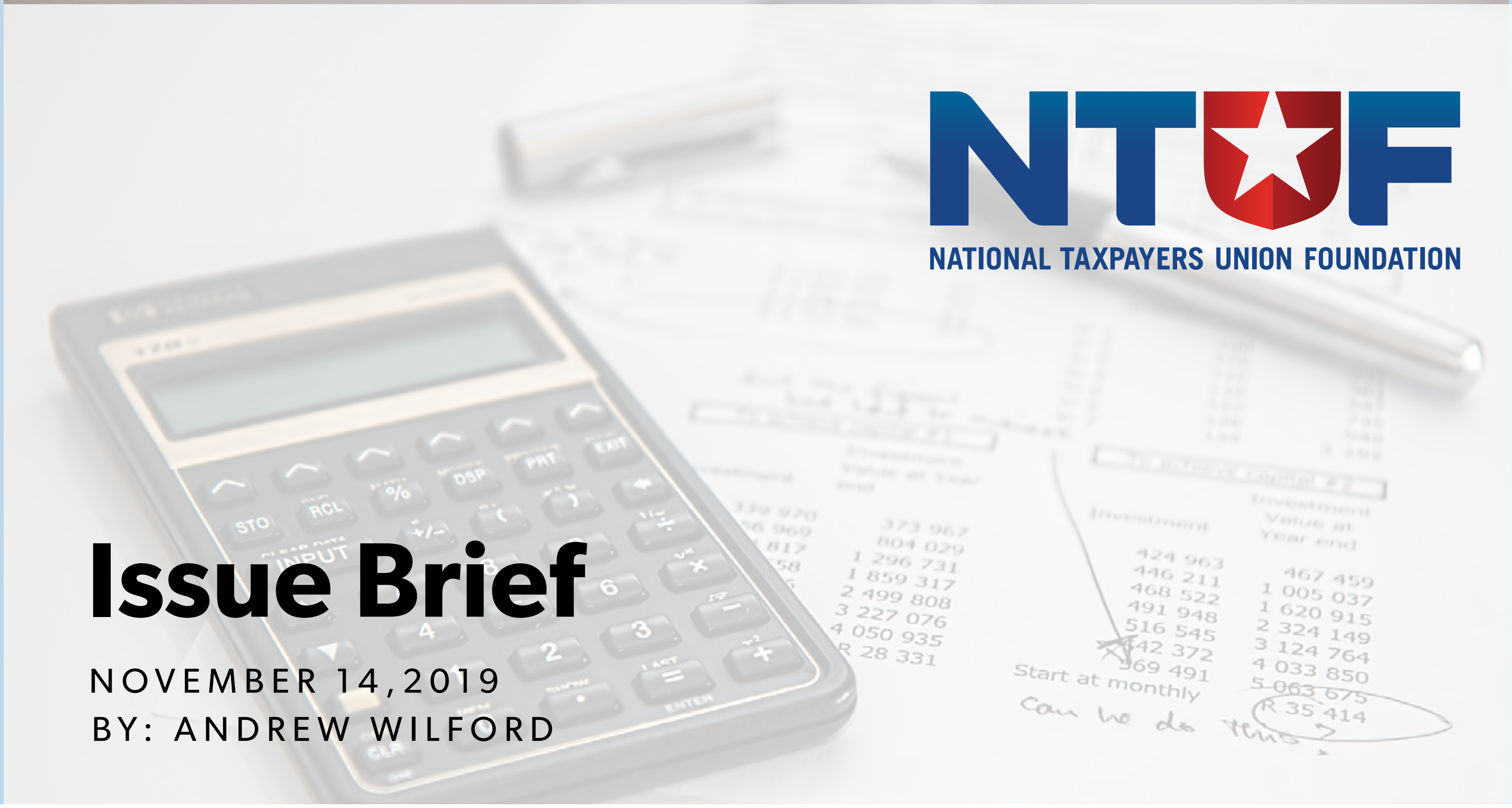

NATIONAL TAXPAYERS UNION FOUNDATION

Issue Brief

NOVEMBER 14, 2019
BY: ANDREW WILFORD

Warren's Medicare For All Funding Plan Utilizes Disastrous Employee Head Tax

Sen. Elizabeth Warren's recent release of her plan to fund Medicare For All features tax hikes that would fall on the middle class and fund only a little more than half of the $34 trillion needed to fund her proposal. One underreported element is the embrace of a harmful tax policy heretofore confined to the local level: an employee "head tax."

The Sordid History of Employee Head Taxes in the U.S.

Head taxes, or per-person taxes, have been around since Biblical times, but the modern incarnation is generally tied to employment. Perhaps the best-known originated in 1973, when Chicago implemented a tax which required employers to pay $4 per employee per quarter. Denver instituted one even earlier in 1969, though it functioned slightly differently, with liability for the tax being split between employers and employees. Pittsburgh, and many other Pennsylvania localities, have a $1 per week employee head tax; Pittsburgh's dates to the 1960s.

Key Facts:

Senator Elizabeth Warren has released a plan which she claims will fund Medicare for All with no middle-class tax increases.

Not only does this plan fall short of the figure Warren needs to fund her universal healthcare plan, but it also includes an employee head tax, a type of tax which disproportionately harms middle-class workers.

Employee head taxes have failed on the local level because they create an incentive for employers to cut jobs — and the idea would fail on the national level as well.

Sometimes called employment-based head taxes or EHTs, the levies never inspired a trend. In 2012, Chicago Mayor Rahm Emanuel made eliminating the city's EHT a key pillar of his mayoral campaign. The Windy City's EHT was phased out and eventually eliminated by 2014.

And for good reason. Mayor Emanuel correctly identified the city's EHT as a "job killer." Taxing something means you get less of it, and EHTs mean fewer jobs. Nearly all business taxes negatively impact employment in some way, but doing business in a city with an EHT in place provides employers with an incentive to get by with as little staff as possible — under an EHT, each individual employee means additional local tax obligations.

And though most cities put in place a small business exception along with their EHT, this can also reduce employment in another way. Businesses under the threshold have an incentive not to grow their businesses above the threshold, lest they take on a substantial new tax burden. Not only does this harm employment opportunities, it restricts entrepreneurship and competition by acting as a market distortion.

Unfortunately, in recent years EHTs have begun to see a resurgence as tech hubs seek to exploit the tech boom for tax revenue. Most notably, Seattle recently underwent a well-publicized battle over a proposal to revive its EHT, only to reverse course when faced with significant political backlash.

Seattle had previously instituted an EHT in 2006, though the city moved to repeal the unpopular tax as soon as 2009. Despite its previous failure, in 2018 city council members proposed a $500 per-person head tax, hoping to squeeze more revenue out of its status as Amazon's headquarters. The city passed an EHT soon after, though the rate was reduced to $275 per person after the city's mayor threatened a veto.

Even the watered-down version didn't last long. Amazon suspended planned investments and expansions, more than a hundred Seattle businesses signed an open letter opposing the head tax, and a grassroots campaign to put the EHT to a referendum garnered more than double the number of required signatures. In the face of such immense public pressure (polling strongly suggested the city would lose the referendum vote), Seattle's city council backed down and repealed the tax just weeks after it was passed.

Other tech hubs did not heed the lesson of Seattle, unfortunately. Silicon Valley cities including Mountain View, Cupertino, San Francisco, and East Palo Alto all considered some form of EHT. Though only Mountain View ended up moving forward with one, the others aren't necessarily in the clear. Cupertino simply postponed a decision on its proposed EHT until 2020, while East Palo Alto passed a tax on commercial office space which will likely have a similar negative effect. San Francisco passed a gross receipts tax, which is harmful for entirely different reasons than an EHT.

No longer are EHTs the exclusive domain of shortsighted city policymakers, unfortunately. Senator Warren's plan to fund Medicare For All proposes a funding mechanism that is, for all intents and purposes, an EHT.

Warren's Medicare For All EHT

A major pillar of Sen. Warren's plan to pay for Medicare For All is a new "Employer Medicare Contribution." This "contribution" would be calculated by the employer, who would determine their average spending on health insurance per employee in the last few years, adjust for inflation in the industry, and then multiply by the number of employees in the company. The employer would then take 98 percent of this number (so employers receive a "discount" on total health care spending) to arrive at their Employer Medicare Contribution.

While described in media reports as a payroll tax, this is functionally an EHT. With every new employee brought on, firms would be on the hook for a flat increase to their Employer Medicare Contribution tax liability. Whether the new employee is a senior-level executive or an entry-level hire, the amount they will add to the employer's Employer Medicare Contribution will be the same. This differs from traditional payroll taxes, which are based on wages paid to the employee.

The Employer Medicare Contribution would make low-level hires relatively more expensive and upper-level hires relatively less expensive to add in terms of tax costs, making the impact of the policy regressive. In fact, this tax is even more regressive than a payroll tax, since the employee's wage rate is not considered in the tax base.

A particular irony of this plan is that it would punish employers that are currently more generous with their healthcare benefits. Businesses that currently offer more generous health insurance benefits would effectively be locked in with the higher Employer Medicare Contribution tax bills. At the same time, they would lose whatever competitive advantage in hiring they are currently gaining from being able to offer better health benefits since all health insurance would come from the government.

Warren argues that her plan would benefit businesses because they would pay just 98 percent of what they are paying now, but this is not necessarily true. Businesses with 50 or more employees that did not previously offer health insurance would be on the hook for an Employer Medicare Contribution as well. Employees under 26 years old that were previously covered under their parents' health insurance plans, or employees that declined health insurance coverage to be covered under their spouse's plans, previously did not cost a cent towards their employers' health insurance costs. Under Warren's plan, they would suddenly cost the same as any other employee. Employers would be liable for an Employer Medicare Contribution for their part-time employees as well, albeit on a prorated basis. Additionally, over time, rates would equalize across all employers, driving up per-employee prices for many.

And just like with other EHTs, the small-business exemption can be a double-edged sword. While on the one hand it protects businesses with under 50 employees from paying the Employer Medicare Contribution, it also provides an incentive for small businesses not to expand above this threshold, lest they take on a new tax burden. This would restrict entrepreneurship and risk throttling potentially successful businesses in the crib.

When combined with Warren's plan to raise the corporate tax rate to 42 percent (a 35 percent rate plus a 7 percent "real corporate profits tax") and the myriad other business tax increases under Warren's proposals, worker compensation would almost certainly shrink, all else equal. While health insurance costs would be borne by the government, economic literature is clear that wages are significantly affected by the corporate tax rate, which would exert downward pressure on compensation under the weight of Warren's heavy tax increases. Businesses may be the ones liable for filing these taxes, but it's people, such as workers, that bear the true economic costs.

There's also the question of how to avoid gaming of the system. Businesses anticipating the enactment of Warren's plan would have a strong incentive to reduce their "average spending on healthcare" in the years leading up to the plan's passage to lower their Employer Medicare Contribution tax liability. Independent contractors would also be exempted from any Employer Medicare Contribution calculation, meaning many businesses would consider restructuring positions on their workforce as "independent contractors" rather than "employees," — a decision that would have dramatic impacts to compensation, benefits, and tax administration for impacted workers.

All told, even many Medicare For All advocates are wary of Warren's proposed funding mechanism. The People's Policy Project, a left-wing think tank very favorably disposed towards Medicare For All, called Warren's EHT plan "unworkable and bad." Ryan Cooper wrote in The Week that this would be a "monstrous tax" (italicization in the original). Even Senator Bernie Sanders, the only other major candidate supporting Medicare For All, expressed concern that the Employer Medicare Contribution would have "a very negative impact" on job creation. When Bernie Sanders is concerned that a proposal to tax businesses may harm the economy, perhaps it's time to take a step back.

Conclusion

There's a reason that economists of all shapes and sizes are coming out against Senator Warren's Medicare For All funding plan. It utilizes a tax concept that, up until now, has been largely sent to the trash heap of American policymaking. If federalism enables states and localities to be policy laboratories, employee head taxes are the failed experiment that blew up a couple workshops.

Instead of rewarding bad tax policy ideas by employing them at the national level, taxpayers should demand better from their presidential candidates. The employee head tax should be put back where it belongs: on the long list of failed tax ideas that should be phased out entirely rather than scaled up.

About the Author

Andrew Wilford is a Policy Analyst with National Taxpayers Union Foundation.