



# New ACA Medicare Payroll Tax Hits Massachusetts, \$1.7 Billion Over 10 Years

## The Impact of the Affordable Care Act's Additional Medicare Tax

by Josh Archambault and Sadat Donkor

### Introduction

The financing provisions of the Affordable Care Act (ACA), levy 20 new taxes. The purpose of this report is to estimate the annual impact of one of these taxes: the law's additional 0.9 percent Medicare payroll tax – a 62 percent increase – on residents who trigger the new tax by making more than the wage threshold set in the ACA.

The additional Medicare tax should be of particular interest to Massachusetts citizens and policymakers because the Commonwealth maintains a higher average income than most other states in the country. As a result, a disproportionate share of the tax revenue raised will come from the wallets of citizens of the Bay State, when compared to other states.

Pioneer Institute estimates that every year taxpayers will be sending the federal government in Washington, D.C. an additional \$165,550,909 to help finance the ACA due to this one tax. This translates into approximately \$1,655,509,087 over 10 years.

For illustration, Pioneer also calculated the impact of this additional Medicare tax on the top ten highest paid athletes (plus Gisele Bündchen) in Massachusetts. If the players receive their full wages as described by *Boston Business Journal*, these athletes combined will pay close to \$1,500,000 a year, and \$15,000,000 over 10 years.<sup>1</sup> Tom Brady and Gisele Bündchen will pay roughly \$526,950 this year alone, due to this one new ACA tax.

The ACA also includes an additional Medicare tax on net investment income, a first in our nation's history, of 3.8 percent on interest, dividends, capital gains, rental income, royalty income, and passive activity businesses.<sup>2</sup> An analysis of the impact of this larger tax on Massachusetts residents is difficult to calculate given the incomplete data available at the Massachusetts Department of Revenue and the Internal Revenue Service; additional research is needed.

This brief is part of an occasional series from Pioneer Institute examining the direct effects of the ACA on Massachusetts. Please see the end of the paper for more examples.

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### **Keys Facts on ACA’s Additional Medicare Tax**

Starting in tax year 2013, the federal government will, for the first time, require all employers to withhold an additional 0.9 percent in Medicare payroll tax (increasing the tax rate from the current 1.45 percent to a permanent 2.35 percent). Unlike “basic” Medicare taxes, this additional tax is paid solely by the employee. However, the tax will only be levied on those whose modified adjusted gross income (MAGI) exceeds:

- \$250,000 for married taxpayers filing jointly
- \$125,000 for married taxpayers filing separately
- \$200,000 for individual returns
- \$200,000 for head of household (with qualifying persons)
- \$200,000 for widow(er)

### **Calculating the Additional Medicare Tax’s Impact on Massachusetts**

The Pioneer Institute requested the following information from the Massachusetts Department of Revenue (DOR):

1. The number of **joint returns** received reporting wages of \$250,000 per year or more.

2. The number of **married but filing separate** returns received reporting wages of \$125,000 per year or more.
3. The number of **individual returns** received reporting wages of \$200,000 or more.

The DOR provided the number of residents who made over the income threshold in 2010 (the most current available data) and how much aggregate income they reported that year for each category. Based on this information, Pioneer multiplied the number of residents in each category by the income threshold for each and subtracted that number from the aggregate reported income to obtain the income that would be subject to the additional tax. Pioneer then multiplied the remaining income by .9% to estimate the annual impact of the ACA’s additional Medicare tax.

Pioneer Institute estimates that every year taxpayers will be sending the federal government in Washington, D.C. an additional \$165.6M to help finance the ACA. This translates into approximately \$1,655,509,087 over 10 years.

**Table 1. Impact of Federal Health Law’s New Medicare Tax on Massachusetts Residents**

	# of Taxpayers	State Income Reported	Taxable Income Over \$200,000	Additional Tax Liability
Single Filers: \$200,000 and Up	8,012	\$3,153,488,953	\$1,551,088,953	\$13,959,801
Joint Filers: \$250,000 and Up	59,004	\$30,782,142,369	\$16,031,142,369	\$144,280,281
Separate Filers: \$125,000 and Up	2,603	\$816,478,141	\$491,103,141	\$4,419,928
Head of Household Filers: \$200,000 and Up	1,816	\$684,410,952	\$321,210,952	\$2,890,899
<b>Total Annual Additional .9% Medicare Tax</b>				<b>\$165,550,909</b>

Source: Massachusetts Department of Revenue and author’s calculations.

## Limitations

The estimate should be read with the following caveats. First, DOR was unable to provide 2011 or 2012 data, so Pioneer has assumed no change in the method by which citizens file their taxes year to year. In addition, economic changes and changes in individuals’ relationship status could impact the estimate in future years.

Second, DOR has made it clear that the methodology for calculating income currently utilized by the state for individuals is slightly different from the methodology (MAGI) proposed under ACA. However, the agency was unable to fully explain how the changes will impact the number of filers in each category.

The agency also informed Pioneer that they believe the level of income reported to DOR currently will be lower when compared to the new federal MAGI standard. In an e-mail the agency said, “In general we believe the MA wages from tax returns are smaller than wages (Medicare wages) on (sic) Affordable Care Act Tax.” In other words, if the Medicare tax is applied to the higher federal income standard, then the impact on Massachusetts residents will be even higher than calculated here.

## More Information on the Additional Medicare Tax

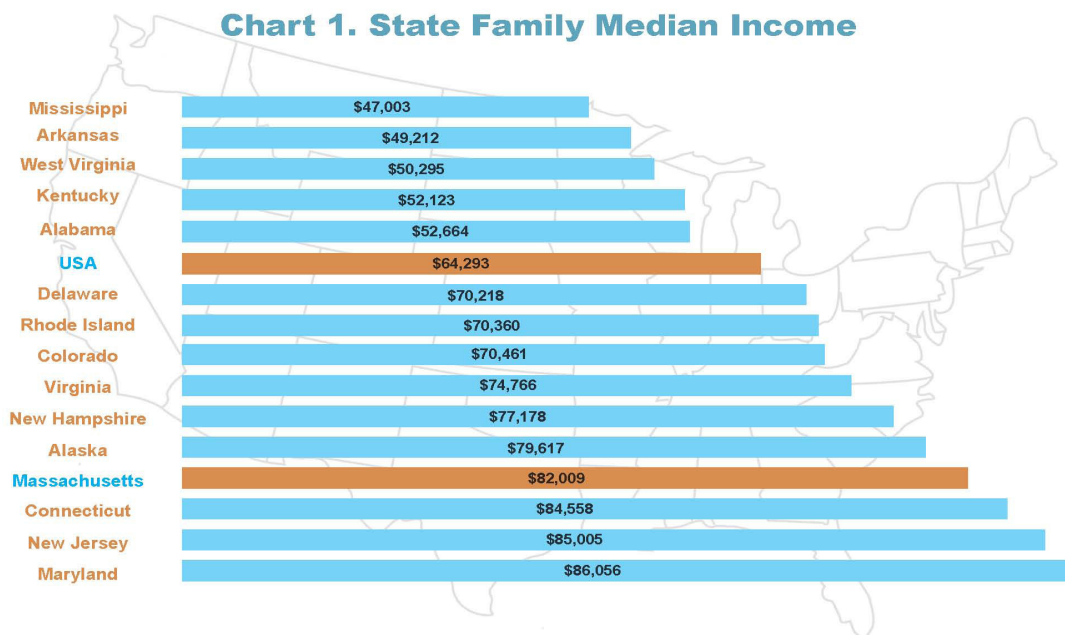
### *Estimated Direct Impact on Taxpayers*

Overall, Massachusetts is a higher-income state. According to the U.S. Department of Commerce, Massachusetts has a median family income of \$82,009 compared to that of \$64,293 nationwide (128 percent higher than the average).<sup>4</sup> The Bay State is fourth to Maryland (\$86,056), New Jersey (\$85,005), and Connecticut (\$84,558) as the state with the highest median family income.

### *Statutory Language*

As indicated in section 9015 and amended by section 10906 of ACA, individuals subject to the additional Medicare tax will calculate .9% tax liability on their individual income tax returns (Form 1040). Those subject to this tax will also report the amount withheld by their employers on their individual tax returns.

Questions over the complicated nature of implementation of this tax resulted in the Internal Revenue Service (IRS) issuing an almost 50-question Frequently Asked Questions (FAQ) document to clear up some of the confusion.<sup>5</sup>



Source: U.S. Census Bureau

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The IRS document indicates that it is important for employers and employees to stay in constant communication about how much tax is being withheld and how much should be self-reported. In other words, both employers and employees will play an active role in reporting the amount of tax due under different employment situations.

For example, question 8 from the FAQ illustrates this challenge:

### **Will Additional Medicare Tax be withheld from an individual's wages?**

An employer must withhold Additional Medicare Tax from wages it pays to an individual in excess of \$200,000 in a calendar year, without regard to the individual's filing status or wages paid by another employer. An individual may owe more than the amount withheld by the employer, depending on the individual's filing status, wages, compensation, and self-employment income. In that case, the individual should make estimated tax payments and/or request additional income tax withholding using Form W-4, Employee's Withholding Allowance Certificate.

Question 30 also highlights further specifications:

### **I have two employees who are married to each other. Each earns \$150,000, so I know that their combined wages will exceed the threshold applicable to married couples that file jointly. Do I need to withhold Additional Medicare tax?**

No. An employer should not combine wages it pays to two employees to determine whether to withhold Additional Medicare Tax. An employer is required to withhold Additional Medicare Tax only when it pays wages in excess of \$200,000 in a calendar year to an employee.

And question 19 highlights the challenge of combining self-employment with employer-based employment:

### **How do individuals calculate Additional Medicare Tax if they have wages subject to Federal Insurance Contributions Act (FICA)**

### **tax and self-employment income subject to Self-Employment Contributions Act (SECA) tax?**

Individuals with wages subject to FICA tax and self-employment income subject to SECA tax calculate their liabilities for Additional Medicare Tax in three steps:

Step 1 Calculate Additional Medicare Tax on any wages in excess of the applicable threshold for the filing status, without regard to whether any tax was withheld.

Step 2 Reduce the applicable threshold for the filing status by the total amount of Medicare wages received - but not below zero.

Step 3 Calculate Additional Medicare Tax on any self-employment income in excess of the reduced threshold.

*Example 1:* C, a single filer, has \$130,000 in wages and \$145,000 in self-employment income.

1. C's wages are not in excess of the \$200,000 threshold for single filers, so C is not liable for Additional Medicare Tax on these wages.

2. Before calculating the Additional Medicare Tax on self-employment income, the \$200,000 threshold for single filers is reduced by C's \$130,000 in wages, resulting in a reduced self-employment income threshold of \$70,000.

3. C is liable to pay Additional Medicare Tax on \$75,000 of self-employment income (\$145,000 in self-employment income minus the reduced threshold of \$70,000).

*Example 2:* D and E are married and file jointly. D has \$150,000 in wages and E has \$175,000 in self-employment income.

1. D's wages are not in excess of the \$250,000 threshold for joint filers, so D and E are not liable for Additional Medicare Tax on D's wages.

2. Before calculating the Additional Medicare Tax on E's self-employment income, the \$250,000 threshold for joint filers is reduced by D's \$150,000 in wages resulting in a reduced self-employment income threshold of \$100,000.

3. D and E are liable to pay Additional Medicare Tax on \$75,000 of self-employment income (\$175,000 in self-employment income minus the reduced threshold of \$100,000).

*Example 3:* F, who is married and files separately, has \$175,000 in wages and \$50,000 in self-employment income.

1. F is liable to pay Additional Medicare Tax on \$50,000 of his wages (\$175,000 minus the \$125,000 threshold for married persons who file separately).

2. Before calculating the Additional Medicare Tax on self-employment income, the \$125,000 threshold for married persons who file separately is reduced by F's \$175,000 in wages to \$0 (reduced, but not below zero).

3. F is liable to pay Additional Medicare Tax on \$50,000 of self-employment income (\$50,000 in self-employment income minus the reduced threshold of \$0).

4. In total, F is liable to pay Additional Medicare Tax on \$100,000 (\$50,000 of his wages and \$50,000 of his self-employment income).

*Example 4:* G, a head of household filer, has \$225,000 in wages and \$50,000 in self-employment income. G's employer withheld Additional Medicare Tax on \$25,000 (\$225,000 minus the \$200,000 withholding threshold).

1. G is liable to pay Additional Medicare Tax on \$25,000 of her wages (\$225,000 minus the \$200,000 threshold for head of household filers).

2. Before calculating the Additional Medicare Tax on self-employment income, the \$200,000 threshold for head of household filers is reduced by G's \$225,000 in wages to \$0 (reduced, but not below zero).

3. G is liable to pay Additional Medicare Tax on \$50,000 of self-employment income (\$50,000 in self-employment income minus the reduced threshold of \$0).

4. In total, G is liable to pay Additional Medicare Tax on \$75,000 (\$25,000 of her wages and

\$50,000 of her self-employment income).

5. The Additional Medicare Tax withheld by G's employer will be applied against all taxes shown on her individual income tax return, including any Additional Medicare Tax liability.

Many benefit groups have also released guidance to clients in an attempt to explain the challenges associated with the implementation of the new tax, and to guide them in cases of underwithholding or overwithholding.<sup>6</sup>

## **Conclusion**

One of the stated goals of the ACA is to expand insurance coverage. In order to do so, the law includes over 20 taxes or revenue-raising mechanisms. Inherent to this policy experiment will be tradeoffs. While some will gain insurance coverage, the individuals and industries taxed will make adjustments to their behavior or mode of conducting business. Companies may adjust their compensation structure in light of the additional tax discussed here: Medicare payroll tax.

What has been lacking from the conversation on health policy in the Commonwealth is an informed review of the financial consequences of each provision of the ACA for the Commonwealth. This brief is a small part of the broader education effort that is needed as the ACA is implemented in Massachusetts.

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### **Endnotes**

1. Boston Business Journal, “The 25 highest-paid athletes in Boston,” July 22, 2013. Accessed at: <http://www.bizjournals.com/boston/subscriber-only/2013/07/12/highest-paid-athletes.html>
2. The tax went into effect January 1, 2013, and will be assessed on joint filers with a modified adjusted gross income (MAGI) over \$250,000. For single filers it is assessed with a MAGI over \$200,000.
3. Personal e-mail to authors, April 5, 2013.
4. U.S. Department of Commerce. Located at: <http://www.census.gov/hhes/www/income/data/statemedian/>
5. Internal Revenue Service, “Questions and Answers for the Additional Medicare Tax,” accessed on 8/5/2013, located at: <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax>
6. Schaeffer, J. “IRS Releases Guidance on the Additional Medicare Tax Under the Affordable Care Act,” Health Reform Advisory Practice, Lockton Benefit Group, December 19, 2012.

### **Examples of past research include the following and can be located at [www.pioneerinstitute.org](http://www.pioneerinstitute.org):**

- Archambault, J. and Zhou, X. “[First Do No Harm ‘The Impact of the Affordable Healthcare Act on Massachusetts’ Medical Device Industry](#),” April 12, 2013.
- Archambault, J. “[Impact of the Federal Health Law’s ‘Cadillac Insurance Tax’ in Massachusetts](#),” October 5, 2012.
- Archambault, J. “[ACA Premium Roller Coaster for Small Business Coming to Massachusetts](#),” June 17, 2013.
- Archambault, J. “[Massachusetts Connector Up to \\$180 Million for ACA Changes](#),” January 18, 2013.
- Archambault, J. “[\\$3.89 Billion in New Insurance Taxes Over 10 Years](#),” December 6, 2012.
- Archambault, J. “[\\$14B in Medicare Cuts under ACA for Massachusetts](#),” September 12, 2012.

## **About the Authors**

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## **About Pioneer**

Pioneer Institute is an independent, non-partisan, privately funded research organization that seeks to improve the quality of life in Massachusetts through civic discourse and intellectually rigorous, data-driven public policy solutions based on free market principles, individual liberty and responsibility, and the ideal of effective, limited and accountable government.



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