The "ObamaCare" Tax Hike and Redistribution

By John Miller

"ObamaCare's Worst Tax"

Opponents [of ObamaCare] should go down swinging, and that means exposing such policy debacles as President Obama's 11th-hour decision to apply the 2.9% Medicare payroll tax to "unearned income."

That's what savings and investment income are called in Washington, and this destructive tax wasn't in either the House or Senate bills, though it may now become law with almost no scrutiny.

For the first time, the combined employer-worker Medicare rate would be extended beyond wages to interest, dividends, capital gains, annuities, royalties and rents for individuals with adjusted gross income above $200,000 and joint filers over $250,000.

Earning even a single dollar more than $200,000 in adjusted gross income will slap the tax on every dollar of a taxpayer's investment income, creating a huge marginal-rate spike that will most hurt middle-class earners, as opposed to the superrich.

—*Wall Street Journal* editorial, March 17, 2010

There are plenty of legitimate complaints about "ObamaCare," but its tax hike on unearned income is surely not one of them.

The tax does take a bite out of the income of the rich. It adds 0.9 percentage points to the current hospital insurance tax on most wage-income above $200,000. It also levies a 3.8% tax on investment income, e.g. dividends and capital gains. Only the richest 5% of taxpayers, with 2009 incomes above $231,179, will pay the new tax. And the richest 1%, with incomes in excess of $624,396 in 2009, will pay 85% of the tax hike.

That is a good thing. But the new tax hardly constitutes soaking the rich. Even after the tax, the rich will hand over a smaller portion of their income in federal income taxes than they did before three decades of pro-rich tax cutting. According to the Tax Policy Center, the new tax would push up the tax burden of the richest one percent by 1.3 percentage points, to 33.6% of their income, still well below their 37.0% effective tax rate in 1979. In any case, the rich can surely afford it. The income of the top 1% roughly doubled from 1979 to 2009, even after correcting for inflation.

Beyond that, the new tax was a compromise. It replaced the 5.4% tax on income above $1 million in the House healthcare bill. That tax would have been paid exclusively by the richest 1%. Also the new tax postponed the start date for the excise tax on high-cost healthcare plans in the Senate bill, but didn't eliminate it. When it goes into effect in 2018, the tax on "Cadillac" healthcare plans will fall mostly on better-off households, but nonetheless will collect one-third of its taxes from individuals who currently have incomes between $50,000 and $100,000.

What really has the *WSJ* editors in a lather is levying hospital insurance taxes onto non-wage income, or unearned income. They claim that middle-income taxpayers, not the super-rich, will ultimately bear the burden of the tax. Why? Because by taxing savings and investment income, the new tax will put a stopper in "trickle-down economic growth" (not that we have seen much trickling down over recent decades).

But economic evidence suggests otherwise. First, unearned income is not the same thing as savings and investment. Take stock-trading, the source of most capital gains. From 1998 to 2007, $27 in stocks was traded on the U.S exchanges for very dollar corporations invested in plant and equipment, according to a recent study by economists Robert Pollin and Dean Baker. The bulk of the gains of financial investors, therefore, comes from trading existing assets, not financing investment in new assets. Second, there is no solid evidence that lower taxes on unearned income do much to spur economic growth. Economist Joel Selmrod, director of the office of Tax Policy Research at the University of Michigan, reports: " I know of no evidence that establishes a connection between prosperity and the rate we tax capital gains." Finally, the editors fail to take into account that the new tax hike will go to expand health insurance coverage for families with incomes below four times the poverty level.

Health care reform surely could have done more to redistribute income and economic power, by squeezing out private insurers' massive overhead costs and profits, and relying on the House tax on income over $1 million. But even as is, ObamaCare should do more than any legislation in many years to help generate the bottom-up economic growth that could replace the "trickle-down" economic growth that has rewarded so few with so much. D&S

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Sources: David Leonhardt, "In Health Bill, Obama Attacks Wealth Inequality," *New York Times*, March 23, 2010; Robert Pollin and Dean Baker, "Public Investment, Industrial Policy, and U.S. Economic Renewal," Political Economy Research Institute, December 2009; Tax Policy Center, "The Medicare Tax as Proposed in H.R. 3590 (Senate Health Bill) and H.R 48723 (Reconciliation Act of 2010)," March 19, 2010.