the Senate unanimously (98 to zero) passed a resolution foreswearing taxation of benefits: "*Resolved,* it is the sense of the Senate that any proposals to make social security benefits subject to taxation would adversely affect social security recipients and their confidence in the social security program, that social security benefits are and should be exempt from federal taxation, and that the Ninety-Seventh Congress will not enact legislation to subject social security benefits to tax."[113] In response to this legislative inaction, in December 1981 President Ronald Reagan established the National Commission on Social Security Reform, chaired by economist Alan Greenspan and popularly (or unpopularly) known as the Greenspan

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[111]Employee Retirement and Income Security Act of 194, Pub. L. No. 93-406, § 2002, 88 Stat. 829, 958.

[112] 1979 Reports, supra note 102, at 5.

[113]Senate Resolution 97-87 (July 14, 1981).

Commission.[114] In April 1982, just months after its creation, the Commission received a bombshell of an Annual Report from the Social Security Trustees, warning that "[w]ithout corrective legislation in the very near future, [Social Security] will be unable to make benefit payments on time no later than July 1983."[115] In response to this emergency declaration, the Commission urged sweeping reforms to improve the near-term and long-term financial soundness of Social Security. One of the recommended reforms was that "50% of [retirement] benefits should be considered as taxable income for income tax purposes for persons with adjusted gross income (before including therein any [Social Security] benefits) of $20,000 if single and $25,000 if married. The proceeds from such taxation, as estimated by the Treasury Department, would be credited to the [Social Security] Trust Funds under a permanent appropriation."[116]

Although the Commission's Report does not explain the reasoning behind its 50% inclusion proposal, the fact that the 50% figure is identical to the inclusion percentage recommended by the 1979 Council suggests the Commission adopted the Council's analysis as well as its conclusion. Despite featuring the same 50% inclusion ratio as the Council's proposal, the Commission's proposal differed from the Council's in two significant respects. First, the Commission's proposal to dedicate the income tax revenue from the 50% inclusion to the Social Security Trust Funds was original with the Commission–and in keeping, of course, with the

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[114]Ronald Reagan, Executive Order 12335 (December 16, 1981).

[115]1982 Annual Report, Federal Old-Age and Survivors Insurance and Disability Trust Funds 2 (April 1, 1982).

[116]Report of the National Commission on Social Security Reform, 46(2) Soc. Sec. Bull. 3, 7 (1983).

Commission's focus on improving Social Security's financial situation.

Second, the Council had recommended 50% inclusion with respect to *all* Social Security benefits, relying on personal exemptions and the zero bracket to relieve the low-income elderly from the burden of a 50% inclusion.[117] By contrast, the Commission proposed continuing the 100% exclusion for beneficiaries with adjusted gross incomes below $20,000 (single) or $25,000 (married). The Commission estimated only about 10% of Social Security recipients would be subject to tax under its proposal,[118] so the Commission actually proposed continuing the 100% exclusion for nine out of ten beneficiaries. On the merits, the Council had the better of this disagreement. If the generally available personal exemptions and zero bracket (or, today, the standard deduction) are set appropriately to protect subsistence-level income from tax, there is no good reason to provide an additional exclusion for lower-income taxpayers in receipt of a particular type of benefit. One suspects the Commission recognized this point, but considered the $20,000 and $25,000 taxability thresholds crucial to the political viability of its proposal. That certainly would have been a reasonable conclusion in light of the unanimous Senate resolution of 1981.

Of course, a resolution of the 97th Congress could not bind the 98th Congress, and in April 1983 the 98th Congress–faced with the prospect of Social Security being unable to make promised payments by July in the absence of legislative reforms–followed the Commission's

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[117]1979 Reports, supra note 102, at 5 ("Of the 24.2 million filing units . . . receiving social security benefits, [only] 10.6 million would pay additional taxes" under the Council's proposal").

[118]Report of the National Commission, supra note 113, at 7.

recommendation by enacting (among many other reforms) a 50% inclusion.[119] The provision gradually phased in the taxation of Social Security benefits for taxpayers with modified adjusted gross incomes above $25,000 (single) or $32,000 (joint return),[120] with the estimated revenues from the new tax dedicated to the Trust Funds.[121]

The Ways and Means Committee's expressed rationale for taxing a portion of Social Security benefits was consistent with (but less detailed than) the analysis offered by the 1979 Council: "The committee believes . . . that social security benefits are in the nature of benefits received under other retirement systems, which are subject to taxation to the extent that they exceed a worker's after-tax contributions and that taxing a portion of social security benefits will improve tax equity by treating more nearly equally all forms of retirement . . . income . . . ."[122] Identical language appeared in the report of the Senate Finance Committee.[123] The two committee reports thus followed the lead of the 1979 Council in (1) conceptualizing an employee's payment of payroll tax as a form of after-tax (i.e., after *income* tax) retirement savings,[124] and (2) aiming for rough equivalence between the income taxation of Social Security taxes and benefits, and the

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[119]Social Security Amendments of 1983, Pub. L. No. 98-21, § 121, 97 Stat. 65, 80.

[120]Id., § 121(a), 97 Stat. 83 (codified at IRC §§ 86(a), (b), and (c)).

[121]Id., § 121(e), 97 Stat. 65, 83.

[122]House Report 98-25, Part 1, at 24 (March 4, 1983).

[123]Senate Report 98-23, at 24 (March 11, 1983).

[124]Consistent with the view expressed in the committee reports, the employer's payroll tax payments would also be conceptualized as retirement savings (made by the employer on the employee's behalf). They would not, however, be *after-tax* savings, and so would not justify excluding from gross income any retirement benefits attributable to the employer's payroll tax payments.

income taxation of other forms of retirement savings and benefits.

V. 1993: Income Taxation of 85% of Social Security Benefits (for Some)

In February 1993, in his first Presidential Budget Message, Bill Clinton proposed "including up to 85 percent of [Social Security] benefits in adjusted gross income, for those with income and benefits exceeding the current $25,000/$32,000 thresholds."[125] Explaining that "pension benefits that exceed an employee's after-tax contributions to qualified pension plans are subject to tax at distribution," Clinton claimed that "[e]xtending this approach to Social Security would mean including at least 85 percent of benefits in taxable income."[126]

Clinton did not give a source for the 85% figure, but it is consistent (with rounding) with the 83 percent estimate of the 1979 Council,[127] and with a 1989 analysis by Robert J. Myers which concluded that "a 'blanket' figure of 85% is justified because this would be on the low side for everybody, but barely so in some cases."[128] Reacting to the Clinton proposal in March 1993, Myers cautioned that the 85% estimate was not "perpetually correct," that "a factor of 80 percent (rather than 85 percent) would be reasonable for the next few years," and that the inclusion factor should then decline gradually over time, down to 72% after 2027.[129]

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[125]William J. Clinton, A Vision of Change for America 101 (February 17, 1993).

[126]Id.

[127]1979 Reports, supra note 102, at 5.

[128]Robert J. Myers, 23(9) The Actuary 8 (October 1989). Myers was the Chief Actuary of the Social Security Administration from 1947 to 1970, the Deputy Commissioner of the Social Security Administration from 1981 to 1982, and the Executive Director of the Greenspan Commission.

[129]Robert J. Myers, Is the 85-Percent Factor for Taxing Social Security Benefits Perpetually Correct?, 58 Tax Notes 1545 (1993).

A *Los Angeles Times* story characterized the proposed increased tax on Social Security benefits as "the most difficult part of Clinton's economic program for his allies in Congress to defend."[130] After narrowly defeating a Republican amendment to remove the 85% inclusion from the pending legislative package, Senate Democrats attempted to give themselves some political cover by adopting a resolution asking the Finance Committee to raise the income threshold for the 85% inclusion above the threshold for the 50% inclusion.[131] The Senate Finance Committee not only complied with the resolution (with income thresholds of $32,000/$40,000 for the 85% inclusion); it provided additional political cover by dedicating the additional revenue from the 85% inclusion to the Medicare Hospital Insurance Trust Fund "because this fund is currently in a weak financial position."[132] The Finance Committee's rationale for the 85% inclusion echoed Clinton's: "The committee desired to more closely conform the income tax treatment of Social Security benefits and private pension benefit by increasing the amount of Social Security benefits included in gross income for certain higher-income beneficiaries."[133]

As eventually enacted, the 1993 revisions featured $34,000/$44,000 income thresholds for the 85% inclusion,[134] and the commitment of revenues from the 85% tax to the Hospital

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[130]William J. Eaton, Plan to Raise Pension Tax Survives Test, Los Angeles Times, March 25, 1993, at OCA3.

[131]Id.

[132]Fiscal Year 1994 Budget Reconciliation Recommendations of the Committee on Finance 120 (Senate Print 103-37, June 1993).

[133]Id.

[134]Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §§ 13215(a), (b), 107 Stat. 312, 475-76.

Insurance Trust Fund.[135] Since 1993, Congress has made no changes in the income tax treatment of Social Security benefits, and the statutory income thresholds (which are not inflation-indexed) have been eroded by more than three decades of inflation.

Myers' analysis indicates that, even under the analytical framework adopted by Clinton and Congress in 1993, an 85% inclusion was slightly too high at the time, and is significantly too high now, thirty-two years later. From today's perspective, however, the real problem with the 1993 revisions is not the dubious actuarial support for the 85% figure, but rather the entire analytical framework. Although it would be unfair to blame policymakers in 1993 for failing to anticipate the legislative introduction of wage tax treatment of retirement savings a few years later, the fact is that Roth IRAs (and, eventually, Roth 401(k)s) *did* emerge. Their emergence fatally undermines the stated rationale for including more than half of Social Security benefits in the base of the income tax.

VI. Conclusion

At the end of the long and winding historical road is a satisfyingly simple Goldilocks conclusion–income taxation of 85% of Social Security benefits is too hard, complete exclusion is too soft, and taxing half of benefits is just right. Although this may have the appearance of a compromise, in fact it is the first-best, theoretically correct, approach–*if* one accepts that payroll taxes should be analogized to actual retirement savings for purposes of the income taxation of Social Security benefits. To be sure, it is only an analogy, and scholars have offered thoughtful arguments for rejecting the analogy. Nevertheless, as the preceding historical account has demonstrated, in legislating the income tax treatment of Social Security benefits–in both 1983

[135]Id., § 13215(c), 107 Stat. at 476.

and 1993–Congress accepted the analogy and enacted rules which it believed would conform the income tax treatment of Social Security benefits with that of private retirement savings. Whatever the merits of those rules at the time they were enacted, the rules now fail to accomplish the legislative objective because they do not reflect the post-1993 transformation of the tax treatment of retirement savings by the introduction of the wage tax (Roth IRA) option.