CTJ Citizens for Tax Justice

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# Two Proposals to Pay for Health Care Reform without Hurting Struggling Families in Florida

### Expanding the Medicare Tax or Limiting the Benefits of Itemized Deductions Can Make the Tax Code Fairer and Help Finance Health Care Reform

Health care reform can save us all money in the long-run by bringing all Americans into the health insurance system and rooting out the inefficiencies that drive up costs. But to make that happen, Congress will first need to raise revenue to finance an overhauled health care system.

There are several ways to raise this revenue that would not hurt working families in Florida or in any other state. One is to make the Medicare tax a more progressive tax that investors pay just like everyone else. Another is to limit, as President Obama has proposed, the value of itemized deductions, which currently benefit rich families more than middle-income families.

If Congress enacts the Medicare tax expansion described here, the richest one percent of taxpayers in Florida would have an average tax increase of $31,280 while the middle fifth of taxpayers would have an average tax increase of just $33.

If Congress instead enacts the President's proposal to limit itemized deductions for the wealthy, the richest one percent of Florida taxpayers will have an average tax increase of $12,991 while the middle fifth of taxpayers will have no tax increase at all.

## Proposal 1: Make the Medicare Tax Fairer

### Problem: We Have a Tax to Fund Health (the Medicare Tax) But Paris Hilton Is Exempt!

The Medicare payroll tax is the one important tax we already have that is dedicated to funding health care, but it completely exempts wealthy investors whose income takes the form of capital gains, stock dividends, and interest. Someone who does not have to work because she owns a lot of stocks or other assets and receives capital gains, dividends and interest currently pays no Medicare tax whatsoever.

**Expanding the Medicare Tax to Cover Unearned Income and Add Higher Rate for the Rich, Impact in 2011 in Florida**

| Income Group | Average Income | Average Tax Increase | Share of Tax Increase |
|---|---|---|---|
| **Lowest 20%** | $ 10,812 | $ 6 | 0.3% |
| **Second 20%** | 23,166 | 14 | 0.6% |
| **Middle 20%** | 37,078 | 33 | 1.5% |
| **Fourth 20%** | 60,383 | 73 | 3.3% |
| **Next 15%** | 110,607 | 211 | 7.2% |
| **Next 4%** | 281,370 | 1,719 | 15.7% |
| **Top 1%** | 2,054,298 | 31,280 | 71.3% |
| **ALL** | **$ 73,878** | **$ 434** | **100.0%** |
| **Bottom 60%** | $ 23,694 | $ 18 | 2.4% |

Source: ITEP Microsimulation Model, July 2009

The Medicare payroll tax is levied at a flat rate of 2.9 percent on all wages and salaries. Technically, half is paid by the employee and half is paid by the employer (but most economists think that the employee ultimately pays the employer portion as well through reduced wages).

**Solution: Make the Medicare Tax a More Progressive Tax that Investors Pay Just Like Us**

The Medicare tax can be improved with a few simple steps that have been formulated by Citizens for Tax Justice (CTJ) and endorsed by Health Care for America Now (HCAN). First, the individual portion of the Medicare tax (the 1.45 percent tax currently paid by employees) can be extended to cover unearned income (investment income) like capital gains and stock dividends in addition to earnings.

Second, the individual portion of the Medicare tax (which would now cover both earnings and investment income) can be made progressive by introducing a higher rate of 2.5 percent that applies to the earned and unearned income above $200,000 (or $250,000 for married couples). The employer portion of the Medicare tax would not be changed.

Third, to prevent a tax increase on moderate-income seniors, the expanded Medicare tax can exempt the first $50,000 of investment income for seniors (or $100,000 for married seniors).

**How Much Revenue would This Raise to Pay for Health Care and Who would Pay It?**

The proposal outlined here would raise $40.5 billion in revenue in 2011 and around $500 billion over a decade, without disproportionately impacting families that are currently struggling to obtain health care and other necessities.

If Congress enacted this proposal, most Americans would either see no tax increase at all or would see a tax increase of less than $100 a year. That's because the proposal mainly targets unearned income (investment income), and the vast majority of investment income is received by the richest Americans.

As a result, about 71 percent of the resulting tax increase for Florida taxpayers would be paid by the richest one percent of the state's taxpayers. About 87 percent would be paid by the richest five percent of the state's taxpayers.

This proposal would also have little impact on seniors. Most Social Security benefits are already exempt from taxes, and this proposal would not change that. In addition, the exclusion for investment income for seniors ($50,000 for singles and $100,000 for married couples) would be more than adequate to shield the vast majority of seniors from a tax increase.

# Proposal 2: Limit Itemized Deductions for Rich Families

**Problem: Itemized Deductions Subsidize Activities at Higher Rates for High-Income People**

Itemized deductions provide subsidies for certain activities (like buying a home or giving to charity) through the tax system. But they unfairly subsidize these activities at higher rates for wealthy families than they do for middle-income families.

People filing their federal income taxes are allowed deductions to lower their taxable income. They can either take a "standard deduction" or choose to "itemize" their deductions. Most people take the standard deduction, but well-off families typically itemize.

**President's Proposal to Limit Benefit of Itemized Deductions to the Wealthy to 28 Percent, Impact in 2011 in Florida**

| Income Group | Average Income | Average Tax Increase | Share of Tax Increase |
|---|---|---|---|
| **Lowest 20%** | $ 10,812 | $ — | — |
| **Second 20%** | 23,166 | — | — |
| **Middle 20%** | 37,078 | — | — |
| **Fourth 20%** | 60,383 | — | — |
| **Next 15%** | 110,607 | 5 | 0.5% |
| **Next 4%** | 281,370 | 552 | 14.5% |
| **Top 1%** | 2,054,298 | 12,991 | 84.9% |
| **ALL** | **$ 73,878** | **$ 151** | **100.0%** |
| **Bottom 60%** | $ 23,694 | $ — | 0.0% |

Source: ITEP Microsimulation Model, July 2009

The income tax allows you to take an itemized deduction for interest you paid during the year on a home mortgage, for charitable donations you made during the year, for state and local taxes you've paid, and for several other expenses.

The problem is that itemized deductions subsidize certain activities at a higher rate for high-income taxpayers. For example, the itemized deduction for home mortgage interest is supposed to encourage home ownership, but it does so in an outrageously unfair manner. Someone rich enough to be in the 39.6 percent income tax bracket will save almost 40 cents for each dollar they spend on mortgage interest.

A middle-income family might be in the 15 percent tax bracket. This family will save only 15 cents for each dollar they spend on mortgage interest.

If a member of Congress proposed a program to encourage home ownership through direct subsidies, with larger subsidies going to rich families than middle-income families, we would say that's absurd. But that's exactly how the itemized deductions work.

**Solution: President Obama Would Limit Tax Savings to 28% of Itemized Deductions**

The President would reduce, but not eliminate, this disparity by limiting the savings for each dollar of deductions to 28 cents. So someone in the 39.6 percent tax bracket would save 28 cents (instead of nearly 40 cents) for each dollar of itemized deductions. That's still more than the family in the 15 percent bracket would save, but the difference would be reduced.

**How Much Revenue would This Raise to Pay for Health Care and Who would Pay It?**

The President's proposal to limit the benefits of itemized deductions for high-income people would raise over $20 billion in 2011 and over $260 billion over ten years, without impacting the vast majority of Americans at all.

Only 1.8 percent of Florida taxpayers would be impacted in any way. As a result, about 85 percent of the resulting tax increase for Florida taxpayers would be paid by the richest one percent of the state's taxpayers. About 99 percent would be paid by the richest five percent of the state's taxpayers.

**Misinformation about the Impact on Charities**

Some lawmakers have expressed concern that this proposal would hurt non-profits because it would reduce the tax subsidy for charitable donations by wealthy taxpayers. But a recent report from the Center on Budget and Policy Priorities concludes that this proposal would only reduce charitable giving by around 1.9 percent.

That's partly because only a small group of wealthy taxpayers are affected, and they only account for a fraction of the total charitable giving (about 17 percent) in the United States. Using previous studies on the way tax rates impact charitable giving, they estimate that this fraction of charitable giving will be reduced somewhat, but the overall impact on donations will be a reduction of only 1.9 percent.

The report also points out that non-profits could gain enormously if Congress uses this proposal to fund reform of the health care system, making it easier for non-profits and other entities to make sure their employees have adequate coverage.