2021 Wage Cap Rises Modestly for Social Security Payroll Taxes

Wages subject to Social Security FICA taxes will go to $142,800 from $137,700

By Stephen Miller, CEBS
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Starting Jan. 1, 2021, the maximum earnings subject to the Social Security payroll tax will increase by $5,100 to **$142,800**—up from the $137,700 maximum for 2020, the Social Security Administration (SSA) announced Oct. 13 (https://www.ssa.gov/news/press/releases/2020/#10-2020-1). The SSA also posted a fact sheet (https://www.ssa.gov/news/press/factsheets/colafacts2021.pdf) summarizing the 2021 changes.

The taxable wage cap is subject to an automatic cost of living adjustment (COLA) each year based on increases in the national average wage.

Payroll Taxes: Cap on Maximum Earnings		
Type of Payroll Tax	**2021 Maximum Earnings**	**2020 Maximum Earnings**
Social Security	$142,800	$137,700
Medicare	No limit	No limit
Source: Social Security Administration.		

FICA Rates

Social Security and Medicare payroll taxes are collected together as the Federal Insurance Contributions Act (FICA) tax. FICA tax rates are statutorily set and can only be changed through new tax law.

Social Security is financed by a 12.4 percent payroll tax on wages up to the taxable earnings cap, with half (6.2 percent) paid by workers and the other half paid by employers. Self-employed workers pay the entire 12.4 percent.

For employers and employees, the Medicare payroll tax rate is a matching 1.45 percent on all earnings (self-employed workers pay the full 2.9 percent), bringing the total Social Security and Medicare payroll withholding rate for employers and employees to 7.65 percent—with only the Social Security portion limited to the taxable maximum amount.

FICA Rate (Social Security + Medicare Withholding)	
Employee	7.65% (6.2% + 1.45%)

Employer	7.65% (6.2% + 1.45%)
Self-Employed	15.3% (12.4% + 2.9%)
Note: For employed wage earners, their Social Security portion is 6.2% on earnings up to the taxable maximum. Their Medicare portion is 1.45% on all earnings.	

Some Payroll Taxes Suspended Due to COVID-19

In response to the COVID-19 pandemic, relief was put into place affecting payroll withholding for Social Security FICA taxes in 2020.

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law in March and implemented through IRS Notice 2020-22 (https://www.irs.gov/pub/irs-drop/n-20-22.pdf) and a series of IRS FAQs (https://www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020), allows eligible employers to defer the deposit and payment of the *employer's* share of Social Security FICA taxes from March 27 through Dec. 31, 2020. The deferred payments must then be paid to the Treasury Department, with half due by Dec. 31, 2021, and the other half by Dec. 31, 2022.
- IRS Notice 2020-65 (https://www.irs.gov/pub/irs-drop/n-20-65.pdf), issued on Aug. 28, allows employers to suspend withholding and paying to the IRS eligible *employees'* Social Security payroll taxes. The payroll tax suspension period runs from Sept. 1 through Dec. 31, 2020 (www.shrm.org/ResourcesAndTools/hr-topics/compensation/Pages/IRS-Guidance-Workers-Payroll-Tax-Holiday.aspx), and applies only to employees whose wages are less than $4,000 for a biweekly pay period, including salaried workers earning less than $104,000 per year.

Companies that suspend withholding of employees' payroll tax would collect additional amounts from workers' paychecks from Jan. 1 through April 30, 2021, to repay the tax obligation. Only a small percentage of private-sector employers appear to have suspended employees' Social Security tax withholding, however.

Adjust Systems, Notify Employees

Employees whose compensation exceeds the current 2020 taxable earnings cap of $137,700 may notice a slight decrease in net take-home pay beginning next January due to the payroll tax adjustment.

By the start of the new year, U.S. employers should:

- Adjust their payroll systems to account for the higher taxable wage base under the Social Security payroll tax.
- Notify affected employees that more of their pay will be subject to payroll withholding.

Social Security Earnings Test COLA

Workers can start to collect Social Security retirement benefits as early as age 62, but their monthly payment will be lower than if they wait until their normal retirement age (https://www.ssa.gov/benefits/retirement/planner/ageincrease.html)—age 66 for people born in 1943 through 1954, for instance.

In addition, those who collect Social Security before their full retirement age but continue to earn income will have their monthly benefits reduced if their earnings exceed an annually adjusted earnings test limit:

- **For those collecting benefits in 2021 before their full retirement age,** SSA will deduct $1 from their monthly benefits for each $2 earned over $18,960 per year (or $1,580 per month), up from $18,240 per year (or $1,520 per month) in 2020.
- **For those reaching their full retirement age in 2021,** SSA will deduct $1 from their monthly benefits for each $3 earned over $50,520 per year (or $4,210 per month) until the month in which the worker reaches full retirement age, up from $48,600 per year (or $4,050 per month) in 2020.

There is no limit on earnings under this test for workers who have reach or passed their full retirement age for the entire year.

Social Security Benefits COLA

Monthly Social Security and Supplemental Security Income benefits for 64 million people in the U.S. will increase by 1.3 percent in 2021, the SSA also announced.

"The SSA calculates the percent change between average prices in the third quarter of the current year with the third quarter of the previous year; that's why the final number comes out in October (https://www.ajjcs.net/paper/main/2020/10/12/upcoming-2021-social-security-cola-2/)," according to A.J. Johnson Consulting Services. In addition, the SSA "ties its adjustment for Social Security benefits to the wage earners' consumer price index, which is similar to, but not the same as, the urban dwellers' consumer price index (which drives inflation reporting)."

The consultancy noted, "There have been three years (2010, 2011, and 2016) with no COLA increase. Since 2009, the average COLA has been 1.75 percent with the highest being 5.8 percent in 2009."