ObamaCare's Worst Tax Hike

For the first time, payroll levies will hit investment income.

The forced march to pass ObamaCare continues, and all that matters now is raw politics. But opponents 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 2.9% 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.

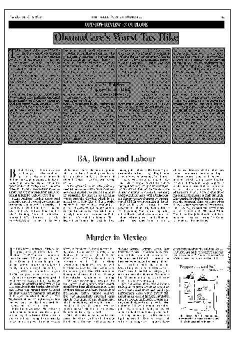
That would lift the top capital-gains rate in the U.S. to 22.9% as the regular rate bounces back to 20% from 15% when the Bush tax cuts expire at the end of this year. The top rate for dividends would rise to 42.5% when the Bush income-tax rates expire. The White House plan also raises the ordinary Medicare payroll tax by 0.9 percentage points for the same filers, bringing it to 3.8%.

Preliminary estimates from the Joint Committee on Taxation peg the revenue from these changes at $183.6 billion over 10 years. The Tax Policy Center of the Urban Institute and Brookings Institution estimates that 86% of the revenue from the investment tax would come from people making more than $624,000, or about 1.2 million Americans. This has led many liberals to claim that it won't matter to investors or harm the economy.

Yet these static analyses ignore the incentive effects forecast by the Institute for Research on the Economics of Taxation. Stephen Entin and colleagues estimates that the investment tax would depress GDP by about 1.3% and reduce capital formation by 3.4%, and thus reduce the after-tax incomes of everyone not paying the tax directly in the neighborhood of 1.1% to 1.2%. Labor productivity and wages would fall across the board, while the lost government revenues from the more-sluggish economy would offset the expected receipts.

Earning even a single dollar more than $200,000 in adjusted gross income will slap the 2.9% 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.

This two-tier tax also fundamentally and probably irrevocably alters the social insurance model that has governed Medicare for more than a half-century. Medicare is supposed to be a universal entitlement with at least some connection between the taxes paid on wages in return for benefits. The investment tax, and the apparatus of ObamaCare financing more generally, severs this link by redirecting



Medicare's "dedicated" revenues toward a new entitlement. Even Bill Clinton didn't cross this policy threshold in the health debate of the early 1990s, proposing to fund HillaryCare entirely through new corporate taxes and preserving Medicare as its own discrete program.

Mr. Obama gave a preview of the fiscal confusion this creates at a Wednesday campaign stop in St. Charles. Shortly after accusing his critics of being "just plain wrong" about everything, he went on to boast that "we're going to be able to help ensure Medicare's solvency for an additional decade" and also "reduce the deficit by a trillion dollars."

Yet his claims are just plain wrong, as already exposed by the Congressional Budget Office. The government can't spend the same Medicare dollar twice: Either it can reduce the deficit or extend the life of Medicare, but not both. this may seem an arcane point, but the White House obviously knows better and yet continues to peddle this falsehood.

The White House has embraced this investment tax because Big Labor opposed its preferred excise tax on high-cost health plans. So the White House decided to delay the excise tax, which meant losing $116.2 billion in revenue over the first 10 years. Voila, out came the 2.9% investment tax.

So for reasons of political expediency, Democrats will now impose a destructive tax that will permanently skew the incentives to work, save and create jobs. Come to think of it, that sums up this entire exercise.