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ObamaCare's Tax on Work

Middle-income families will face a big marginal rate increase.

None of the new distortions that the Senate health-care bill will layer onto the already-distorted tax code have received the attention they deserve, but in particular its effects on marginal tax rates could use scrutiny. Incredibly, for those with lower incomes, ObamaCare will impose a penalty as high as 34% on . . . work.

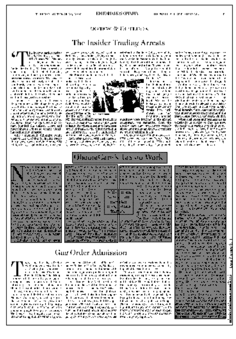
Central to Max Baucus's plan—assuming the public option stays dead—is an insurance "exchange," through which individuals and families could choose from a menu of standardized policies offered at heavily subsidized rates, provided that their employers do not offer coverage. The subsidies are distributed on a sliding scale based on income, and according to the Congressional Budget Office 23 million people will participate a decade from now, at a cost to taxpayers of some $461 billion.

Think about a family of four earning $42,000 in 2016, which is between 150% and 200% of the federal poverty level. CBO says a mid-level "silver" plan will cost about $14,700 in premiums, of which the family will pay $2,600—since the government would pay the other $12,100. If the family breadwinner (or breadwinners, because the subsidies are based on combined gross income) then gets a raise or works overtime and wages rise to $54,000, the subsidy drops to $9,900. That amounts to an implicit 34% tax on each additional dollar of income.

Or consider a single worker earning $20,600 and buying an individual "silver" policy with a premium at $5,000. Again according to CBO, if his income rises to $26,500, his subsidy plummets to $2,700 from $4,400 (including a cost-sharing subsidy that goes away). This is a 29% marginal tax; moving to other income levels yields increases in the neighborhood of 20% to 23% for both individuals and families. Jim Capretta, a fellow at the Ethics and Public Policy Center, calculates that when combined with other policies like the Earned Income Tax Credit that also phase out, the effective marginal rate would rise to nearly 70% at twice the poverty level.

The incentives for low-wage workers are especially perverse. The exchanges give them a huge break and then take it away gradually as their income goes up. Usually such phase-outs are used to make sure "the rich" don't benefit from IRS dispensations, but here they will have a giant effect on decisions about whether and how much to work, since each additional hour worked reduces the subsidy.

As CBO noted in a July health brief,



"Higher [marginal] tax rates also reduce people's incentive to raise their income in other ways, such as working harder in the hope of winning raises; accepting new positions or responsibilities with higher compensation; or investing in their future earning capacity through education, training or other means." This disincentive effect will be especially hard on workers in the middle of their careers and who may not see the same potential for upward mobility as younger workers, but who could earn more through work and effort.

These marginal rate "cliffs" are also a sneaky way for Congress to lower the "scorable" cost of the bill without appearing to do so, because diminishing these rate hikes would boost the total cost of the subsidy. For the same reason, the subsidy is only extended to certain favored people, making it deeply unfair to those not allowed into the exchanges. Families earning identical amounts of money could pay wildly different taxes—a family earning $42,000 and getting insurance through an employer wouldn't receive close to $12,100 from the current tax exclusion for employer-sponsored coverage—while some families earning more money than others will pay significantly lower taxes.

This is an equity catastrophe waiting to happen—and senior Democrats know it. They're laying a political booby-trap that will transfer even more health spending to government after ObamaCare passes.

A far better and cleaner alternative would be to extend the same tax exclusions to individuals that employees receive if they get coverage from their employers. The current bias for one type of insurance has persisted for decades despite its unfairness and irrationality. But ObamaCare will keep all that, while in the process creating many new problems.