



Raising Medicare Taxes to Pay for Non-Medicare Benefits

In order to pay for their \$2.5 trillion-dollar health care bill, Senate Democrats would raise the Medicare payroll tax on American families earning more than \$250,000 (\$200,000 for individuals) to 3.4 percent. This new tax represents a fundamental change in how Medicare taxes have traditionally worked and makes a bad bill even worse.

- **Harms small business and kills jobs:** Because many small businesses pay taxes at the individual level, imposing higher individual income taxes hurts these engines of job creation. Sixty-seven percent of tax filers who earn more than \$200,000 a year report business incomeⁱ – each new dollar of tax raised from these people provides a disincentive to invest in businesses that innovate and create jobs. The Joint Committee on Taxation recently estimated that one-third of the income that would be taxed under a similar House proposal comes from small businesses.ⁱⁱ
- **Raises Medicare taxes to pay for non-Medicare benefits:** Democrats are, for the first time, breaking the link between the Medicare tax base and Medicare benefits. Using dedicated revenues to defray the cost of new entitlement programs sets a dangerous precedent that can be used to fund any number of new federal programs in the future. As the Wall Street Journal pointed out, this new tax would “sever the link between the tax paid over a lifetime and the medical benefits received, officially making Medicare an income redistribution program.”ⁱⁱⁱ Democrats have traditionally opposed breaking this link; the late Democratic Senator Daniel Patrick Moynihan defended the link between payroll taxes and benefits received when he said, “...we refer to them as taxes, as payroll taxes, and yet they are not taxes. They are payments, payments into an insurance fund.”^{iv}
- **Introduces a new marriage penalty:** Under the Democrats’ bill, two people earning \$130,000 each would suddenly get hit by the new tax simply by getting married. This would introduce a marriage penalty into the payroll tax system for the first time.
- **Will act as a new Alternative Minimum Tax:** Because the \$250,000/\$200,000 thresholds are not indexed for inflation, this new payroll tax will hit more and more Americans each year as inflation drives up their wages. Much like the Alternative Minimum Tax, this will creep further down into the middle class until Congress is forced to protect people who were never intended targets of the tax, gutting a key provision that makes this bill appear to improve the deficit.
- **Does not fully finance health care shortfalls:** According to Bloomberg News, House Democrats rejected the new payroll tax proposal adopted by Senate Democrats “because lawmakers concluded they may need to increase the payroll tax in the future to pay Medicare benefits that are projected to outpace revenue.”^v Even with this tax increase, the bill falls far short of paying for itself or achieving solvency in the Medicare program. The *New York Times* pointed out that “the higher payroll tax would not be sufficient in the long run. Payroll tax revenues generally grow with payroll, which is expected to increase more slowly than health costs.”^{vi} Given that the Medicare Part A trust fund is insolvent, how long before Democrats raise the rate or lower the threshold on this new tax to fix the Part A shortfall?
- **Breaks another of President Obama’s pledges:** Candidate Obama promised that “Everyone in America -- everyone -- will pay lower taxes than they would under the rates Bill Clinton had in the 1990s.”^{vii} Under President Obama’s budget proposal, this additional payroll tax increase will raise taxes on many Americans higher than they were under the rates Bill Clinton had in the 1990s. Under the President’s budget, in 2011, taxes for families earning more than \$250,000 are already going back to the level they were when Bill Clinton left office. This additional tax increase will push them over the top.

ⁱ The Tax Foundation, “The Effect of the Presidential Candidates’ Tax Plans on Flow-Through Business,” October 2008.

ⁱⁱ In a letter to the Senate Finance Committee dated November 3, 2009, JCT wrote that the proposal for a 5.4 percent surtax on income over \$500,000 (\$1 million for couples) would raise 1/3 of the revenue from small business income.

ⁱⁱⁱ Wall Street Journal, “A Tax a Day,” November 16, 2009.

^{iv} Daniel Patrick Moynihan, "Removing Social Security from the Budget," Congressional Record, Vol. S14753, October 9, 1990.

^v Bloomberg, “Orszag Expects Health Bill to be Completed This Year,” November 12, 2009.

^{vi} *New York Times*, “Reid Mulls Medicare Taxes for High Earners,” November 13, 2009.

^{vii} Peter Cohn, “Health Surtax Plan Might Push Rates Past Obama Pledge,” [CongressDaily](#), July 14, 2009.