FACTSHEET

HOW SOCIAL SECURITY AND MEDICARE TAXES ARE DETERMINED

SOCIAL SECURITY TAXES

The basic idea of Social Security is simple. During working years, employees, their employers, and self--employed people pay Social Security taxes. This money is used only to pay benefits to Social Security beneficiaries and the administrative costs of the program. Then, when today's workers' earnings stop or are reduced because of retirement, disability, or death, benefits will be paid to them and their eligible family members from Social Security taxes.

Part of the "FICA" tax goes for hospital insurance under Medicare. It helps pay hospital bills for workers and eligible family members at age 65 or if they receive Social Security disability benefits for two years or more. A second part of Medicare is Supplementary Medical Insurance. Approximately one--fourth of the cost is financed by premiums paid by people who have enrolled for this protection and the balance is paid by general tax revenues. The Government's share of the cost of the medical insurance part of Medicare comes from general revenues of the Federal Treasury, not from payroll taxes.

All Social Security and Medicare funds not required for current benefit payments and expenses are invested in interest--bearing U. S. Government securities.

HOW TAXES ARE PAID

If you are employed, your Social Security and Medicare taxes are deducted from wages each payday. Your employer matches your payment and sends the combined amount to the Internal Revenue Service.

If you are self--employed and your net earnings are $400 or more in a year, you must report your earnings and pay the self--employment tax each year when you file your Federal income tax return. This is true even if you owe no income tax.

Your wages and self--employment income are entered on your Social Security record throughout your working years. This record of your earnings will be used to determine your eligibility for benefits and the amount of cash benefits that you and your eligible family members will receive.

As long as you have earnings that are covered, you continue to pay Social Security and Medicare taxes—regardless of your age and even if you are receiving Social Security and Medicare benefits.

SETTING TAX RATES

The tax rates are set in the law, and are intended to ensure sufficient income to pay current benefits plus a reserve to make up for any shortfall in income and to help pay future benefits. (See Handout 2 for tax rates.) Social Security and Medicare tax rates are not currently scheduled to change. As noted elsewhere, however, future demographic trends will require either higher tax rates, lower program expenditures, or some combination to keep the Social Security and Medicare programs in financial balance.

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AUTOMATIC INCREASES IN EARNINGS BASE	The maximum amount of annual earnings subject to Social Security taxes and creditable for Social Security benefits increases each year with increases in earnings levels. This is called the earnings and benefits base. Earnings over the maximum may appear on your Social Security earnings record, but they cannot be used to determine your benefit rate. The maximum rises automatically in future years as earnings levels rise. This ensures that Social Security continues to cover the same proportion of earnings. When the amount of wages on which you pay tax increases, the amount of the tax you pay increases, of course, even if the tax rate does not change. The maximum earnings base has been eliminated for the Medicare Hospital Insurance tax; this tax is applied to all your earnings.
EXCESS EARNINGS AND TAXES	When you work for more than one employer in a year and pay Social Security taxes on wages over the maximum amount, you may claim a refund of the excess amount on your Federal income tax return for that year. If you work for only one employer who deducts too much in taxes, you should apply to the employer for a refund. A refund is made only when more than the required amount has been paid. Questions about taxes or refunds should be directed to the Internal Revenue Service.