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How to Fund Social Security with the Economy We Have

Revenue Ideas from Roosevelt's Good Life Residents

By Tyler Bond, Jonathan Schwabish, and Lena Simet

Good Life
RESIDENTS

Roosevelt Institute

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Modernizing Social Security's Revenue for the Economy We Have

For more than 90 years, Social Security has rested on three promises: Benefits will be there when people need them; they will remain progressive, helping protect workers with lower lifetime earnings; and they will be reliable and easily accessible to people across the country. Workers contribute throughout their careers and rightly regard Social Security as something they have paid into. But the program's deeper logic is social insurance: Contributions are pooled across workers, families, and generations to protect people in retirement and against the shared risks of disability and death.

Over the decades, the program has changed in order to better keep those promises. Social Security's architects regarded the 1935 law as a foundation on which to build, not a finished product. Congress substantially revised the program just four years after its passage and has passed other major reforms throughout the 20th century. Updating Social Security in response to economic and social change is not a departure from its history; **it is how the program has endured**.

The financing challenge now approaching presents another such moment. The 2026 Social Security Trustees Report projects that the Old-Age and Survivors Insurance Trust Fund reserves will be depleted in the fourth quarter of 2032 (a timeline similar to the Congressional Budget Office estimates). At that point, Social Security would not disappear, but without congressional action to rightsize the program's revenues, beneficiaries would likely see a more than 20 percent across-the-board cut.

Financing Rules Have Fallen Behind the Economy

Recent Roosevelt research highlights how unanticipated changes in the broader economy have gotten us here. The last major reform, in 1983, largely prepared Social Security for the retirement of the baby boom generation, but Congress did not anticipate how sharply earnings would become concentrated among those above the payroll-tax cap or how much lasting damage the Great Recession and its slow recovery would cause. Congress could have acted years ago when it became apparent that incoming revenues would fall short of what would be required. While we've lost time, lawmakers can still address these changes in our economy as they take on Social Security reform.

How Social Security Taxes Currently Work

Social Security taxes have followed the same basic structure since the program's beginning. Workers and their employers pay a percentage of their annual earnings—known as the Federal Insurance Contributions Act (FICA) tax—into the Social Security Trust Fund. Currently, that tax rate is 12.4 percent, split equally between employees and employers. (If you receive a W-2 tax form at the end of each year from your employer, you can see how much Social Security taxes you paid in Box 4). Self-employed workers are responsible for the entire 12.4 percent.

Workers don't pay taxes on all of their annual earnings; instead, they pay a share of their earnings up to a maximum amount. This is known as the **taxable maximum**, which in 2026 was $184,500. That dollar amount is tied to wage inflation (the same index used to increase benefits) and is commonly used as a baseline in policy discussions because it was the share of covered earnings at the time of the 1983 reforms (which had been determined by legislative changes in 1977). Today, due to changes in the workforce, growing inequality, and other factors, only about 83 percent of total earnings are covered by these taxes.

But being specific about the root causes of the revenue shortfall is important. Mismatches between Social Security's structure and other parts of today's economy have further weakened the system's revenue base:

- More economic gains at the top take the form of capital income, accumulated wealth, inheritances, and business income rather than conventional wages.
- Companies increasingly organize work through contractors, subcontractors, staffing arrangements, and digital platforms.
- Some active business owners can receive compensation for their work as business profit rather than wages.

In each case, Social Security may collect less—not because the economic activity or income has disappeared, but because the program's rules do not fully reflect how work is organized and how economic gains are taxed today.

While there are critical decisions regarding how benefits are designed and delivered, the essays in this series explore three complementary ways to update how the program is funded to better match our economic reality.

1. **Restore the taxable wage base.** Tyler Bond examines options for raising or eliminating the cap on earnings subject to Social Security contributions. The reason for such a change is not simply that the program needs more revenue

(though it does). The erosion of the wage base reflects decades during which earnings at the top grew much faster than average wages, all while Congress allowed the share of earnings contributing to Social Security to decline. Restoring that base would ask more of those whose earnings have grown the most and reinforce the financing structure that has long anchored the program.

2. **Reach resources beyond conventional payroll taxation.** Jonathan Schwabish considers whether high-end capital income, concentrated wealth, large inheritances, and undertaxed business income could provide dedicated support for Social Security. These sources may help stabilize the program and provide important resources for its expansion, particularly as a larger share of economic gains accrues outside ordinary wages. Drawing revenue from a broader base need not undermine Social Security's character as social insurance. Properly designed, these resources can extend the program and preserve its progressive guarantee while also making it more resilient, particularly as new technologies evolve and potentially generate significant wealth.

3. **Close gaps created by classification and business structure.** Finally, Lena Simet connects two practices often discussed separately: The misclassification of lower-paid workers as independent contractors and the ability of some high-income business owners to label compensation for their labor as profit. Although they operate at opposite ends of the labor market, both allow economically similar work to be treated differently for Social Security taxation purposes. Reestablishing employer responsibility, applying contributions more consistently to active business income, and strengthening enforcement would protect both the Social Security Trust Fund and workers whose benefits depend on complete earnings records.[1]

A Standard for Good Reform

Our principles must therefore begin with a firm commitment: **Cuts to existing benefits are unnecessary.** A cuts-first approach undermines the collective coverage Social Security represents and, in any event, would be disingenuous given the multitude of creative approaches our authors present and that will be available to lawmakers.

[1] These approaches address both the short and long-term needs of the program, but continued monitoring and intervention may be necessary if labor market shocks alter the economy in unpredictable ways, e.g., artificial intelligence. Social Security has been historically robust when tested by recessions and technological change, though any sufficiently strong disruption would require more than a response to Social Security's revenue structure alone. Such a response will be the focus of future research from the Roosevelt Institute.

These essays also outline principles for reform: restore and expand the wage base, reach gains that have moved outside of payroll taxation, and prevent employers and high earners from avoiding contributions.

Yet closing the solvency gap should not be the outer limit of our ambition. Reform should preserve the guarantee, progressivity, and broad accessibility that have defined Social Security at its best while creating room to expand the program—**to improve benefit adequacy, recognize caregiving more fairly, reflect new forms of work, and offer more complete protection against the risks workers and families face in today's economy.**

Social Security's promises remain sound, which is, in part, why the program has remained incredibly popular. The task now is to modernize the financing rules and the economy that supports them so that we can build a program that provides even greater security for the generations that follow.

Fixing the Tax Max: Restoring Social Security's Wage Base

by Tyler Bond

Social Security's Old-Age and Survivors Insurance (OASI) trust fund reserves will be depleted in six years, according to the latest estimates. Avoiding benefit cuts requires aligning revenues with benefit payments to eliminate the financing gap. While some politicians claim benefits must be cut to resolve the funding shortfall, that approach is neither popular with the American public nor reflective of the root causes of the financing gap. Simply put, the discussion of how to close Social Security's financing gap must start with the need for additional revenues, not benefit cuts, because the erosion of the program's revenue base is the heart of the problem.

The OASI program receives more than **90 percent** of its revenue from payroll tax deductions from nearly all wage and salary workers. Restoring Social Security's wage base would be a policy correction after years of inaction by Congress, and it's an approach that would quickly bring money into the program.

Addressing the shortfall is critical, not only for beneficiaries, but also for the broader economy. Social Security spending generates at least $2.6 trillion of economic activity annually, and across-the-board benefit cuts would reduce economic activity by more than $300 billion. Allowing indiscriminate benefit cuts to occur (or proactively enacting them) would also significantly increase income and wealth inequality, as lower-income beneficiaries would lose a disproportionate share of their income.

This paper first explains why restoring Social Security's revenue base—rather than cutting benefits—should guide the response to the financing gap. It then traces the history and erosion of the taxable maximum, compares leading options for raising or eliminating it, and considers how tax reforms could fit into a broader package of revenue changes.

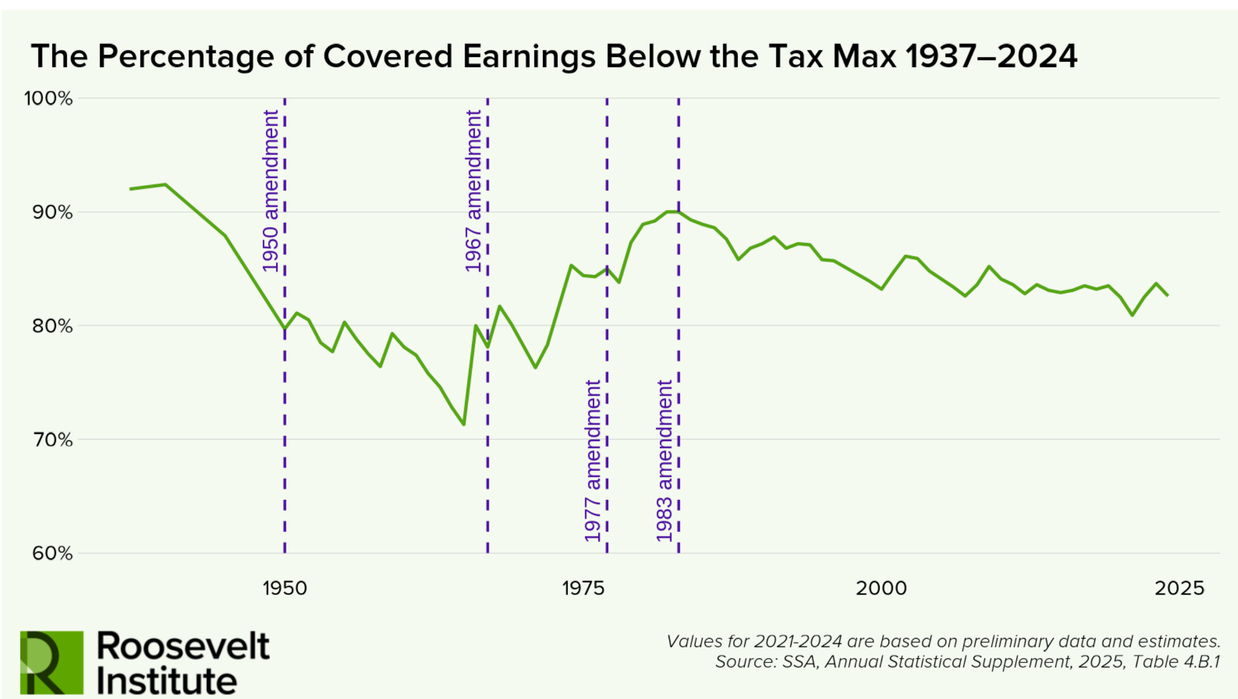
A Brief History of the "Tax Max" and the Current Debate

Social Security uses a "contribution and benefit base" to determine both how much workers contribute and how much they will receive in benefits. The contribution and benefit base only goes up to a certain dollar amount of wages and salaries, which is $184,500 in 2026. This amount is often referred to colloquially as the taxable maximum, or "tax max" for short. Any earnings above the tax max in a given year are not taxed for the purposes of making Social Security contributions. In addition, earnings above the tax max are not used to calculate Social Security benefits when a person retires or claims benefits in another way.

Social Security has always had a tax max. The Social Security Act of 1935 established the tax max at $3,000 per year, or the equivalent of $250 per month, which was featured in the proposal from President Franklin D. Roosevelt's Committee on Economic Security. The original Social Security Act did not contain any provisions for indexing the tax max, so it remained at $3,000 for years. Eventually, Congress realized the tax max needed to be higher so that the contributions and benefits workers make and receive would reflect the growing earnings of the American middle class. Throughout most of the 1950s and 1960s, Congress made ad hoc increases to the tax max. Congress finally realized that ad hoc increases were an inefficient way to administer this aspect of the program and, starting in the 1970s, began to index the tax max to increases in the average wage. This is largely how it has functioned since.

While Congress has increased the nominal tax max over the years, the percentage of covered earnings below or above it has varied. When Social Security began, 92 percent of all covered earnings were below the tax max (which thus helped fund Social Security). When tax max increases were ad hoc, the percentage of covered earnings fluctuated dramatically, as shown in Figure 1. The percentage of covered earnings below the tax max was 90 percent in 1982 and 1983 (as a result of Social Security amendments passed in 1977 and 1983), but it fell after 1983 and has been slowly declining since then. Indexing the tax max to changes in the average wage does not guarantee that a certain percentage of covered earnings will remain below the tax max, because the distribution of earnings differs from the average. Social Security's recent experience illustrates this point.

Figure 1



When Congress enacted the 1983 Social Security reforms, it was estimated that the percentage of covered earnings below the tax max would remain at 90 percent, harkening back to the earliest years of the program. This level of covered earnings, in combination with other changes, was projected to keep Social Security fully funded for the next 75 years. However, congressional leaders in 1983 did not anticipate how dramatically compensation patterns would shift over the coming decades and, as a result, likely had no reason to think that the current tax max structure would be insufficient for Social Security's future needs.

The percentage of covered earnings subject to payroll tax contributions has declined over time due to the rapid growth of income above the taxable maximum. Currently, only 82.6 percent of covered earnings are subject to the Social Security payroll tax. Therefore, even as wages have risen, especially for the highest earners, Social Security's revenue base has failed to keep up with the program's needs.

Options for Changing the Tax Max

Considering this history and the present circumstances, Congress urgently needs to restore the Social Security wage base by resetting the tax max at an appropriate level. Social Security receives nearly all of its revenues from contributions made by current workers.[2] Therefore, unless Congress considers a new revenue source, raising revenue from current workers will be necessary to resolve the financing gap, and to do so quickly.

Congress, theoretically, has a large number of potential revenue sources if one considers revenue in the broadest possible sense. However, given its nature as an insurance program, Social Security has always connected contributions from current workers to payments to current beneficiaries. Adding a new revenue source that is not based on a worker's earnings and compensation could be administratively complex and could change people's perceptions of Social Security.

This discussion also centers on an argument for fairness. Social Security insures all of society against risk. Since society benefits from this program and the protection it provides, as many people as possible should contribute to its success. Those who have gained the most from recent decades of economic growth have also contributed less toward Social Security as that growth has occurred. Raising or eliminating the tax max would restore some balance between economic growth and social protection.

[2] OASI also receives revenues from interest earned on the bonds held in the trust funds and from the taxation of the Social Security benefits of some higher earners. These are unlikely sources to resolve the trust fund reserve depletion given that interest earnings will decline as trust fund reserves are depleted and that increasing the taxation of benefits would only have a small effect on Social Security's financing.

Finally, proposals to adjust the tax max must consider the interaction between contributions and benefits within Social Security. Historically, benefits have been calculated based on the amount contributed. That's why the tax max is officially called the "contribution and benefit base." Some proposals would increase both contributions and benefits at the higher coverage level, meaning higher earners who contribute more would also receive more in benefits, while other proposals would only increase contributions and leave the cap on benefits in place.

Raising the cap on contributions while leaving a cap in place for benefits would change the relationship between contributions and benefits. The connection wouldn't be completely eliminated, because higher-income workers would still receive more in total benefits, but some wealthier workers would contribute more to shore up Social Security's overall financial health without a commensurate increase in future benefits. This may be considered an appropriate trade-off given the extreme wage growth at the very top of the income distribution in recent decades.

With these considerations in mind, this paper evaluates three buckets of options for reforming Social Security's tax max:

A. Permanently setting the tax max at 90 percent of earnings.
B. Eliminating the tax max completely so all earnings are subject to the payroll tax.
C. Different variations on options A and B that would involve a less direct change to the tax max.

Table 1 shows the share of the 75-year shortfall closed by options A and B, including whether benefits would be increased based on contributions above the current tax max.

Table 1. Percent of 75-Year Solvency Gap Closed by Proposed Tax Max Changes

	Increase Benefits	Do Not Increase Benefits
Option A: Set tax max at 90 percent of earnings permanently	22%	28%
Option B: Completely eliminate the tax max	48%	67%

A. The 90 Percent Approach With and Without Benefit Increases

The first option to consider is permanently setting the tax max so that 90 percent of all wage and salary earnings fall below it each year. Due to its historical connection to the 1983 amendments, some advocates have called for the tax max to be set to cover 90 percent of earnings in perpetuity. This would account for some of the growth in income inequality in recent decades and, to some, represents a reasonable amount of Social Security coverage.

Permanently setting the tax max at 90 percent acknowledges not just that almost all workers and employers have an obligation to contribute to this critically important program, but also that nearly everyone will need Social Security benefits in retirement. Aside from the very wealthy, who don't derive much of their wealth from earnings anyway, most workers, including upper-middle-class workers, rely on Social Security as an important component of income in retirement and as an economically efficient source of protection against risk throughout life.

However, estimates from the Office of the Chief Actuary at the Social Security Administration (SSA) indicate that setting the tax max at 90 percent of covered earnings would only eliminate 22 percent of Social Security's current shortfall. Setting the tax max at 90 percent, without providing benefit increases for contributions between the current tax max and 90 percent, would reduce the funding gap by 28 percent (see Table 1). These are meaningful reductions, but, on its own, setting the tax max at 90 percent of earnings is insufficient.

B. Eliminate the Cap With and Without Benefit Increases

The second option for changing the tax max would be to remove the cap entirely and make all wage and salary earnings subject to the payroll tax that funds Social Security contributions. Estimates from SSA's Office of the Chief Actuary state that approximately two-thirds (67 percent) of the shortfall could be reduced by eliminating the cap on contributions but maintaining the cap for benefit calculations. Scrapping the tax max and giving additional benefits for additional contributions would eliminate just under half (48 percent) of the shortfall (see Table 1).

Increasing the payroll tax contributions of the highest earners would bring in substantial revenue for OASI while being less economically disruptive than other options, such as increased federal government borrowing or across-the-board benefit cuts. Moreover, for either option A or B, the mechanism to increase payroll tax contributions already exists, and the increase would be straightforward to implement.

Approximately 6 percent of workers earn above the tax max each year, and only 20 percent will ever do so at any point in their career. Receiving more contributions from higher-income individuals, who receive a disproportionately large share of the tax advantages for retirement savings elsewhere in the tax system, would have a smaller impact on the economy than other possible changes to Social Security, especially if that increase is phased in over time.

Eliminating the cap on contributions while retaining a cap on benefit calculations would represent a greater shift in the connection between contributions and benefits, but this shift is worth considering because it does much to resolve the financing gap. That much additional revenue would allow Social Security reformers more flexibility when considering other potential reforms, such as combining other revenue-base restorations discussed below.

C. Variations on Tax Max Changes

A third set of options would all involve changes to the tax max, but with variations that make them distinct from the direct changes discussed above. The list of options presented below is not meant to be exhaustive, but rather to illustrate a variety of ways Congress could change the tax max to serve the goals of Social Security.

1. Congress could eliminate the tax max and increase benefits for additional contributions, but only modestly, perhaps by adding a third bend point to benefit calculations. One such proposal was estimated to reduce the 75-year shortfall by 62 percent.
2. Congress could set the tax max at 90 percent of earnings for both contributions and benefits, but then collect additional contributions above the 90 percent tax max that aren't used for benefit calculations. A proposal like this was estimated to reduce the 75-year shortfall by 39 percent.
3. One widely discussed proposal in recent years would leave the current cap in place but reimpose the payroll tax on earnings above $400,000. The gap, or "donut hole," between the current cap ($184,500) and $400,000 would close over time as the current cap rises with average wage indexing. This would bring in new revenues more slowly than other potential approaches. One version of this proposal, which would provide benefit increases for the additional contributions, was estimated to reduce the 75-year shortfall by 58 percent.
4. Finally, there have been proposals to raise or eliminate the cap on contributions only on one side of the contribution split: either from employees or from employers. One of these proposals was estimated to reduce the 75-year shortfall by 41 percent.[3]

These alternative proposals would bring in additional revenue, yet, as with options A and B, none of the proposals in isolation would close the financing gap.

[3] Regardless of which contributor is asked to pay more, only increasing the contributions on part of the contribution base would bring in much less revenue than other options. And it could have unexpected and unintended consequences for how certain workers choose to be compensated.

Changes to the Tax Max in the Context of a Broader Package of Reforms

Any potential change to the tax max must be paired with other changes to fully resolve the financing gap since none, implemented alone, achieves full solvency. Additionally, other policy changes included in a potential package of reforms could affect how a tax max change would impact the 75-year funding shortfall.

For instance, if raising the tax max were paired with an increase in the contribution rate (e.g., from 6.2 percent to 7.2 percent), this combination would bring in more total revenue for the program and increase the amount individual workers contribute. While some workers might change their economic behavior in response, Congress must consider the efficacy and efficiency of any potential policy change while acknowledging that behavioral responses are unavoidable.

Another consideration relevant to potential tax max changes is that the very wealthy don't derive most of their wealth from wage and salary earnings. Above a certain level, most earnings don't come from wage income but from other income sources, such as dividends or capital gains. Thus, the revenue resulting from lifting the tax max may not be as significant as some would expect. However, an increase in the amount of wage and salary earnings subject to the payroll tax contribution rate, paired with a new contributory tax on other sources of income, could greatly increase revenue to Social Security. **One analysis estimated that eliminating the tax max combined with reforming how S corp income is treated for Social Security contribution purposes alone could close the financing gap with no need for benefit cuts or borrowing of any kind.**

Regardless of how Congress ultimately decides to increase revenues to meet Social Security's needs, these changes should be sustainable to reduce uncertainty about Social Security's future after reform. Greater confidence in the program's future could have unexpected economic value by reducing the financial anxiety many workers and their families face.

Conclusion

Social Security has always had a tax max, but the nominal amount of that cap and the percentage of earnings subject to it have fluctuated throughout the program's 91-year history. The tax max should be set based on what Social Security needs to accomplish its purpose: to protect society as a whole against various risks. This level of risk protection at this relatively modest cost can only be provided at scale when everyone in society contributes. As income and wealth patterns change, the provisions of Social Security should change with them.

Thus, when Congress finally reforms Social Security to resolve the financing gap and prevent indiscriminate, across-the-board benefit cuts, changes to Social Security's tax max will likely be included in that reform. The need for additional revenues to close the financing gap, as well as the societal impact of increased income inequality, makes it almost inconceivable that Congress would leave the current tax max unchanged. Given this reality, it is important to consider the strengths and weaknesses of various approaches to changing the tax max.

The clearest option for resolving the financing gap is to eliminate the cap on contributions while retaining a cap on benefits. This reform would generate substantial revenue to reduce the funding shortfall. This approach could lead to income shifting among some higher-income workers, which is why it would be important to pair a tax max change with other revenue base restorations to ensure that a worker's full compensation is contributing to Social Security's long-term success. This combined approach would also avoid the need to cut benefits in the name of solvency.

Funding Social Security with More Than Just Payroll Taxes

by Jonathan Schwabish

To address Social Security's projected trust fund depletion through changes to benefits, policymakers have typically focused on a familiar set of reform levers: changing the benefit formula—either the initial calculation or how benefits grow after claiming—or changing eligibility rules, such as the early retirement age or who qualifies for spousal and survivor benefits.

On the tax side of the policy discussion, proposed reforms typically focus on the two key pieces of the formula—the tax rate employees and employers pay, and the maximum amount of earnings that are taxable. While important to reform, these levers are unlikely to close the solvency gap on their own or provide sufficient revenue for targeted program expansion. Therefore, it's prudent to discuss how other tax streams could help fund the system.

The current policy debate around wealth taxes and, more generally, how to tax super wealthy Americans is perhaps a leading indicator of changes in this discussion. As the millionaire and billionaire class grows, policymakers have made it easier than ever for wealthy taxpayers to shield their income from standard income and Social Security taxes. Remember, Social Security taxes are paid on earnings, not on returns from the stock market, bonds, or other forms of income. For instance, Warren Buffett, whose wealth is estimated at roughly $140 billion, famously earns a salary of $100,000, less than the current taxable maximum of $184,500.

This paper extends the policy discussion on the revenue side of the Social Security reform debate by examining ***additional*** tax sources that could be tapped to help fund the system. However, how these forms of revenue are structured could alter the long-standing link between earnings and benefits. Social Security is built on the principle that a worker's benefits (and those of their spouse and dependents) are an explicit function of their earnings from work. That link is not absolute, and there are adjustments at the margins: The progressive benefit formula returns a higher share of earnings to lower earners, the taxable maximum caps the relationship, and revenue from the taxation of benefits already flows into the trust funds from a non-payroll base.

Including income from investments or real estate, or other measures of wealth, in the Social Security tax base (without increasing benefit amounts) changes that link. Policymakers can, of course, change that underlying philosophy, but doing so would mark a significant shift in how the program has operated for the past 90 years—which some argue is the basis of the program's bipartisan popularity. Yet, given the important role Social Security plays in people's retirement and retirement planning (and, for many, life and disability insurance) and the federal government's overall tax-spending balance, policymakers need to consider every possible option to bring Social Security (and the nation's fiscal picture) into balance.

Although this would be a new approach for Social Security, it is not a new idea in other policy discussions. For example, a mixed revenue stream, with a payroll tax that is not capped like Social Security taxes, has always funded Medicare, yet Medicare enjoys a similar level of popularity to Social Security and is regarded as an earned benefit from work. And lawmakers have seriously discussed—under both President Barack Obama in 2010 and President Joe Biden in 2024—applying revenues from the Net Investment Income Tax (NIIT) to Medicare (though, when the NIIT was passed as an amendment to the Affordable Care Act in 2010, the funds were directed to general revenues rather than to Medicare). Policymakers should therefore consider the full menu of available revenue options for Social Security as well.

Surveying Potential Revenue

Introducing new or additional taxes would also have implications for households, firms, and the broader economy. New or higher taxes affect decisions people make about work, savings, investments, and the timing of retirement. And those decisions are not uniform across different tax types—an increase in the payroll tax or a new estate tax has different impacts on different types of people.

The options described below are not inherently "good" or "bad"; rather, this brief snapshot of revenue options offers a governing framework that policymakers can use to evaluate them as they debate Social Security reform. Any such decision should be weighed against several criteria, five of which are listed here:

- **Revenue Adequacy:** Does the policy (alone or in conjunction with others) raise enough money to meaningfully improve solvency?
- **Distributional Fit:** Where does the policy place the burden? Does it fall primarily on high-income/wealthy households, or on low- and middle-income workers? And how does the policy interact with existing tax policies?
- **Program Fit:** Can the revenue stream be dedicated to Social Security without weakening the program's earned-benefit structure?
- **Administrative Feasibility:** Is the policy enforceable and resistant to avoidance?
- **Political Durability:** Is the policy understandable to the public and resilient against repeal?

This is not an exhaustive list, and policymakers and the public may wish to see other guideposts included. But it serves as a starting point for a broader discussion about what taxes might be changed or introduced to support Social Security. Importantly, no single option is likely to satisfy all five criteria equally well, and trade-offs among them are often unavoidable; the framework's value lies in making those trade-offs explicit.

This snapshot also categorizes the tax options into four different revenue types that policymakers might use to fund Social Security:

1. **Investment and Capital Income:** Apply the Social Security tax to investment income, like dividends, interest, and capital gains.
2. **Wealth and Asset Taxes:** Apply taxes to wealth and assets to high-wealth individuals and households.
3. **Estate and Inheritance Taxes:** Change current estate and inheritance tax laws and rates to capture a greater share of total income.
4. **Business Income:** Apply the payroll tax to tax status corporations that use the pass-through as income, or expand other business taxes to cover pass-through incomes above some cutoff.

These revenue sources track income and wealth gains that have, in recent decades, grown largely outside the reach of the payroll tax. This is especially true for people at the top of the income distribution, whose financial assets have grown more quickly than those at the bottom. Over the past four decades, the labor share of national income has declined (which the Social Security Trustees incorporate into their projections), while household net worth has grown substantially relative to income.

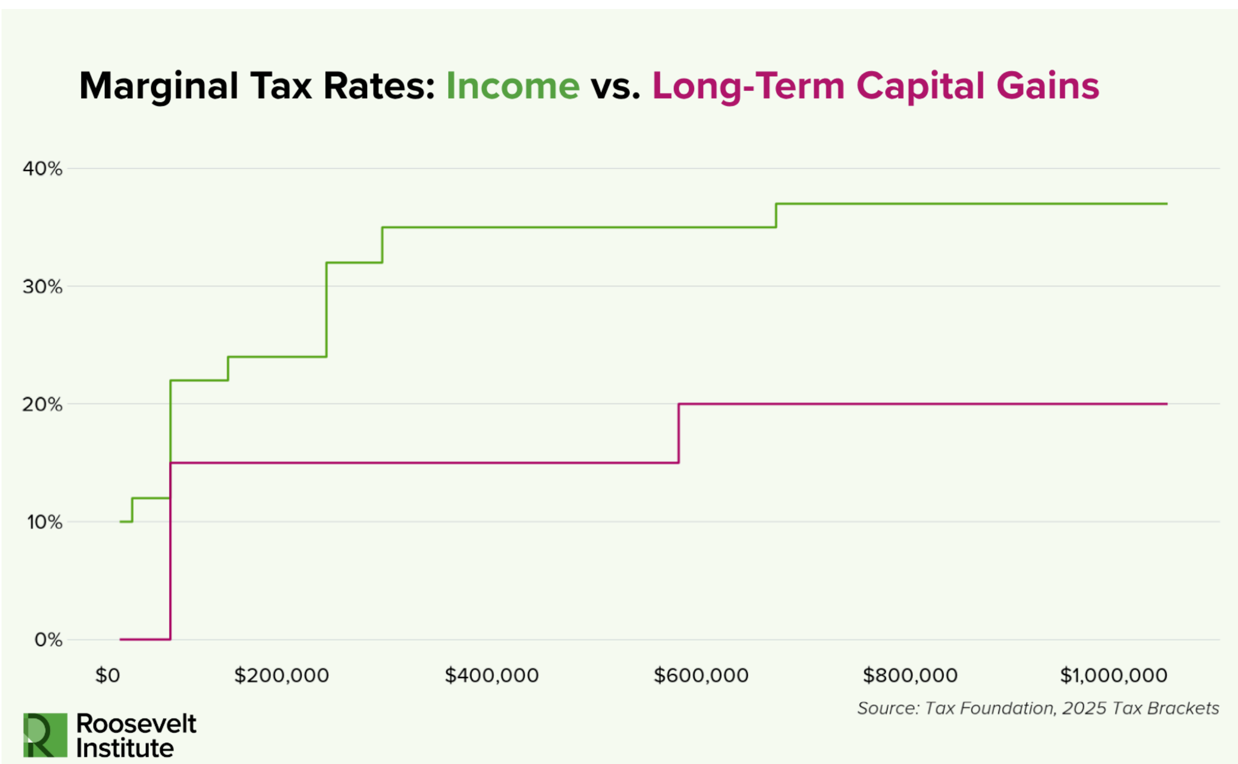
Many of the policy options presented below include the total 10-year revenue estimates from the 2024 report *Options for Reducing the Deficit: 2025 to 2034* from the Congressional Budget Office (CBO). Those estimates assume funds will flow into the government's general revenue, and it is not clear how—or even if—they might differ if the revenue were dedicated to Social Security. This snapshot also does not estimate the combined or net effects of these revenue options, including additional impacts on labor force participation or the overall economy, nor how changes to the benefit formula (if any) would impact the total revenue estimates or the distributional effects of such policies. This paper instead summarizes major revenue options that policymakers could explore to fund Social Security (see Table 2).

Investment and Capital Income

- **Apply the Social Security payroll tax to net investment income (dividends, interest, capital gains) for high earners.** This option would extend the 12.4 percent payroll tax (the level of which could be modified) to passive investment income, such as dividends, interest, and capital gains, above a high-income threshold. Under the current system, the payroll tax applies only to wages and self-employment income, so a large (and growing) share of top-earner income escapes the tax entirely. This option fits squarely within the current scope of the program and would be relatively easy to implement, as it would largely expand the definition of "earnings" for purposes of Social Security. One such recent proposal from Sen. Sheldon Whitehouse (D-RI) and Rep. Brendan Boyle (D-PA), the Medicare and Social Security Fair Share Act, would apply the 12.4 percent Social Security payroll tax to wages above $400,000 as well as to investment income for individuals with modified adjusted gross income above $400,000 (and couples with MAGI over $500,000).

- **Tax carried interest as ordinary income, subject to payroll tax.** Private equity and hedge fund managers typically receive two types of compensation: a fee tied to a percentage of the fund's total assets, and a percentage of the fund's total profits. This latter form of compensation is known as "carried interest," named so because the managers "carry" the risk of the fund's performance. Carried interest is taxed at long-term capital gains (0%, 15%, and 20%) rates rather than as ordinary income, where there are currently seven tax rates (i.e., brackets): 10%, 12%, 22%, 24%, 32%, 35%, and 37% (see Figure 2). This option would treat carried interest as compensation and subject it to both income and payroll taxes; thus, it is consistent with the current system and, like the previous option, would be relatively easy to implement. CBO estimates that this kind of tax could raise $13 billion in general revenue over 10 years.

Figure 2



- **Raise capital gains rates for top earners and dedicate them to Social Security.** As noted, profits from investments held more than a year are currently taxed at 0%, 15%, or 20%, much lower than the top rate on regular incomes like wages. In other words, people who get a lot of their annual income from their wealth face much lower tax rates than people who get their income from earnings. Raising the top capital gains rate—or, alternatively, taxing gains as ordinary income for high earners—would raise substantial sums and target a major source of income for the wealthiest households. CBO estimates that raising all three long-term capital gains rates by 2 percentage points (to 2%, 17%, and 22%) would raise about $103 billion in general revenue over 10 years.

Modeling Future Social Security Finances

Precious few large-scale validated models reliably estimate the long-term finances of the US Social Security system. Existing Social Security calculators and similar tools typically take a single cross-section of US workers, reweight it to reflect projected demographic shifts, and grow earnings and incomes using projected growth rates from federal sources such as the Social Security Administration (SSA) and CBO. What these models cannot do is trace how an individual's earnings, family structure, or health evolve over a lifetime, so they are ill-suited to questions about how specific cohorts or subgroups fare under reform. And because they often do not have measures of lifetime earnings—which are necessary to estimate the Average Indexed Monthly Earnings to calculate Social Security benefits—these models are unable to accurately project benefit receipt at the individual or family level.

Microsimulation models have the functionality and sophistication needed for these projections. The Congressional Budget Office's Long-Term Model, the Social Security Administration's Modeling Income in the Near Term, and the Urban Institute's Dynamic Simulation of Income Model (DYNASIM) are some of the most prominent models that do this. These models project the finances of the Social Security system (and other long-run programs) from the perspective of an individual worker and their family. DYNASIM, for example, starts with longitudinal earnings records from the Survey of Income and Program Participation, statistically matches them to historical earnings records from longitudinal earnings data, including SSA's public use Summary Earnings Records, the Panel Study of Income Dynamics, and the National Longitudinal Survey of Youth, and then, for each individual in the sample, simulates life events like marriage, divorce, migration, employment, retirement, and more. Some of these individual outcomes, such as immigration and fertility, are benchmarked against aggregate projections produced by SSA and CBO.

Because individual earnings and retirement behavior are the primary inputs to a Social Security microsimulation model—and are enormously complex on their own—some microsimulation models do not focus on other forms of income and wealth, such as stock and bond holdings, pensions, and housing wealth (DYNASIM is the exception). Incorporating or expanding those modeling capabilities would take time and effort to find and process the best underlying data, understand the existing literature on trends and trade-offs, and blend them into the existing individual base files. But having the capability to incorporate such measures (and behavioral responses) would be of enormous value to the research and policymaking communities. Greater investment, either from the federal government or other funders, would provide support for these models and the expanded capabilities that would make them more useful for answering policymakers' questions.

Wealth and Asset Taxes

- **Tax net wealth.** This option would impose an annual percentage levy on the total net worth of the wealthiest households, including stocks, real estate, business interests, and other assets above a certain threshold. Unlike income taxes, it would reach accumulated wealth regardless of whether it generates taxable income in a given year. Several states, including California, Minnesota, and Rhode Island, are considering (or have considered) wealth tax policies in recent years. Critics have pointed to the difficulties in measuring wealth for the purposes of such taxation, while proponents argue that it could help address wealth and income inequality and generate revenue.

- **Levy a billionaire minimum income tax.** This would establish a minimum effective tax rate (e.g., 20–25 percent) on total income for households with wealth above some cutoff amount. The Biden administration proposed this kind of option in FY23, FY24, and FY25, which would have imposed a minimum 20 percent tax on total income—including unrealized capital gains—for all taxpayers with net worth exceeding $100 million. Like the net wealth tax, this revenue option when applied to Social Security changes the link between earnings and benefits. It would also likely be difficult to accurately measure wealth and thus taxes due. The US Treasury Department estimated that the FY23 proposal would raise $361 billion over 10 years.

- **Raise the financial transaction tax (FTT)—a small percentage levied on the purchase or sale of financial assets such as stocks, bonds, and derivatives.** Because trading volume is enormous, even a very low rate generates substantial revenue while having minimal effect on long-term investors. High-frequency traders and large financial institutions would likely bear most of the cost, though the increase in transaction costs could result in lower trading volume, lower liquidity, and potentially increased stock volatility. The existing US FTT is very small, at about 2 cents per $1,000 in trading volume. Because the tax already exists, this option would be relatively easy to implement to fund Social Security, but it would change the program's underlying philosophy, which directly links earnings and benefits. Some proposals would increase the FTT to 0.01 percent, or 10 cents per $1,000 in trading volume, which CBO has estimated would generate about $297 billion over 10 years.

Estate and Inheritance Taxes

- **Lower estate tax exemption or raise tax rates.** The federal estate tax is a tax on property such as cash, real estate, and other assets transferred from a deceased person to their heirs. The tax is levied only on the portion of the estate's value that exceeds a certain threshold, currently $30 million for a couple (over their lifetimes), though it was as low as $1.35 million for a couple in 2001. The tax rates range from 18 percent to 40 percent, though the average effective tax rate is estimated at 14.1 percent, well below the top marginal income tax rate of 37 percent. Lowering the exemption threshold, raising the rates, or both would significantly increase tax revenues from large intergenerational wealth transfers. But because taxpayers already routinely try to avoid it, such a tax may be difficult to administer. It's not a perfect comparison, but the Joint Committee on Taxation (JCT) estimated that permanently extending the 2017 Tax Cuts and Jobs Act estate and gift tax cuts—which doubled the exemption amount from $5 million to $10 million in 2011 dollars (indexed for inflation)—would reduce federal revenues by $235 billion over FY 2025–35.

- **Implement the carryover basis reform (tax unrealized gains at death).** Under current law, inherited assets receive a "stepped-up" basis, meaning the value of the asset is adjusted to its fair market value on the date of death. For example, if a single person sold an investment in 2025 with $1 million in capital gains during their lifetime, they would owe about $166,000; if, however, they held the investment until death and passed it onto their heirs, no capital gains tax would be owed. Any capital gains accrued during the decedent's lifetime are permanently forgiven, meaning they do not have to pay taxes on the asset's growth over time. At least two policy options are possible: Under the first, the law would switch to the "carryover basis." Under this approach, the inherited asset would be taxed at the decedent's cost basis, then at the heirs' tax rate when they sell it. CBO estimates that this policy would raise $197 billion over 10 years. Under the second policy, capital gains would be taxed at the time of the person's death, as if the asset had been sold at death. CBO estimates that this would raise

$536 billion over 10 years. The large difference in the two estimates is likely due to the price of deferral—in the second option, the government collects taxes at the time of the person's death, while in the first, the heir pays taxes when they decide to sell, which could be many years in the future. In both cases, administering and enforcing the tax can be difficult because records with the original asset price are often missing or incomplete.

- **Tax inheritance (for the recipient, not the estate).** Unlike an estate tax, which is levied on the entire estate before it passes to heirs, an inheritance tax is levied on recipients based on the amount each receives and their relationship to the deceased. For example, if a Pennsylvania resident (Pennsylvania is one of five states with an inheritance tax as of 2025) left a $1 million inheritance to their adult child, the child would owe about $45,000 in inheritance tax (a 4.5 percent tax rate). No federal inheritance tax currently exists in the US, and introducing one would shift the framing from taxing death to taxing windfalls. A 2020 Hamilton Project chapter by Lily Batchelder includes Tax Policy Center estimates that show that replacing the estate and gift taxes with an inheritance tax integrated into the income and payroll tax system would raise between $337 billion and $1.4 trillion over 10 years, depending on the lifetime exemption level. Enforcing such a policy could be difficult, though Batchelder walks through a series of steps that could "substantially curtail the ability of taxpayers to temporarily and artificially deflate the value of inheritances at the time the tax liability is assessed."

Business Income

- **Expand Net Investment Income Tax (NIIT) to cover all pass-through income above $400,000–$500,000.** The NIIT is a 3.8 percent tax levied on certain investment earnings of higher-income individuals, estates, and trusts. As currently structured, income generated by some types of businesses—such as limited partnerships and S corporations—may be excluded from the tax under certain circumstances. Thus, high-income taxpayers who run those kinds of businesses can avoid paying taxes on their share of the firm's net profits. This option partially preserves the link between earnings and benefits by blending labor and capital in estimating a person's Social Security benefit. CBO estimated that imposing the NIIT on all income derived from business activity would raise $420 billion over 10 years.

- **Apply payroll tax to S corp owner pass-through income.** When S corp owners classify income as "business distributions" rather than wages, they can avoid payroll taxes on the nonwage portion of their income. Similar to modifying the NIIT, this policy would require all active business income above the compensation component to be subject to the self-employment/payroll tax, which broadens the definition of earnings in the Social Security benefit formula. The Office of the Chief Actuary of the Social Security Administration estimates that this kind of policy would close a quarter of the existing Social Security long-run shortfall.

- **Tax corporate windfalls/excess profits.** This option would impose a surtax on corporate profits above a “normal” return threshold, such as average returns over some historical period. It is often framed as a way to target extraordinary profits earned by companies during periods of market disruption or monopoly pricing power. In 2024, Sen. Bernie Sanders (I-VT) introduced the Ending Corporate Greed Act, which would have established a 95 percent windfall profits tax on a company’s profits that exceeded their average inflation-adjusted profits from 2015–19, but neither CBO nor JCT provided an official estimate of the revenue this proposal would generate. Such a policy could be difficult to enforce because it requires defining what counts as “excess” profit.

Conclusion

Each of these options has the potential to raise meaningful revenue over the next decade, precisely as policymakers face the need to strengthen the Social Security program. Dedicating new taxes on high-end capital income, concentrated wealth, inherited wealth, or undertaxed business income to Social Security would involve a real policy choice, because other public priorities, from defense to healthcare to childcare to debt reduction, also require public investment. But that trade-off does not weaken the case for directing revenue to Social Security (especially if adjustments to the current payroll tax structure resolve much of the shortfall).

The central design question is how to modernize Social Security’s financing while preserving what has made the program durable for nearly 100 years: a dedicated revenue stream from workers and employers, broad participation across the entire country, and its earned social insurance structure. New revenue sources need not weaken that foundation. Properly designed, taxes on high-end capital income, concentrated wealth, inheritances, or undertaxed business income can reinforce Social Security’s core goals by asking those who have benefited most from today’s economy to contribute more to a system that protects workers and families against economic insecurity across their lifetimes.

Table 2. Comparing Revenue Options for Social Security

Tax Policy	Revenue Adequacy		Distributional Fit	Program Fit	Administrative Feasibility	Political Durability
	Does the policy raise enough money to meaningfully improve solvency?	**Source**	**Where does the policy place the burden?**	**Can the revenue stream be dedicated to Social Security without weakening its earned-benefit structure?**	**Is the policy enforceable and resistant to avoidance?**	**Is the policy understandable to the public and resilient against repeal?**
Apply the Social Security payroll tax to net investment income (dividends, interest, capital gains) for high earners	N/A	N/A	Highly progressive	Weakens earnings-benefit link	Enforceable; relies on existing reporting infrastructure	Builds on NIIT precedent
Tax carried interest as ordinary income, subject to payroll tax	$13B over 10 years	CBO 2024	Falls narrowly on high-income recipients	Treats income as earnings	Enforceable, but people may relabel their pay to get around it	Broad public support; limited legislative traction
Raise capital gains rates for top earners and dedicate them to Social Security	$103B over 10 years	CBO 2024	Highly progressive	Weakens earnings-benefit link	Enforceable, but may cause people to hold assets longer rather than selling	Fragile; rate-cycle volatility
Tax net wealth	N/A	N/A	Falls almost entirely on high-wealth households	Weakens earnings-benefit link	Difficult to enforce	Vulnerable to constitutional challenge
Levy a billionaire minimum income tax	$361B over 10 years	US Treasury 2023	Falls almost entirely on high-wealth households	Weakens earnings-benefit link	Difficult to enforce because assets that are not publicly traded are difficult to value	Untested; raises unresolved realization questions

Raise the financial transaction tax (FTT)	$297B over 10 years	CBO 2024	Progressive; some saver pass-through	Weakens earnings-benefit link	Easy to enforce because the tax is collected automatically	Faces industry opposition
Lower estate tax exemption or raise tax rates	$235B over 11 years	JCT 2025	Falls primarily on high-wealth households	Weakens earnings-benefit link	Already established, but taxpayers routinely avoid	Vulnerable to negative public framing
Implement the carryover basis reform (tax unrealized gains at death)	$197B–$536B over 10 years	CBO 2024	Falls primarily on high-wealth households	Weakens earnings-benefit link	Difficult to enforce because records original asset price are often missing	Previously enacted and later repealed
Tax inheritance (for the recipient, not the estate)	$337B–$1.4T over 10 years	Batchelder 2020	Falls on high-income recipients	Weakens earnings-benefit link	Difficult to enforce because it requires tracking transfers over a lifetime	Untested federally
Expand Net Investment Income Tax (NIIT) to cover all pass-through income above $400,000–$500,000	$420B over 10 years	CBO 2024	Progressive; threshold-based	Partially preserves the earnings-benefit link; pass-through income mixes labor and capital	Enforcable, uses a system already in place	Threshold structure may aid public acceptance
Apply payroll tax to S corp owner pass-through income	Close roughly one-quarter of the existing Social Security long-run shortfall	SSA 2026	Falls mainly on business owners, not uniformly by income	Most directly strengthens the earnings-benefit link	Enforceable, but requires distinguishing between an owner's salary and their business profits	Often described in base-broadening terms
Tax corporate windfalls/excess profits	N/A	N/A	Unclear who ultimately bears the cost	No earnings-benefit link	Difficult to enforce because it requires a definition of what counts as “excess” profit	Temporary by design

Closing the Contribution Gap: Misclassification, Pass-Throughs, and Social Security

by Lena Simet

Much of the debate over how to close Social Security's funding gap has focused on lifting the cap on the payroll tax, so higher earners contribute more. Less attention has been paid to another potential source of revenue: labor income that falls outside Social Security's contribution base when workers are misclassified or when business owners take pay for their work as profit rather than wages.

Since Congress last restored solvency to Social Security's trust fund reserve in 1983, the labor market has changed substantially. Contractor work, digital labor platforms, and pass-through businesses have become a larger part of the economy. As they have grown, the rules that distinguish wages, self-employment earnings, and business profit have become more important to Social Security's finances.

This paper argues that worker misclassification at the bottom of the labor market and business structuring at the top are two expressions of the same underlying problem. Firms treat workers as independent contractors while retaining many employer functions, and active business owners reduce their own Social Security contributions by characterizing their labor income as profit rather than wages. The rules differ, but both practices have the same effect: Social Security collects less because of how work and income are labeled, not because the underlying economic activity has changed.

Capturing this revenue could make a major difference. For instance, Social Security's actuaries estimate that taxing the pass-through business income of high-income business owners could close a quarter of the program's long-term funding shortfall.

Fissured Work and Lost Contributions from Below

Changes in the organization of work have weakened Social Security's contribution base. Since the 1980s, companies have increasingly outsourced work once performed in-house to subcontractors, staffing agencies, and, more recently, digital labor platforms. Although firms often continue to control how work is priced, scheduled, and evaluated, they classify workers as "independent" contractors rather than employees, allowing them to avoid responsibilities they would otherwise bear as employers. What at first glance may appear to be solely a labor rights issue also has implications for Social Security. First, misclassified workers tend to earn less than comparable employees, reducing the earnings on which contributions are based. In addition, their contributions depend on individual reporting rather than automatic payroll withholding.

Former US Wage and Hour Administrator David Weil calls this the "fissuring" of the workplace. It shifts costs and risk onto workers, incentivizes misclassification,[4] and strips away minimum wage, overtime, and collective bargaining protections. Weil, Heather Boushey, and others trace much of the growth in earnings inequality over the past several decades back to this transformation. In 2020, the National Employment Law Project estimated that between 10 and 30 percent of employers misclassified at least some workers.

The effects on earnings, and with them on Social Security contributions, are substantial. A 2022 Center for New York City Affairs study found that misclassified full-time independent contractors in low-wage New York industries earned about 31 percent less than payroll employees in those industries. Lower pay results in fewer earnings that are taxed for Social Security. A 2026 Economic Policy Institute study of 11 commonly misclassified occupations found that social insurance contributions fall by as much as 30 percent for each misclassified worker.

Moreover, misclassification changes how contributions are collected. Employees contribute automatically through payroll withholding, whereas independent contractors must track their net earnings, calculate self-employment tax, and file quarterly payments through a far more complicated system. The National Academy of Social Insurance finds that self-reporting lowers compliance and is particularly burdensome for workers with irregular earnings to navigate.

A 2023 survey of freelancers and gig workers by American University's Kogod Tax Policy Center shows the implications for workers: 37 percent of respondents said they felt anxious or confused about how to file their taxes, 25 percent did not know how to file at all, and about 33 percent did not know whether they owed quarterly estimated taxes. The IRS's most recent compliance estimates, based on tax years 2014 to 2016, found that income with little or no third-party reporting (the category most contractor income falls into) is misreported about 55 percent of the time. For wages subject to full withholding, that rate is just 1 percent. The IRS has not updated this behavioral estimate since, though its most recent tax gap projections, for tax year 2022, put unpaid self-employment tax from underreporting and non-filing at $80 billion annually.

Congress tried to facilitate reporting in 2021, when the American Rescue Plan Act lowered the threshold at which gig platform companies like Uber and DoorDash had to report workers' earnings from fares and delivery fees to the IRS, from $20,000 a year to $600. The change mattered because many gig workers earn well under $20,000, and even those who earn more in total may remain below the threshold on each individual platform they use. As a result, platforms did not directly report much of their workers'

[4] Misclassification occurs when an employee is incorrectly labeled an independent contractor. It deprives governments of revenue, disadvantages law-abiding businesses, and denies workers labor and employment protections.

income to the IRS. The 2025 One Big Beautiful Bill Act reversed the reform and restored the $20,000 threshold retroactive to 2022. The Joint Committee on Taxation estimates that this will reduce federal revenue by $8.9 billion over 10 years. The law also raised the reporting threshold for bonuses and incentives paid separately from fares, from $600 to $2,000, beginning in 2026. Both changes mean that platforms report less income directly to the IRS.

And reporting has gotten harder for another reason. A $1.1 billion cut to the IRS's 2026 budget left the agency with fewer staff and less taxpayer assistance capacity. The agency also lowered its call-answering target from 85 percent to 70 percent and ended its free Direct File program. The Center on Budget and Policy Priorities has documented how cuts to IRS funding, staffing, and taxpayer assistance, along with the cut of Direct File, have made tax compliance harder, especially for low- and middle-income filers.

Together, lower earnings and incomplete reporting reduce not only the contributions Social Security receives but also the benefits and protections available to workers and their families. The American Academy of Actuaries finds that a worker who has only half their career earnings reported can see their future benefits cut by a third. A 2026 analysis by Craig White and Matias Sokolowski similarly shows how underreporting gig earnings can compound over a career and substantially reduce retirement benefits. In some cases, workers may not qualify for benefits at all because they lack sufficient reported earnings over enough years. According to the Social Security Administration, a worker who becomes insured at age 20 has a one-in-four chance of developing a disability and a one-in-eight chance of dying before reaching retirement age. Misclassification can leave workers with disabilities, or surviving family members, without benefits they might otherwise have received.

The costs of fissuring are also highly uneven. Misclassification disproportionately affects lower-income workers, immigrants, and workers of color, who are least able to absorb unstable income and the loss of labor protections. They bear the brunt when firms reduce their labor costs and shift responsibility for Social Security onto workers.

Business Structuring and Lost Contributions from the Top

Business owners can also erode the contribution base from above, not by reclassifying workers but by reclassifying labor income itself. As business ownership has evolved, economically similar labor income is increasingly treated differently depending on the legal form and tax classification under which it is earned, allowing some of the highest-income earners to contribute less to Social Security than employees with comparable earnings.

This issue has become more important with the rapid expansion of pass-through businesses, including partnerships, S corporations, and limited liability companies (LLCs), whose profits are reported directly on their owners' individual tax returns rather than taxed at the corporate level. Today, pass-through businesses employ most of the private-sector workforce and generate roughly half of all US business income. Matthew Smith et al. estimate that the shift toward pass-through businesses accounts for one-third of the measured decline in the corporate-sector labor share, which fell from 62.9 percent in 1978 to 57.9 percent in 2017.

For Social Security, the significance lies in how different forms of income are taxed. Social Security taxes wages and self-employment earnings, but not business profits distributed to S corporation shareholders and certain limited partners. That creates an advantage for some owners, especially S corporation shareholders and certain partners, who can receive part of the income generated by their own work as wages and part as profit.[5] By reporting more of their labor income as profit, they can reduce their Social Security taxes without reducing their total income.

High-income earners benefit disproportionately from this structure. The Urban-Brookings Tax Policy Center estimates that the top 1 percent of tax filers report more than three-quarters of all partnership and S corporation income. A substantial share of that income reflects payment for the owners' work. Smith et al. estimate that about three-quarters of the pass-through income reported by high-income owners is actually labor income, not returns to capital.

Tax law attempts to limit this practice. S corporation owners who perform services for the business must pay themselves "reasonable compensation," subject to Social Security tax, before taking the remainder as profit distributions. What is considered reasonable, however, is inherently subjective, creating substantial opportunities to understate wages while maximizing distributions.

Enforcement could close this gap. In 2021, the Treasury Inspector General for Tax Administration examined S corporation returns filed from 2016 to 2018 with a single shareholder, more than $100,000 in profits, and zero reported officer compensation, the most easily detected violation of the rule. Those owners took $69 billion in distributions while reporting no wages, and the inspector general estimated they failed to report nearly $25 billion in compensation, resulting in about $3.3 billion in unpaid Social Security and Medicare taxes. From 2017 to 2019, the IRS audited fewer than 1 percent of S corporations, and even when it conducted an audit, nearly half of

[5] Not all pass-through owners can benefit from this tax advantage. Sole proprietors, including single-member LLC owners that have not elected S corporation treatment, generally pay Social Security taxes on their business income.

examinations did not review whether owners paid themselves reasonable compensation.[6]

Recent changes have only widened this gap. The 2017 Tax Cuts and Jobs Act allowed eligible business owners to subtract up to 20 percent of qualifying pass-through income when calculating their taxable income, giving them another reason to report income as profit rather than pay. The Center on Budget and Policy Priorities found that the provision did little to spur new investment and instead largely encouraged owners to relabel existing labor income as profit. More than half of its benefits went to millionaire households, and Treasury estimates that roughly 90 percent went to white households. Congress made the deduction permanent in 2025.

The implications for Social Security are considerable. The Social Security Administration's Office of the Chief Actuary estimated that applying Social Security taxes consistently to active S corporation shareholders and limited partners who materially participate in the business they own would close 25 percent of the program's projected 75-year financing shortfall.[7] Combined with removing the payroll tax cap, this change could close most of the long-term financing shortfall.

Rebuilding the Contribution Base

Social Security's financing rules should reflect today's economy. That means closing the loopholes that allow firms and high-income business owners to lower their contributions by changing how workers and labor income are classified. Three complementary reforms would go a long way toward that end.

1. **(Re)establish employer responsibility for contract and platform work.** Businesses that routinely rely on contractors, including digital labor platforms, should contribute to Social Security just as employers do for payroll workers. Congress should require them to pay a "Contractor Tax," an employer-equivalent Social Security contribution made on the worker's behalf and credited against the worker's self-employment tax to avoid double taxation. Requiring businesses to contribute regardless of how workers are classified would reduce the incentive to misclassify workers in the first place. The payment should supplement, not substitute for, existing labor protections such as minimum wage and overtime laws.

[6] One of the cases the IRS did audit was Iowa accountant David Watson, who in 2002 and 2003 paid himself a salary of $24,000 while taking more than $200,000 in profit distributions through his S corporation. The IRS challenged the arrangement and reclassified part of those distributions as wages. In 2012, the Eighth Circuit upheld the finding that $91,044 constituted wages, requiring Watson to pay Social Security taxes on the difference. The IRS continues to cite *Watson v. Commissioner* in its guidance on reasonable compensation.

[7] The actuary's estimate assumes that Social Security taxes would apply to pass-through income for people earning more than $200,000 a year, or $250,000 for married couples filing jointly.

2. **Require Social Security contributions consistently for active pass-through owners.** People who actively work in businesses they own should contribute to Social Security on the income they earn from that work, regardless of how their business is organized. Congress should apply Social Security taxes to labor income earned through S corporations, partnerships, and LLCs, even when it is reported as business profit.[8] The principle could also extend to carried interest in private equity and hedge funds, where compensation for managing other people's money is often treated as investment income rather than earnings from work.

3. **Improve reporting, withholding, and enforcement.** As Social Security increasingly relies on workers who report and remit their own contributions, Congress should expand withholding for contractor income, restore Direct File, and rebuild IRS enforcement. It should dedicate funding specifically to enforce worker classification and pass-through tax rules and require the IRS to report publicly on how the funds are spent and what revenue it recovers. Enforcement should prioritize firms that exploit classification rules and make compliance easier for low-income workers with volatile earnings.[9]

These reforms work together rather than in isolation. A Contractor Tax would restore business contributions for outsourced work, while stronger reporting support would make contributions easier to collect. Consistent treatment of pass-through owners would close gaps that the subjective "reasonable compensation" standard leaves open. Together, the reforms would make it much harder to avoid Social Security contributions simply by relabeling wages as contractor earnings or labor income as business profit.

Conclusion

Social Security's retirement program faces a long-term financing shortfall that threatens the adequacy of benefits for millions of people, particularly those who rely on it most. But that shortfall is not the product of demographic change. It reflects an economy that has outgrown the financing rules that were last comprehensively reformed in 1983.

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[8] As an illustrative example, the Medicare and Social Security Fair Share Act, introduced by Sen. Sheldon Whitehouse (D-RI) and Rep. Brendan Boyle (D-PA), would extend Social Security taxes to certain active S corporation shareholders and limited partners while restoring payroll taxation above $400,000 ($500,000 for married couples filing jointly). The Social Security Administration's chief actuary estimated that this provision would improve Social Security's 75-year actuarial balance by 1.83 percent of taxable payroll.
[9] The Direct File Act of 2026, introduced by Sens. Elizabeth Warren (D-MA), Ron Wyden (D-OR), and Chris Coons (D-DE), would permanently authorize the IRS's free Direct File system after it was ended in 2025. The National Academy of Social Insurance has recommended expanded withholding, stronger information reporting, and simpler ways for independent contractors to make payments.

Since then, earnings and wealth have become increasingly concentrated at the top, while a growing share of labor income has moved outside Social Security's contribution base. Firms have shifted work to contractors while retaining many employer functions, and high-income business owners have increasingly characterized compensation for their own labor as business profit rather than wages. In each case, the label attached, not the work or income itself, determines how much reaches Social Security.

These reforms would substantially contribute to closing the funding gap. Social Security's actuaries estimate that even a limited reform focused on the active business income of high-income owners could close about a quarter of the projected long-term shortfall. Restoring Social Security's finances therefore requires rebuilding the contribution base so that economically similar labor income is subject to comparable contributions, regardless of the contract or legal entity through which it is earned. That does not require reinventing Social Security. It requires updating its financing rules to reflect how labor is organized today rather than how it was organized four decades ago.

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