

Educational Series

Social Security Insolvency: What Can Be Done and What's at Stake?

April 2025

All data, projections and opinions are as of March 31, 2025 and subject to change.

The Board of Trustees of the Social Security trust funds published its 2024 Annual Report¹ on the financial health of Social Security and Medicare. This report is a reminder of the stark realities facing retirees in the near term and all workers in the longer term. The report warns of the possibility that the primary trust funds for paying Social Security benefits could be insolvent by 2035, one year later than the trustees determined in their prior report. We explore a brief history of Social Security, the report's findings, and we discuss potential solutions in part one. In part two, we discuss the calculation and taxation of participant, spousal and family Social Security benefits.

PART 1: SOCIAL SECURITY AND IMPENDING INSOLVENCY

How has Social Security evolved since it was established?

The Social Security Act, signed by President Franklin D. Roosevelt on August 14, 1935, established the program of The Federal Old-Age Benefits System that is often referred to as the Old-Age, Survivors, and Disability Insurance (OASDI) program. Much more limited than the current scope of the Social Security program, this bill provided benefits for retired workers over age 65. Subsequent amendments to the program have continued to expand and modify benefits over the years. Some of the changes that have shaped the Social Security program as we know it today include:

- 1939: Created benefits for spouses and minor children of retired workers, as well as survivor benefits.
- 1956: Added benefits for disabled workers between the ages of 50 and 64. Disability rules were amended in 1960 to provide benefits to disabled workers of any age and their dependents.
- 1965: The federal Medicare program was created and placed under the Social Security Administration (SSA). This program provides health insurance to retirees aged 65 and older.
- 1972: A needs-based program known as Supplemental Security Income (SSI) was created for individuals who are over 65, disabled or blind. Unlike Social Security and Medicare, this program, while administered by the SSA, is not funded by payroll taxes, but through general federal government revenue.
- 1983: Reforms to the Social Security program included an increase in the age at which workers may qualify for their full retirement benefit: from 65 to 67 for those born in 1960 or later.

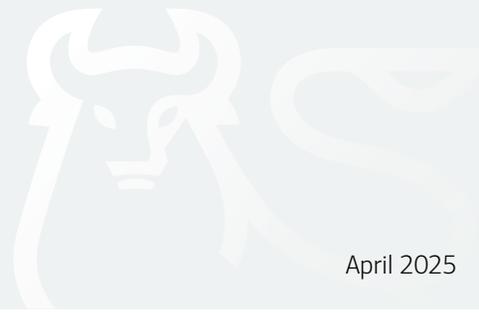
¹ "The 2024 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds", May 2024 (The Trustees' 2024 Report).

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How is the Social Security program funded?

Social Security is primarily funded through payroll taxes, paid equally by the employee and the employer, known as OASDI tax. The employee and employer each pay 6.2% on wages up to \$176,100 per year for 2025. This amount is paid into federal accounts known as the Social Security trust funds, with 5.015% paid to the OASI Trust Fund and 1.185% to the Disability Insurance Trust fund.²

What is the current financial status of the Social Security trust funds?

Social Security trust funds (OASI and DI) at U.S. Treasury receive payroll taxes collected, pay benefits, and hold any surpluses. The Social Security trust funds consist of the OASI and the Disability Insurance (DI) Trust Funds. Both are managed by the Department of the Treasury. The Social Security Act limits trust fund expenditures to benefits and administrative costs. Benefits to retired workers and their families, and to families of deceased workers, are paid from the OASI fund, benefits to disabled workers and their families are paid from the DI fund.

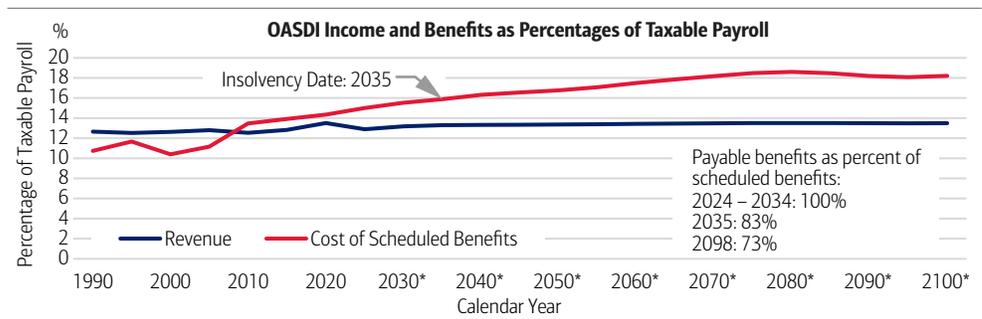
The trust funds can only be invested in securities guaranteed as to both principal and interest by the federal government. All securities held by the trust funds are "special issues" of the U.S. Treasury, which are available only to the trust funds and can be redeemed at any time at face value. This gives the trust funds the same flexibility as holding cash. Money to cover benefit payments from the trust funds comes from the redemption of securities held by the trust funds. When "special-issue" securities are redeemed, interest is paid.

At the end of 2023, the total funds in the trusts were \$2.79 trillion. During 2023, 67 million people received benefits (59 million received retirement benefits from OASI, 9 million received benefits from DI) totaling \$1.379 Trillion. During that same period, 183 million workers paid \$1.233 trillion of payroll taxes to the fund (other revenue including taxes paid on benefits and interest earned by trusts also added to the balances) leaving a \$41.4 billion deficit for 2023. The Trustees anticipate that fund reserves will continue to be depleted in 2024, and all years going forward, as total costs are projected to exceed total income, as they have since 2021.³

When are the Social Security trust funds estimated to become insolvent?

According to The Trustees' 2024 Report, the combined Social Security trust funds (OASI and DI) will be fully depleted in 2035, effectively making the program insolvent. The Congressional Budget Office (CBO) also prepares an analysis of the financial health of social security. The CBO's report (August 2024) projects insolvency of the combined trust funds to occur one year earlier in 2034. We note that Insolvency means that trust funds are unable to pay benefits in full and on time. It does not mean that Social Security will be completely eliminated and unable to pay any benefits. It is expected that future benefits could be paid only from taxes collected, which would cover roughly 83% of benefits.⁴

Exhibit 2: Social Security Projected Shortfall.



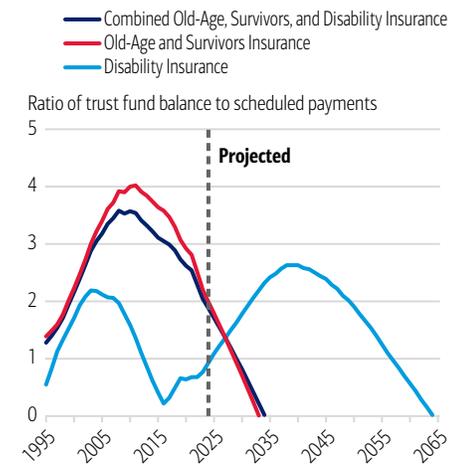
*Estimate. Source: The 2024 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, May 2024 (The Trustees' 2024 Report).

² These contributions are implemented through the Federal Insurance Contribution Act and are often referred to as FICA taxes. FICA taxes include not only 6.2% for OASDI (Social Security), but also 1.45% for hospital insurance for senior citizens and the disabled (commonly known as Medicare).

³ Source: Status of the Social Security and Medicare Programs: A Summary of the 2024 Annual Reports.

⁴ 2024 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, (May 6, 2024). The CBO's 2024 Long-Term Projections for Social Security projects that, after insolvency, future benefits could be paid from annual taxes collected, but that would cover roughly 77% of benefits—a 23% shortfall.

Exhibit 1: Social Security Trust Fund Ratios.



Source: Congressional Budget Office 2024 Long-Term Projections for Social Security. Latest data available.

What happens if Social Security becomes insolvent?

If the trust funds became depleted and current receipts were insufficient to cover current expenditures, there would be a conflict between two federal laws. Under the Social Security Act, beneficiaries would still be legally entitled to their full scheduled benefits. On the other hand, the Anti-deficiency Act prohibits government spending in excess of available funds, so there would be no legal authority to pay full Social Security benefits on time.⁵

Are there possible solutions to restoring the long-term solvency of Social Security?

There are few levers to pull when it comes to shoring up Social Security. Most rely on increasing contributions to the trust fund by increased taxes. Far fewer rely on decreasing benefits by delaying the full retirement age. If the trust funds were to run out, Congress could eliminate annual cash-flow deficits by cutting benefits so that benefits (spending) equal contributions on an annual basis. Achieving such an annual balance would require benefit cuts of 17% in 2035, the first year of insolvency, rising to 27% by 2098.⁶

When does Congress need to address deficiencies in the Social Security Program?

The short answer: Now. According to the trustees' report, if substantial actions are deferred, even for several years, the changes necessary to maintain Social Security solvency would be concentrated on fewer years and fewer generations. For instance, maintaining solvency through 2098 with changes that begin in 2035 would require: (1) an increase in revenue by an amount equivalent to a permanent 4.02% payroll tax rate increase from 12.4% to 16.42% starting in 2035, (2) a reduction in scheduled benefits by an amount equivalent to a permanent 24.6% reduction in all benefits starting in 2035, or (3) a combination of these approaches.⁶

Why is Social Security heading toward insolvency?

Social Security benefit payments have been increasing much more rapidly than contributions into the trust funds and are projected to continue that way until about 2040. During this period, the retirement of the baby boom generation is increasing the number of beneficiaries much faster than the increase in the number of covered workers, as subsequent lower-birth-rate generations replace the baby-boom generation at working ages. Between 2040 and 2080, benefit payments are projected to continue to grow faster than contributions because of the period of historically low birth rates starting with the recession of 2007-09. Finally, from 2080 to 2098, benefits are projected to grow somewhat slower than contributions, due to projected favorable birth rates.⁷

Will the federal government's efficiency and cost-saving measures affect payments to retirees and other Social Security beneficiaries?

Efforts by the Trump administration's Department of Government Efficiency to reign in government spending have focused on detecting waste, fraud, and abuse for many federal agencies including the SSA. Within the SSA, these efforts have sought out cost savings by reducing overhead, effectively shrinking the agency's workforce and closing offices, and eliminating fraudulent benefit payments. It should be noted that reducing or modifying Social Security benefits payable to retirees and other beneficiaries is outside the purview of this effort, as any changes to the program must be authorized by Congress. However, commentators have noted that closing offices and reducing staff could potentially make it more difficult for individuals to file for the benefits they are entitled to. Additionally, there could be a concern that, in an effort to eliminate fraudulent benefit payments, the process of filing for benefits will become more onerous.

⁵ It is unclear what specific actions SSA would take if a trust fund were insolvent. After depletion, the trust funds would continue to receive tax revenues (payroll taxes and income taxes on benefits), from which a majority (about 83%, declining to 73% in 2098) of scheduled benefits could be paid. One option would be to make timely but reduced payments; another option could be to pay full benefits on a delayed schedule.

⁶ If changes were to take effect immediately, then to maintain solvency through 2098: (1) payroll taxes would need to increase by 3.33% to 15.73%; (2) benefits would have to be reduced to a permanent reduction of 20.8% applied to all current and future beneficiaries, or 24.8% if the reductions were applied only to those who become initially eligible for benefits in 2024 or later; or (3) some combination of these approaches. The CBO report comes to a similar, by slightly more pessimistic, conclusion.

⁷ According to the Trustees' 2024 Report, the combined OASI and DI Trust Fund reserves have a projected depletion date of 2035, a year later than in last year's report. After the depletion of reserves, continuing tax income would be sufficient to pay 83 percent of scheduled benefits for the remainder of 2035, and 73 percent by 2098. The CBO report projects, after depletion of reserves in 2034, continuing tax income would be sufficient to pay 77 percent of scheduled benefits in 2034, and 72 percent by 2098.

Potential solutions to restoring long-term solvency could include the following, some of which have been proposed in Congress:

- Increase full retirement age from 67 (for those born 1960 or later) to 70 (by 2069).
- Increase contribution base over the current \$176,100 or eliminate it completely.
- Apply a 12.4% payroll tax for high earners on wages over a certain amount (\$250,000 and \$400,000 thresholds have been proposed recently).
- Modify Social Security's inflation index to a "chained" consumer price index.
- Reduce benefits for higher lifetime earners.
- Means-test Social Security benefits by reducing benefits for higher-income recipients (unlike the prior option, which uses a measure of career average earnings to reduce benefits, means testing would reduce benefits based on current income).
- Apply payroll tax to a wider array of earnings by collecting tax on contributions to flexible spending accounts and other tax benefits.
- Impose a 12.4% Social Security tax on net investment income.
- Create a sovereign wealth fund to invest Social Security funds.

PART 2: SOCIAL SECURITY BENEFITS AND TAXATION

How are Social Security retirement benefits calculated?

To qualify for Social Security retirement benefits, a worker must meet a minimum standard for having paid into the program. This is met by accruing 40 “credits.” For 2025 a worker will earn a credit for every \$1,810 of earnings subject to the Social Security payroll tax. Each year a maximum of four credits can be earned, and after accruing 40 credits a worker is considered “fully insured” and can qualify for retirement benefits upon reaching their age of eligibility. Family members of a deceased worker may qualify for survivor benefits with fewer than 40 credits earned depending on the worker’s age at death.

After accruing sufficient credits to qualify, benefits are calculated using several formulas. First, Social Security will calculate a beneficiary’s Average Indexed Monthly Earnings (AIME) using up to 35 years of earnings. Past years’ earnings are inflated to account for average wage growth over the beneficiary’s career and then averaged to compute the AIME amount. This calculation is typically based on a worker’s historical earnings upon turning 62, even if the worker is not applying for benefits at that age.

Based on the AIME, the Social Security retirement benefit can then be calculated. This is known as the primary insurance amount (PIA), and represents what the beneficiary would receive on a monthly basis if filing at their full retirement age (e.g., age 67 for those born in 1960 or later).⁸

What should a beneficiary know about applying for and receiving benefits?

As discussed above, a worker with 40 credits is entitled to receive a monthly benefit equal to his or her PIA at their full retirement age. A beneficiary’s full retirement age will depend on the year in which they were born, as summarized in the table to the right.

A beneficiary may choose to begin taking benefits as early as age 62 or may postpone taking their benefit until after their full retirement age. Taking benefits prior to full retirement will result in a reduced benefit of 6.67% per year for taking the benefit up to three years early and 5% for each year early in excess of three years. On the other hand, delaying taking benefits will increase the benefit by 8% for each year up to age 70. These increases are referred to as deferred retirement credits.

If a beneficiary files for Social Security retirement benefits at or after full retirement age, and continues to work, there would be no effect on benefits. However, for a beneficiary filing for benefits before full retirement age, continuing to work could reduce the amount they receive. This reduction is not a complete loss, as future benefits upon reaching full retirement age will be recalculated to account for any months that were subject to reduced payments.

What are the rules for receiving spousal benefits?

A spouse will typically be entitled to benefits based on the working spouse’s Social Security retirement benefits. Spousal benefits include a retirement benefit while the working spouse is living and a survivor’s benefit if the working spouse predeceases. These benefits and eligibility requirements are summarized below. A more detailed discussion, and strategies related to filing for spousal benefits, can be found in the Chief Investment Office Wealth Strategy Report: *Social Security Retirement Benefits—Married Couples*.

To be eligible for Social Security spousal retirement benefits, the couple must be married for at least one year, and the working spouse must have filed for his or her benefits. Generally, a spouse claiming at full retirement age would be entitled to 50% of the working spouse’s PIA; the spouse is not penalized for the working spouse filing early, nor will they benefit if the working spouse delays filing for benefits. This spousal benefit is reduced

Year of Birth	Full Retirement Age
1943-1954	66
1955	66 and 2 Months
1956	66 and 4 Months
1957	66 and 6 Months
1958	66 and 8 Months
1959	66 and 10 Months
1960 and later	67

⁸ For 2025, the PIA calculation is as follows: 90% of the first \$1,226 of the AIME, plus 32% of the AIME over \$1,226 through \$7,391, plus 15% of the AIME over \$7,391 up to \$14,675. The lower percentages for the higher levels of AIME are referred to as “bend points” and result in smaller increases in benefits for earnings exceeding the thresholds.

Finally, benefits paid based on a beneficiary’s work record are subject to a family maximum. This applies to retirement or survivor benefits being paid to the beneficiary (if living), spouse and eligible children. For 2025, this maximum is calculated as follows: 150% of the first \$1,567 of PIA, plus 272% of the PIA over \$1,567 through \$2,262, plus 134% of the PIA over \$2,262 through \$2,950, plus 175% of the PIA over \$2,950.

Whenever family members are concurrently receiving benefits based on a beneficiary’s record, the total monthly amount paid may not exceed this maximum. If the total benefits would exceed this maximum, each family member qualifying for a benefit, except for the worker, would have their benefit reduced equally to meet this cap.

dollar for dollar by any benefit the spouse receives based on his or her own work record. As with a worker's benefit, a spouse may claim a reduced spousal benefit as early as age 62, although an exception applies to a spouse caring for a child who is under age 16 or disabled, in which case a spousal retirement benefit equal to 50% of the retired worker's PIA may be claimed at any age without a reduction in the benefit.

For a surviving spouse to receive Social Security benefits based on a deceased spouse's record, the couple must have been married for at least nine months prior to the spouse's death. The survivor will typically be eligible for the deceased spouse's full benefit that he or she was receiving or would have received upon filing. Therefore, a worker's decision of when to begin taking benefits may affect the benefits a surviving spouse receives. For this reason, both the worker's and the spouse's life expectancies should be considered when deciding when to begin taking Social Security benefits. Generally a surviving spouse may opt to receive reduced benefits as early as age 60 (50 if disabled). However, a surviving spouse caring for a child of the deceased spouse under the age of 16 or disabled would be eligible for a benefit equal to 75% of the deceased spouse's PIA regardless of age.

Can a divorced spouse receive Social Security benefits from a former working spouse?

An ex-spouse is essentially entitled to the same spousal retirement and survivor benefits as a current spouse if they were married at least 10 years. Any benefits paid to an ex-spouse will not affect benefits paid to the beneficiary or other family members, including a current spouse, nor does it count toward the family maximum. Unlike the rule for a current spouse, a divorced spouse can apply for a spousal benefit even if the ex-spouse has not applied for retirement benefits. Remarriage will typically disqualify an ex-spouse from receiving spousal retirement benefits; however, survivor benefits may be paid to an ex-spouse who remarries after age 60.

Under what circumstances may a child receive benefits based on a parent's work history?

Minor or disabled children of a retired or deceased worker may also qualify for Social Security benefits. A child is considered a minor if under 18, or up to 19 years old if they're a full-time student in elementary or secondary school. A qualifying child of a retired worker is entitled to a benefit equal to 50% of the worker's PIA, while a child of a deceased parent is eligible for a benefit equal to 75% of the parent's PIA. When calculating the potential benefits payable to minor children, recall that for all benefits based on a single worker's record, the total received by the worker, the spouse and any children may not exceed the family maximum.

Are Social Security benefits subject to federal income tax?

Up to 85% of Social Security benefits may be subject to federal income tax, this includes retirement, survivor and disability benefits. SSI is not subject to income tax. Calculating the taxable amount of one's Social Security benefits requires a multistep calculation that is beyond the scope of this paper. However, the side bar provides some basic concepts related to Social Security benefit taxation.

SUMMARY

Social Security has evolved over the past several decades from a program to provide limited benefits for retired workers into the largest annual expenditure for the federal government. In addition to workers' retirement benefits, Social Security now provides benefits to the spouses and minor children of retired and deceased workers, as well as disability benefits to workers and their families.

Changing demographics, including longer life expectancies for retired workers and lower recent birthrates, have created an imbalance between benefit payments and funding of the Social Security retirement program. For now, the trust fund will make up the shortfall, and benefits will be paid in full. However, projections indicate that the trust fund will be fully depleted in about a decade. To help avoid a scenario in which beneficiaries receive only approximately 83% of their promised benefits, action should be taken soon. For workers and future beneficiaries, this could mean a combination of higher payroll taxes, older retirement ages and lower overall benefits.

- Taxation is computed based on "combined income": Adjusted Gross Income + Tax Exempt Interest + ½ of Social Security Benefits
- For individuals with combined income between \$25,000 and \$34,000, up to 50% of benefits may be taxable; for combined income levels greater than \$34,000, up to 85% may be taxable.
- For married taxpayers filing joint returns with combined income between \$32,000 and \$44,000, up to 50% of benefits may be taxable; for combined income levels greater than \$44,000, up to 85% may be taxable.

Note that these 50% and 85% thresholds are not adjusted annually for inflation.

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