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INCREASING MEDICARE TAX ON HIGH-WAGE EARNERS COULD HELP PAY FOR HEALTH REFORM AND STRENGTHEN MEDICARE'S FINANCES

By Paul N. Van de Water

Increasing the Medicare payroll tax on high-wage earners would represent a sound and well-targeted way of paying for health reform. It would also improve the solvency of Medicare's Hospital Insurance (HI) trust fund and thereby strengthen this critical program, which provides health coverage for 46 million seniors and persons with disabilities.

Hospital Insurance benefits in Medicare are funded primarily by payroll taxes on wages and self-employment income. Workers and employers each pay a flat 1.45 percent of wages, for a total of 2.9 percent. Unlike Social Security taxes, which are not imposed on earnings above a set level, Medicare taxes are collected on workers' entire earnings. Although half of the tax is nominally paid by employers, most economists believe that employees ultimately pay the employer share as well through lower wages than they otherwise would receive. Self-employed workers pay the entire 2.9 percent tax but are allowed to deduct half of this amount for income tax purposes.

According to media reports, an increase in the payroll tax on high-wage earners is being considered in the Senate as a source of funding for health reform.¹ The proposal under review would increase the employee share of the payroll tax by 0.3 to 0.5 percentage points. The additional tax would apply only to wage and self-employment income over \$200,000 for individuals and over \$250,000 for married couples.

The proposal has much to recommend it:

- Additional revenues are essential for crafting a health reform bill that provides adequate tax credits to make health coverage affordable to low- and moderate-income families, requires people to have insurance, and avoids adding to the federal deficit. President Obama has made clear that health reform must be fully paid for. By one estimate, a 0.5 percentage point increase in the employee share of the Medicare tax would raise \$54 billion over ten years.

¹ Martin Vaughan, "Senate Eyes Medicare Tax Hike for Health Bill," *Dow Jones Newswire*, November 12, 2009.

- The proposal would target those best able to pay. Although distributional estimates are not available, the proposal is likely to affect only those in the top 5 percent of the income distribution. These very high-income households have prospered in recent decades. Between 1979 and 2006 (the most recent year for which data are available), the before-tax income of the top 5 percent of households increased by 143 percent, on average (after adjusting for inflation), compared to an increase of just 15 percent for families in the middle fifth of the income spectrum.²
- Raising the Medicare payroll tax would extend the life of Medicare’s Hospital Insurance trust fund. Under current law, the HI trust fund is projected to become insolvent in 2017. Along with the other Medicare changes in the pending legislation, this proposal would likely push back the date of insolvency by at least four to five years.

A modest increase in the Medicare payroll tax for high earners would thus represent a reasonable way to pay for needed improvements to the Senate’s health reform bill. As other Center analyses explain, the premium credits in the Finance Committee’s bill need to be strengthened to provide people of modest means with sufficient help to make coverage affordable, an improvement that also could enable the mandate for people to have insurance to be strengthened.³ Otherwise, the new health insurance exchanges could be faced with a sicker-than-average pool of beneficiaries, which would push up insurance premiums and could threaten the ability of the exchanges to function effectively. A modest increase in the Medicare payroll tax for high earners could be a sound supplement to the Senate Finance Committee bill’s excise tax on very high-cost insurance policies, an important measure that both raises revenue to help pay for health reform and can help moderate health care cost growth.⁴

² Congressional Budget Office, “Data on the Distribution of Federal Taxes and Household Income,” April 2009.

³ January Angeles and Judith Solomon, *Finance Committee Health Reform Bill Makes Improvements, But Still Falls Short of What Is Needed for Many People to Afford Health Care*, Center on Budget and Policy Priorities, October 13, 2009.

⁴ Paul N. Van de Water, *Excise Tax on Very High-Cost Health Plans Is a Sound Element of Health Reform*, Center on Budget and Policy Priorities, November 10, 2009