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HOW MUCH COULD TAXING HEALTH BENEFITS HELP SOCIAL SECURITY?

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Introduction

Social Security faces a long-term financing gap that, if not addressed by policymakers, could erode benefit adequacy. Since 2021 benefit payments have exceeded revenues, and the gap has been filled by the trust fund that Social Security built up over the last four decades. Once the assets in the trust fund are depleted in 2034, however, the program's trustees forecast that Social Security could pay only 81 percent of scheduled benefits – declining to 72 percent by 2099.[1] Many experts recommend that increased revenue should be at least part of the solution to Social Security's financing imbalance, and public opinion polls show that most Americans favor increasing program revenues over cutting benefits.[2]

Most of Social Security's revenues come from the payroll tax, which is levied on wages and salaries up to a cap, set at $176,100 in 2025. Annual earnings above that cap are exempt from the Social Security payroll tax. The value of most fringe benefits, which are generally not subject to federal income taxes, are also excluded from the payroll tax base. Policymakers could increase Social Security revenues by raising the payroll tax rate, expanding the payroll tax base, or taxing earnings above $176,100. This *brief,* which is based on a recent study, uses data from federal income tax records to explore one specific expansion of the payroll tax base – namely, including the value of employer-sponsored health insurance (ESI).[3]

The discussion proceeds as follows. The first section provides some background on the payroll tax. The second section discusses the data and methodology. The third section presents the results, which show that adding the value of ESI to the payroll tax base would increase Social Security's revenues by about 7 percent. It also compares the impact of expanding the payroll tax base with various approaches to raising the earnings cap. The final section concludes that the expansion of the base to incorporate ESI would reduce Social Security's 75-year deficit by about 25 percent (somewhat smaller than the Social Security actuaries' estimate of 31 percent.[4]) On its own, this option would be somewhat regressive – increasing the tax burden for some low-wage workers, while collecting no additional revenue from workers with earnings above the cap – but perhaps could be part of a larger package of reforms.

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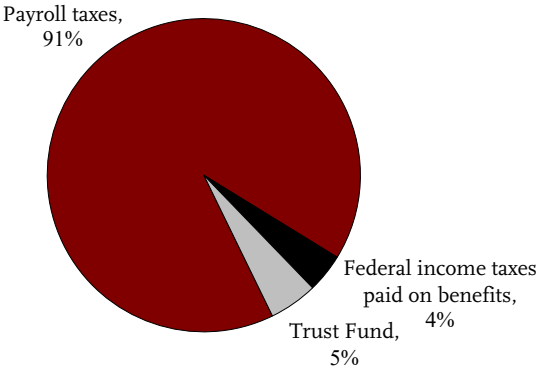
Background

Payroll taxes provide 91 percent of the revenue received each year by Social Security, with 4 percent coming from federal income taxes paid on benefits and 5 percent from interest earned on trust fund assets (see Figure 1). The payroll tax rate for Social Security is currently 12.4 percent, split evenly between employees and their employers.

Figure 1. Sources of Social Security Revenues, 2024



Note: Total revenues received in 2024 were $1.418 trillion, which fell short of total program costs of $1.485 trillion, requiring the program to dip into its asset reserves to cover the $67 billion shortfall.
Source: Authors' calculations from U.S. Social Security Administration (2025).

Some earnings are not subject to the Social Security payroll tax. Most importantly, the contribution base is currently capped at $176,100, and this cap will increase over time with the growth in the economy-wide average wage. Moreover, because earnings have been growing much faster for high-wage workers than low-wage workers recently, the share of total earnings included in the payroll tax base has been shrinking – from 89 percent in 1985 to 83 percent in 2023.[5]

Most employers supplement the cash compensation provided to employees with fringe benefits, such as health insurance, a retirement plan, disability coverage, and/or life insurance.[6] Contributions employers make to fund these benefits are generally not included as compensation under the federal income tax or the payroll tax. Moreover, employees often contribute toward the cost of some of these benefits, usually with pre-tax dollars, and those salary reductions are also generally excluded from the tax base. The one exception is employee deferrals for qualified 401(k)-type retirement plans, which are included in the payroll tax base even though pre-tax deferrals are not subject to income taxation until they are withdrawn from the plan.

Expanding the Social Security contribution base to include additional fringe benefits, especially employer-sponsored health insurance (ESI), could significantly boost revenues. However, unlike raising the program's earnings cap, which would affect only higher earners, adding ESI to the base would increase tax burdens only on workers below the cap, including those with relatively low earnings. To assess the potential impact of such an expansion on workers at various earnings levels, better information is needed on how the availability of ESI is distributed across the workforce.

Data and Methods

The analysis is based on IRS tax return data, which were obtained through the IRS-sponsored Joint Statistical Research Program. The main information comes from Form W-2, which includes uncapped cash wages, wages subject to Social Security payroll tax, and the combined tax-exempt contributions made by both employers and employees for health insurance.[7] The data also include a running record of all individual tax events, including refunds, payments, penalties, and taxpayer status.

The 2021 tax data – the most recent available – are used to create a 1-percent random sample of all people with a Social Security number, generating a file of 2,491,471 unique individuals. Because self-employed workers do not receive Form W-2s, they are excluded from the analysis.

The analysis begins by computing the percentage of Social Security-covered earners receiving ESI, the combined amount paid by employees and their employers, and the ratio of contributions to earnings. The next step is to simulate the potential impact of adding ESI benefits to the Social Security payroll tax base. The simulation is done under two alternative scenarios. The first assumes no change in the taxable maximum earnings cap, so that workers would not pay payroll taxes on any expansion of the contribution base above $142,800, the taxable maximum in 2021. The second scenario expands the base by increasing the taxable maximum and subjecting more earnings to the payroll tax. Both scenarios assume that both the employee and employer portions of the payroll tax would be levied on the expanded contribution base.

Results

The results first show the prevalence and value of ESI benefits, then demonstrate how adding ESI to the payroll tax base would affect workers' payroll taxes, and finally how expanding the tax base by including ESI compares to various options for raising the cap on taxable earnings.

Prevalence and Value of ESI

In 2021, 39.8 percent of wage and salary workers received ESI (see Table 1).[8] Coverage rates increase with earnings. Only 3.6 percent of wage and salary workers earning less than $5,000 annually received ESI, compared with 43.4 percent of those earning $25,000 to $49,999 annually, 68.6 percent of those earning $100,000 to $142,800 (the taxable maximum in 2021), and 76.8 percent of those earning $400,000+.

Table 1. Prevalence and Value of ESI by Annual Earnings, 2021

Annual earnings	Percentage receiving ESI benefits	Average annual ESI value ($)	ESI value as a % of earnings
All	39.8%	$4,260	7.3%
$1 to $5k	3.6	160	7.5
$5k to $25k	14.5	650	4.5
$25k to $50k	43.4	3,640	9.9
$50k to $100k	61.3	7,120	10.2
$100k to $143k	68.6	9,480	8.0
$143k to $250k	72.1	10,790	6.0
$250k to $400k	74.5	12,180	3.9
$400k+	76.8	14,250	1.5

Notes: Estimates are restricted to wage and salary workers with Social Security-covered earnings. ESI value includes contributions paid by both employers and employees.
Source: Authors' tabulations from internal IRS tax return data.

Among wage and salary earners covered by ESI, the average value of ESI in 2021, funded by employer and employee contributions, was $10,710, equal to 11.8 percent of annual total wages.

Potential Impact of Broadening the Payroll Tax Base on Taxes Paid

Table 2 looks at the impact of broadening the payroll tax base to include the value of ESI, while maintaining the current-law earnings cap. Such a change would have boosted average annual 2021 Social Security payroll taxes by $420, from $5,920 to $6,340, a 7.1-percent increase. Of course, the estimated impact would be larger if considering only those with ESI.

Table 2. Average Social Security Payroll Taxes, by Annual Earnings, 2021

Annual earnings	Under current earnings definition	Add ESI	Percentage increase
All	$5,920	$6,340	7.1%
$1 to $4,999	260	280	7.7
$5,000 to $24,999	1,780	1,860	4.5
$25,000 to $49,999	4,570	5,020	9.8
$50,000 to $99,999	8,650	9,540	10.3
$100,000 to $142,800	14,640	15,620	6.7
$142,801 to $249,999	17,710	17,710	0.0
$250,000 to $399,999	17,710	17,710	0.0
$400,000 and more	17,710	17,710	0.0

Notes: Estimates are restricted to wage and salary workers with Social Security-covered earnings. OASDI contributions include both employee and employer. The 2021 taxable maximum was $142,800.
Source: Authors' tabulations from internal IRS tax return data.

Expanding the Discussion to Include Raising the Cap

In contrast to adding ESI to the tax base, eliminating the earnings cap – by itself – would have increased average annual 2021 OASDI contributions by $1,330, or 22.5 percent, about three times more than adding ESI to the payroll tax base (see Table 3 on the next page).

The final exercise looks at the impact of additional proposals to increase the earnings cap, interacted with expanding the base by adding ESI. Raising the 2021 cap from $142,800 to $250,000 without adding ESI

Table 3. Average Increase in Payroll Taxes from Eliminating the Earnings Cap and Then Adding ESI

Annual earnings	Eliminate the cap only		Eliminate the cap and add ESI	
	Dollars	%	Dollars	%
All	$1,330	22.5%	$1,860	31.4%
$142,801 to $249,999	4,730	26.7	6,070	34.3
$250,000 to $399,999	20,530	115.9	22,040	124.4
$400,000 and more	103,070	582.0	104,840	592.0

Notes: Estimates are restricted to wage and salary workers with Social Security-covered earnings in 2021. OASDI contributions include both employee and employer. The 2021 taxable maximum was $142,800.
Source: Authors' tabulations from internal IRS tax return data.

would have increased annual 2021 revenues by 8.2 percent, while revenues would have increased 12.4 percent if the cap were increased to $400,000 and, as noted above, by 22.5 percent if the taxable maximum were eliminated (see Table 4). Keeping the taxable maximum at its current level but adding annual earnings over $400,000 – a popular proposal known as the "donut hole" – would have generated an increase of 10.1 percent, slightly more than adding ESI by itself (with no earnings cap change). When ESI is added to the taxable compensation base – on top of changing the earnings cap – the total increase rises to 17 to 32 percent depending on which cap option is included.

Table 4. Percentage Increase in Payroll Taxes of Raising the Earnings Cap and Then Adding ESI

Proposed cap	Raise the cap only	Raise the cap and add ESI
Current ($142,800 in 2021)	0%	7.1%
Increase to $250,000	8.2	16.6
Increase to $400,000	12.4	21.1
Include earnings above $400,000	10.1	17.5
Include all earnings	22.5	31.5

Notes: Estimates are restricted to wage and salary workers with Social Security-covered earnings in 2021. OASDI contributions include both employee and employer.
Source: Authors' tabulations from internal IRS tax return data.

Conclusion

Adding ESI benefits to the Social Security taxable wage base would have raised the average tax by $420, an increase of about 7 percent, and provided an additional $70 billion to Social Security. Among workers receiving ESI benefits, average annual contributions would have increased by $1,070, or about 12 percent.

The additional revenue generated from broadening the payroll tax base would noticeably improve Social Security's finances. In 2025, Social Security's actuaries estimated that the program's 75-year actuarial deficit equaled 3.8 percent of taxable payroll; adding ESI benefits to the payroll tax base – assuming the impact is the same as our estimate for 2021 – would cut the deficit by about 25 percent. The assumption underlying this calculation is that future workers would not earn higher wages or benefits to reflect the increase in the tax base. Because our analysis excludes self-employed workers, our estimates understate somewhat the potential revenue impact of expanding the contribution base.[9]

Adding ESI benefits to the payroll tax base would generate slightly less revenue than either increasing the annual taxable maximum by about $100,000 or levying the payroll tax on earnings above $400,000. Clearly these policy options would affect lower earners and higher earners very differently. Raising the taxable maximum would require highly paid earners to pay slightly higher taxes. Adding ESI benefits to the payroll tax base would require lower-paid earners to contribute more while collecting no additional revenue from the highest earners. These distributional consequences could be helpful to consider as the debate over Social Security's solvency intensifies and policymakers select various options to include in a package of reforms.

Endnotes

1 These figures are for the combined finances of Social Security's retirement and disability trust funds.

2 Bond and Kenneally (2024); Cook and Moskowitz (2012); Data for Progress (2024); Gallup (2024); Pew Research Center (2024); Tucker, Reno, Bethell (2013); and Walker, Reno, and Bethell (2014).

3 Smith and Johnson (2025).

4 One reason why the Social Security Administration's estimate is larger is that our analysis excludes self-employed workers. It is also worth noting that the actuaries evaluate an ESI proposal that is phased in over time, which would – all other things equal – yield a *lower* estimate than our assumption of a more immediate introduction of ESI into the payroll tax base. For more details on the actuaries' estimate, see U.S. Social Security Administration (2024).

5 U.S. Social Security Administration (2025).

6 For information on the extent of employer provision and take-up of various benefits, see *National Compensation Survey* data from the U.S. Bureau of Labor Statistics (2024).

7 The earnings measure used in this study is *Medicare covered earnings* (reported in box 5 of the W-2), which consist of uncapped annual cash wages, including workers' tax-deferred contributions to retirement plans but excluding most other payroll deductions.

8 This figure is lower than that reported by the U.S. Bureau of Labor Statistics, for various reasons. For example, Form W-2s include many part-year and part-time workers, who are not well represented in the *National Compensation Survey*.

9 Self-employed workers account for about 10 percent of the labor force (U.S. Bureau of Labor Statistics 2025).

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