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WHAT A LONG STRANGE TRIP IT'S BEEN FOR THE 3.8% NET INVESTMENT INCOME TAX¹

AUSHER M. B. KOFKY & BRYAN P. SCHMUTZ*

I. INTRODUCTION

This Article will analyze the surprisingly significant public policy implications of the 3.8% net investment income tax (“NIIT”).² The analysis of this topic is one of first impression. In brief, the NIIT is a peculiar, diminutive, and federal income tax that imposes a flat 3.8% surtax on high income taxpayers’ investment income.³ Introduced to fund the expenses in the Affordable Care Act (“ACA”), the NIIT was alternately titled as the Unearned Income Medicare Contribution and the Medicare Contribution Tax on Unearned Income.⁴

The impetus for the Article was the specific singling out of the NIIT in a May 2017 bill that the Republican Party-majority House of Representatives passed in conjunction with the then newly elected Trump Administra-

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1. Hats off to the Grateful Dead for the beginning of the title to this Article, from lyrics in their song *Truckin’* and later from the title of one of their compilation albums. THE GRATEFUL DEAD, *Truckin’*, on AMERICAN BEAUTY (Warner Brothers 1970); THE GRATEFUL DEAD, WHAT A LONG STRANGE TRIP IT’S BEEN (Warner Brothers 1977).

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2. 26 U.S.C. § 1411 (2012). “Imposition of tax” is the Internal Revenue Code statute for the NIIT. *Id.*

3. Congress defined high income in this context as adjusted gross income of \$250,000 married filing joint, \$200,000 single and head of household, and \$125,000 married filing separately. *See* 26 U.S.C. § 1411(b).

4. Congress named the NIIT the Unearned Income Medicare Contribution in the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1402(a)(4), 124 Stat. 1029, 1060–63 (codified and amended at 26 U.S.C. § 1411). *See* STAFF OF JOINT COMM. ON TAXATION, JCX-36-11, DESCRIPTION OF THE SOCIAL SECURITY TAX BASE 24–25 (2011).

tion.⁵ The NIIT was a relatively new tax, becoming effective only four years earlier.⁶ The House's 2017 bill proposed to eliminate the NIIT as one of a slew of health-care-related tax cuts totaling \$569 billion over ten years.⁷ The legislation was part of the Republican's initial attempt to repeal and replace the ACA,⁸ which the Obama Administration and a then Democratic Party-majority Congress enacted in 2010.⁹ The NIIT was the only income tax in the May 2017 proposed cuts, and at a ten-year projection of \$172 billion, the NIIT was the single largest revenue loss in the bundle.¹⁰ The House effort died in the Senate in July 2017.¹¹

As this Article will detail, Medicare spending then, as now, has been rising inexorably as a share of the federal budget. The rise has continued to the point where, for example, in 2016, Medicare expenditures matched the nation's military budget.¹² Consequently, this Article will open by examining Medicare: its history, sources of funding, and projected future.

The Article will then continue by describing in detail the NIIT: the long strange road to its creation, how the NIIT operates, and data on the NIIT's financial impact. The Article's penultimate section will discuss two public policy implications of the NIIT: the taxation of capital versus labor; and the exclusion from income of employer-paid health insurance premiums that resulted from the inclusion of the NIIT in the ACA due to the "Byrd Rule" in the reconciliation process. The Article will end with its summary and conclusion.

While not without critics,¹³ sustaining Medicare, seems to be a strongly bipartisan objective.¹⁴ The Article will likewise aim to present its infor-

5. American Health Care Act of 2017, H.R. 1628, 115th Cong. (engrossed in House, May 4, 2017).

6. Health Care and Education Reconciliation Act § 1402(a)(4). The provision established the 3.8% tax on net investment income for incomes above non-inflation adjusted thresholds. *Id.*

7. The Joint Committee on Taxation ("JCT") estimated \$569 billion as the bill's total estimated revenue loss over the ten-year window of 2017–2026. See JOINT COMM. ON TAXATION, JCX-30-17, ESTIMATED REVENUE EFFECTS OF THE TAX PROVISIONS CONTAINED IN TITLE I OF H.R. 1628, THE "BETTER CARE RECONCILIATION ACT OF 2017," AN AMENDMENT IN THE NATURE OF A SUBSTITUTE AS POSTED ON THE WEBSITE OF THE SENATE COMMITTEE ON THE BUDGET ON JUNE 26, 2017 (2017).

8. See *supra* note 5.

9. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

10. The JCT estimated that eliminating the 3.8% NIIT would decrease revenues by \$172 billion, or 30%, of the bill's \$569 billion total estimated revenue losses over the ten-year window of 2017–2026. See JCX-30-17, *supra* note 7, at 2.

11. The Senate rejected the legislation in a series of yea and nay votes on July 26 through July 28, 2017. See 163 CONG. REC. S4415 (2017) (recording vote numbers 178 and 179 on July 28, 2017).

12. See *infra* note 78; see also *infra* Figure 4.

13. For instance, the President's 2019 budget proposal, as well as the House Republican's 2019 budget proposal, calls for approximately \$236 billion in Medicare cuts over the next ten years. OFF. OF MGMT. & BUDGET, EFFICIENT, EFFECTIVE, ACCOUNTABLE: AN AMERICAN

mation in a nonpartisan manner. The Article's overarching goal is to help inform the nation's public policy debate regarding the NIIT regardless of the reader's political point of view.

II. ANALYSIS OF MEDICARE

This Part examines Medicare's history, four component parts, sources of funding, trends, and solvency. Understanding Medicare is pivotal because that is where Congress ostensibly targeted the NIIT's revenues.¹⁵ Moreover, as this Part shows, Medicare spending has been consuming a steadily increasing share of the federal budget.

A. *Brief History of Medicare*

After unsuccessful attempts by states from 1915 to 1920, the federal government began debating in the 1930s whether to provide federally administered health insurance for older people.¹⁶ In a letter to Congress dated November 19, 1945, President Harry S. Truman outlined five significant problems that the federal government could help solve by a system of national healthcare.¹⁷ After limited actions in the ensuing decades, in 1965 Congress and President Lyndon B. Johnson enacted the Social Security Amendments of 1965, which created Medicare.¹⁸ In the main, Medicare provides health insurance for the aged, defined as people aged sixty-five and older.¹⁹ In 1972, the Social Security Amendments of 1972, signed by President Richard M. Nixon, extended Medicare coverage to individuals

BUDGET 118 (2018), <https://www.whitehouse.gov/wp-content/uploads/2018/02/budget-fy2019.pdf>.

14. For instance, a Democratic-majority Congress and President Lyndon B. Johnson enacted Medicare in 1965. *See infra* note 18 and accompanying text. A Democratic-majority Congress and Republican President Richard M. Nixon expanded Medicare coverage to include people younger than age sixty-five with end-stage renal disease and other long-term disabilities in 1972. Social Security Amendments of 1972, Pub. L. No. 92-603, § 299I, 86 Stat 1329, 1463-64; *see infra* note 20 and accompanying text. A Republican-majority Congress and Republican President George W. Bush expanded Medicare in 2003 by adding prescription drug coverage entitled Medicare Part D. Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, §§ 101-11, 117 Stat. 2066, 2071-2176; *see infra* note 36.

15. *See supra* note 4 and accompanying text.

16. BARBARA S. KLEES ET AL., *CTRS. FOR MEDICARE & MEDICAID SERVS., BRIEF SUMMARIES OF MEDICARE & MEDICAID: TITLE XVIII AND TITLE XIX OF THE SOCIAL SECURITY ACT AS OF NOVEMBER 1, 2010*, at 3 (2010).

17. President Harry S. Truman, Special Message to the Congress Recommending a Comprehensive Health Program (Nov. 19, 1945), *in* THE HARRY S. TRUMAN PRESIDENTIAL LIB. & MUSEUM, <https://www.trumanlibrary.org/publicpapers/index.php?pid=483&st=&st1=> (last visited Mar. 1, 2019).

18. Social Security Amendments of 1965, Pub. L. No. 89-97, § 102(a), 79 Stat. 286, 291-332.

19. *Id.*

suffering from end stage renal disease.²⁰ Twenty-eight years later, The Medicare, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000 waived the twenty-four month waiting period for individuals under sixty-five who are suffering from amyotrophic lateral sclerosis (“ALS”).²¹

B. Structure of the Medicare System

Medicare’s structure consists of four separate components. Congress named those components Medicare Parts A, B, C, and D.²² Below is an explanation of the four parts.

Medicare Part A (“Part A”), or Hospital Insurance (“HI”), covers medically necessary inpatient hospital care, skilled nursing facility care, hospice care, and home health care.²³ Part A is free for individuals sixty-five years old or older provided the individual or a spouse has paid Medicare payroll tax for ten years, equaling forty quarters.²⁴ For individuals who have not paid forty quarters of Medicare payroll tax, Medicare charges a \$422 monthly premium for those who paid less than thirty months of Medicare payroll taxes and a \$232 monthly premium for those who paid between thirty and thirty-nine months of Medicare taxes.²⁵ While Part A helps cover medically necessary expenses, the program does not cover the expenses completely. For 2018, the Part A deductible was \$1340 and various levels of coinsurance applied depending upon length of stay in a hospital or skilled-nursing home facility.²⁶

Medicare Part B (“Part B”), or Medical Insurance, covers medically necessary doctor’s visits, preventative care, hospital outpatient services, laboratory test, durable medical equipment, mental health, home healthcare, and ambulance services.²⁷ Part B charges a premium, established by the Center for Medicare and Medicaid Services, which is based on several factors including, in large part, the individual’s income.²⁸ For 2018, the stand-

20. Social Security Amendments of 1972, Pub. L. No. 92-603, § 299I(3), 86 Stat. 1329, 1463–64.

21. Appropriations Act, 2001, Pub. L. No. 106-554, 114 Stat. 2763, 2763A-463, 2763A-474, (2000) (incorporating provision of H.R. 5661, Medicaid, and SCHIP Benefits Improvement and Protection Act of 2000).

22. BDS. OF TRS., FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS, 2017 ANNUAL REPORT 1, <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2017.pdf>.

23. Social Security Amendments of 1965 § 102(a).

24. *Part A Costs*, MEDICARE.GOV, <https://www.medicare.gov/your-medicare-costs/part-a-costs> (last visited Nov. 7, 2018).

25. *Id.*

26. *Medicare Costs at a Glance*, MEDICARE.GOV, <https://www.medicare.gov/index.php/your-medicare-costs/medicare-costs-at-a-glance> (last visited Nov. 7, 2018).

27. Social Security Amendments of 1965 § 102(a).

28. *Part B Costs*, MEDICARE.GOV., <https://www.medicare.gov/your-medicare-costs/part-b-costs> (last visited Nov. 7, 2018).

ard monthly premium for Part B was \$134, which increased to \$428.60 for individuals whose 2016 income was above \$160,000.²⁹ Individuals earning less than \$85,000 were eligible for reduced premiums, and the average monthly premium for Plan B was \$134.³⁰ While Part B is optional, most individuals who are covered by Part A elect to enroll in Part B.³¹

Medicare Part C (“Part C”), or Medicare Advantage Plans, formerly called Medicare+Choice, arose as part of the Balanced Budget Act 1997.³² Congress further refined Part C through the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.³³ Medicare Advantage Plans provides similar coverage as Parts A and B above, but private health insurance companies administer the plans.³⁴ These Medicare Advantage Plans must offer the same coverages as “Original Medicare” but may have additional benefits and different cost sharing schemes.³⁵

Medicare Part D (“Part D”), or the Medicare prescription drug benefit, was created as part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003.³⁶ Part D, which is optional, added drug coverage to Original Medicare plans (Parts A & B) as well as Medicare Advantage plans (Part C).³⁷ Part D is only available through private companies.³⁸ Medicare prescription drug benefit charges a monthly premium that varies by plans plus an additional charge that varies by income (ranging from \$0 for those earning \$85,000 or less to \$74.80 for those earning above \$160,000).³⁹

29. *Id.*

30. *Id.*

31. BDS. OF TRS., *supra* note 22, at 181–82, 183 tbl.V.B4. Enrollment in Medicare Part B is dependent up on enrollment in Part A—the data in this table shows that greater than 90% of those enrolled in Part A choose to enroll in Part B. *Id.* at 183 tbl.V.B4. For example, in 2016, 56,463,000 individuals were enrolled in Part A and 52,088,000 (92.25%) of those chose to also enroll in Part B. *Id.*

32. Pub. L. No. 105-33, §§ 4000–4923, 111 Stat. 251, 270–574.

33. Pub. L. No. 108-173, §§ 201–241, 117 Stat. 2070, 2176–2221.

34. *How Do Medicare Advantage Plans Work?*, MEDICARE.COM, <https://www.medicare.gov/sign-up-change-plans/types-of-medicare-health-plans/medicare-advantage-plans/how-do-medicare-advantage-plans-work> (last visited Nov. 7, 2018).

35. *Id.* Original or Traditional Medicare is a term used to describe Parts A and B as they were created under the Social Security Amendments of 1965 signed into law by President Johnson. *History*, CMS.GOV, <https://www.cms.gov/About-CMS/Agency-information/History/> (last visited Feb. 20, 2019).

36. Medicare Prescription Drug, Improvement, and Modernization Act of 2003 § 101–111.

37. *How to Get Drug Coverage*, Medicare.gov, <https://www.medicare.gov/sign-up-change-plans/get-drug-coverage/get-drug-coverage.html> (last visited Jan. 7, 2018).

38. *Id.*

39. *Monthly Premium for Drug Plans*, MEDICARE.GOV, <https://www.medicare.gov/part-d/costs/premiums/drug-plan-premiums.html> (last visited Jan. 7, 2018).

C. Medicare's Financing Mechanisms

Congress established two trust funds, the HI Trust Fund and the Supplementary Medical Insurance ("SMI") Trust Fund to finance, in large part, the federal expenditures for Medicare.⁴⁰ The narrative below describes those two funds.

The specific purpose of the HI Trust Fund is to fund Medicare Part A.⁴¹ Payroll taxes on employee earnings are the main financing mechanism for the HI Trust Fund.⁴² Additional financing for Part A comes from taxes that Congress imposed on Social Security benefits, interest on government securities, and premiums paid by those beneficiaries who have not paid into the system for forty quarters.⁴³ The Medicare HI trustees must invest any excess HI funds in U.S. Treasury securities.⁴⁴

When the Treasury collects those HI fund payroll taxes, the revenue enters the Treasury's general fund.⁴⁵ The Treasury then credits the HI fund with special-issue interest bearing government securities in the same amount.⁴⁶ While these special-issue securities pay interest like Treasury Bills, the HI fund does not trade them on the open market and maintains the securities at par value.⁴⁷ Furthermore, the special-issue securities are redeemable on demand at par value and, therefore, provide the same benefits as holding cash.⁴⁸

When the Treasury makes Medicare payments, the payments come out of the general fund and the Treasury debits an equal amount of special-issue securities from the HI Trust Fund account.⁴⁹ In years where the HI fund receives revenue in excess of expenses, the fund accumulates a positive balance of the special-issue securities.⁵⁰ In years where the HI fund's expenses exceed its revenue, the fund must liquidate accumulated securities to cover the expenses paid by the general fund.⁵¹ If the HI fund is unable to cover

40. See Social Security Amendments of 1965, Pub. L. No. 89-97, § 102(a), 79 Stat. 286, 291-313.

41. See *id.* § 1817, 79 Stat. at 299-301.

42. *Id.*

43. *Id.*; see also Social Security Amendments of 1983, Pub. L. No. 98-21, § 121, 97 Stat. 65, 80; PATRICIA A. DAVIS, CONG. RESEARCH SERV., R43122, MEDICARE FINANCIAL STATUS: IN BRIEF 4 (2018).

44. See Social Security Amendments of 1965 § 1817.

45. DAVIS, *supra* note 43, at 3.

46. *Id.*

47. See Social Security Act Amendments of 1939, Pub. L. No. 76-379, § 201, 53 Stat. 1360, 1362-63.

48. DAVIS, *supra* note 43, at 3 n.11

49. *Id.* at 3.

50. See BDS. OF TRS., *supra* note 22, at 209.

51. *Id.*; see also DAVIS, *supra* note 43, at 6.

all current expenses with revenue and accumulated securities, the fund would be deemed insolvent.⁵²

Congress originally established the SMI to fund Medicare Part B, but now the SMI also partially funds Medicare Part D.⁵³ Unlike the HI fund, no specific payroll taxes finance the SMI fund.⁵⁴ Instead, the general revenue of the federal government provides the main resources for the SMI fund.⁵⁵ Additional financing comes from premiums paid for Part C and Part D coverage and a small amount from the states to cover Part D expenses.⁵⁶ As with the HI Trust Fund, the SMI trustees must invest any excess funds from the SMI Trust Fund in U.S. Treasury securities.⁵⁷

Since the SMI has no dedicated funding sources, deviations from expected expenses can simply be budgeted for in the following year.⁵⁸ That means the SMI fund can recover shortfalls through increased premiums and/or increased transfers from the general fund.⁵⁹ As such, the SMI Trust Fund is continuously in balance and cannot be considered insolvent.⁶⁰ The SMI trust holds income, not currently needed to pay benefits, in the form of the same special-issued interest-bearing securities as the HI fund.⁶¹

Unlike their private sector counterparts, the Medicare HI and SMI trust funds are not trust funds in the usual sense.⁶² The Medicare trust funds do not hold a managed portfolio of marketable (tradeable) assets on behalf of their beneficiaries.⁶³ Instead, the Medicare trust funds are merely accounting mechanisms as described above that facilitate the tracking of earmarked revenues that the funds never actually held in trust.⁶⁴

D. The Past and Future of Medicare Solvency

By nearly all measures, Medicare growth, both in enrollment and in expenditures, is concerning. This is especially alarming when compared to

52. DAVIS, *supra* note 43, at 4.

53. *See* Social Security Amendments of 1965, Pub. L. No. 89-97, § 1841, 79 Stat. 286, 308–09 (establishing funding for Part B); *see also* Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, § 101, 117 Stat. 2066, 2071–2152 (providing funding for Part D from SMI).

54. *See* Social Security Amendments of 1965 § 1841.

55. *Id.*

56. *Id.*; *see also* Medicare Prescription Drug, Improvement, and Modernization Act of 2003 § 101.

57. *See* Social Security Amendments of 1965 § 1841.

58. DAVIS, *supra* note 43, at 5.

59. *Id.*

60. *Id.*

61. Social Security Amendments of 1965 § 1841(c).

62. DAVIS, *supra* note 43, at 2 n.8.

63. *See* Social Security Act Amendments of 1939, Pub. L. No. 76-379, § 201, 53 Stat. 1360, 1362–63.

64. BDS. OF TRS., *supra* note 22, at 206–07.

the insufficient growth in Medicare revenues intended to offset those expenditures. Below are four charts that illustrate these issues.

FIGURE 1: SOURCES OF MEDICARE FINANCING AND ITS PROPORTION OF TOTAL FINANCING INFLOW.⁶⁵

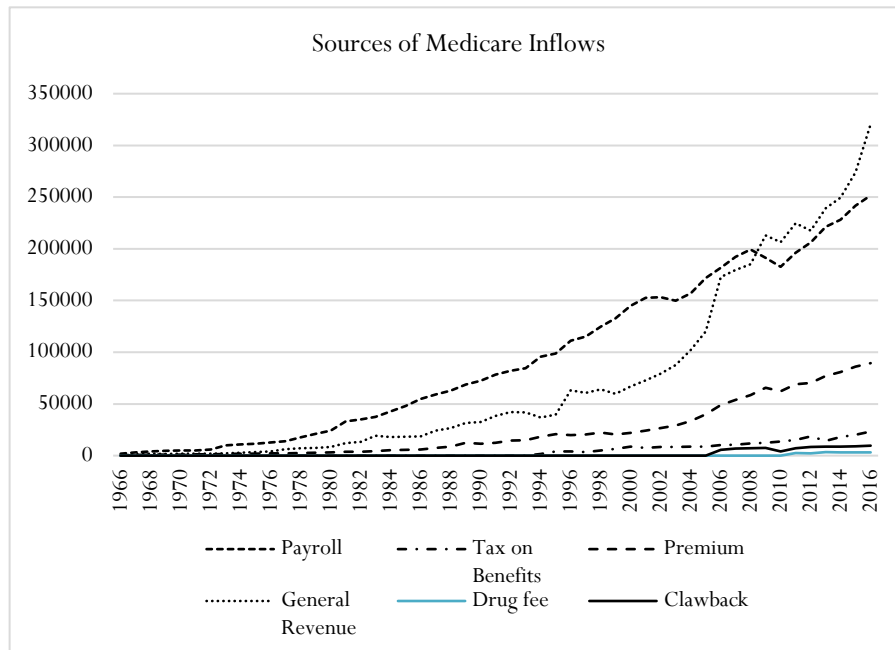


Figure 1 shows that since approximately 2002, inflows from the general revenue fund have been surging. In fact, around 2009, funding from the general revenue fund burst past payroll taxes in becoming Medicare's primary revenue source. This circumstance is especially significant for this analysis because revenues from the 3.8% NIIT flow into the general revenue fund. Stated differently, unless Medicare expenditures decrease, which seems unlikely as discussed below, the federal government would have to find a replacement for the revenues if the government were to reduce or repeal the 3.8% NIIT.

65. *Id.* at 21 fig.II.D2.

FIGURE 2: ANNUAL MEDICARE ENROLLMENT BY PART BETWEEN 1966 AND 2016⁶⁶

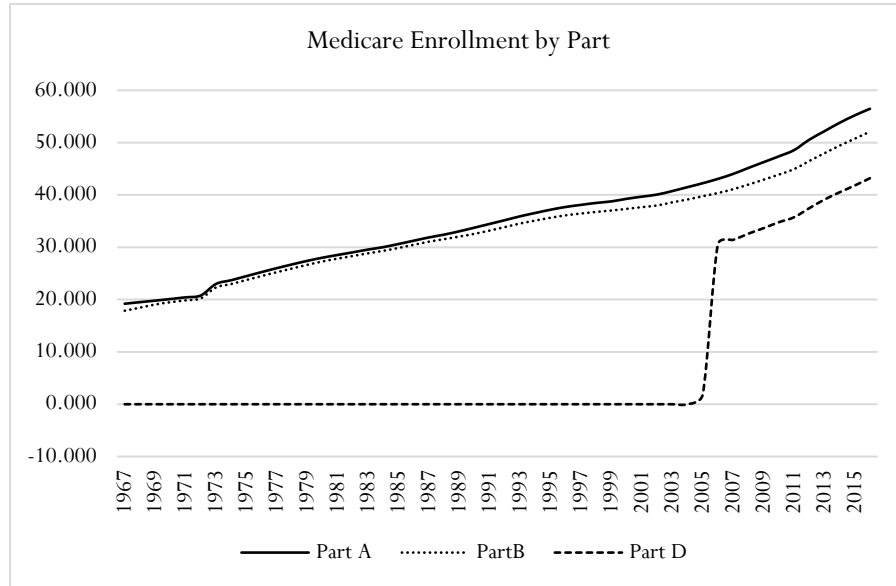


Figure 2 shows that enrollments in Medicare Parts A and B has grown unabated since their inception in 1966. For example, Medicare enrollment rose from 39.7 million individuals in 2000 to 56.8 million in 2016.⁶⁷ Further, the most recent period has seen an acceleration in the rate of growth. Between 2000 and 2010, the average annual enrollment increase was 1.81%, while the average annual enrollment increase for 2010 through 2016 was 2.95%.⁶⁸

Perhaps even more disconcerting, Medicare enrollment growth is outpacing the growth in covered workers.⁶⁹ For instance, over the past thirty-five years, Medicare enrollment has roughly doubled, while the pool of covered workers, meaning those paying into the HI Trust Fund, has only grown by 55%.⁷⁰ In fact, there were 4.5 covered workers per Medicare enrollee in 1966 as compared to only 3.1 in 2016.⁷¹

66. *Id.*

67. *Id.* at 183.

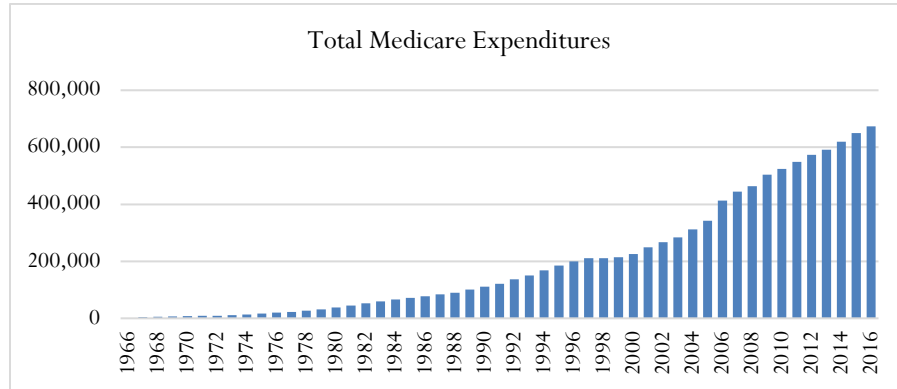
68. *Id.*

69. *Id.* at 182.

70. *Id.*

71. BDS. OF TRS., FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS., *Ratio of HI Covered Workers to HI Beneficiaries, in 2017 EXPANDED AND SUPPLEMENTARY TABLES AND FIGURES*, <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Trustees-Reports-Items/2016-2017.html?DLPage=1&DLEntries=10&DLSort=0&DLSortDir=descending>.

FIGURE 3: TOTAL ANNUAL MEDICARE EXPENDITURES FOR EACH YEAR 1966 TO 2016.⁷²



Comparing Figure 3 expenditures to Figure 1 revenues shows that the annual growth in Part A expenses have been outpacing the annual growth in Part A revenue for every year since 2005.⁷³ In particular, between 2005 and 2016, Part A costs have increased by an average 3.48% versus only a 3.23% increase in Part A income.⁷⁴

For 2016, federal expenditures for Medicare totaled approximately \$588 billion.⁷⁵ That represented 15% of the \$3.9 trillion total 2016 federal budget.⁷⁶ The \$588 billion that the federal government provided to Medicare comprised roughly 87% of all Medicare expenditures for 2016.⁷⁷

72. BD. OF TRS., *supra* note 22, at 177 tbl.V.B1.

73. *Id.* at 62.

74. *Id.*

75. See CONG. BUDGET OFF., MEDICARE—CONGRESSIONAL BUDGET OFFICE'S JUNE 2017 BASELINE 1 (2017), <https://www.cbo.gov/sites/default/files/recurringdata/51302-2017-06-medicare.pdf>; see also CONG. BUDGET OFF., AN UPDATE TO THE BUDGET AND ECONOMIC OUTLOOK 2017 TO 2027, at 15 tbl.2 (2017), <https://www.cbo.gov/sites/default/files/recurringdata/51118-2017-06-budgetprojections.xlsx>.

76. LEIGH ANGRES & MAUREEN COSTANTINO, CONG. BUDGET OFF., THE FEDERAL BUDGET IN 2016 (2017), <https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/graphic/52408-budgetoverall.pdf>.

77. See CONG. BUDGET OFF., *supra* note 75, at 1.

FIGURE 4: ANNUAL PERCENTAGE OF THE THREE LARGEST BUDGET ITEMS, SOCIAL SECURITY SPENDING, MEDICARE SPENDING, AND DEFENSE SPENDING THAT COMPRISE THE FEDERAL BUDGET FOR YEARS 1966–2016⁷⁸

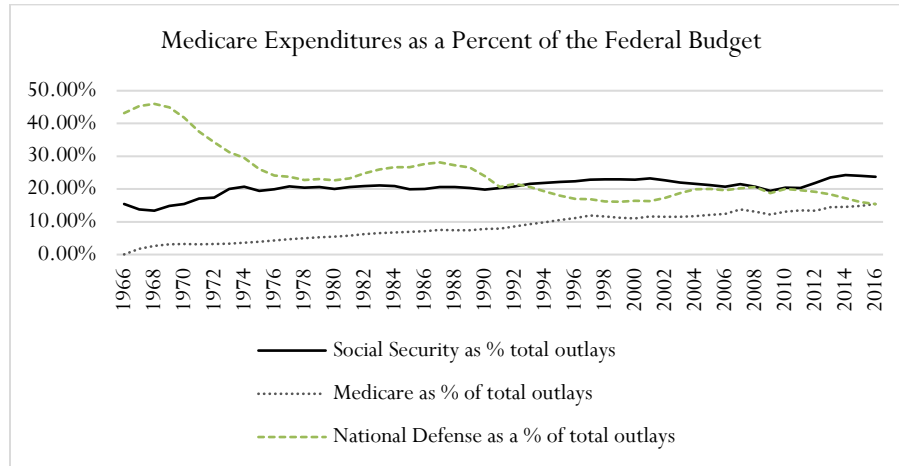


Figure 4 may be the most powerful of the charts. As the reader can clearly see, defense spending has been falling while Medicare spending has been rising steadily since its inception in 1966. The situation has continued to the point where in approximately 2016, Medicare spending matched defense spending, and it seems likely to begin exceeding the military budget. That is exactly the type of guns or butter tradeoff that this Article tries to highlight below in Section III.C, Revenue Generated by the NIIT, by identifying the prices of certain significant national defense projects.⁷⁹

Another yardstick similarly shows the growth of Medicare expenditures. Federal expenditures for Medicare grew from 1.31% of GDP in 1980, to 2.2% of GDP in 2000, and to 3.6% of GDP in 2015.⁸⁰

On the positive side, other measures indicate the rate of growth in Medicare spending has slowed in recent years. Medicare expenditures per capita grew at 7.5% per year between 2000 and 2010, but only at 3.5% per year between 2010 and 2016.⁸¹ The increase in spending per beneficiary also declined since the passage of the ACA from 7.51% per year between

78. See OFF. OF MGMT. & BUDGET, THE HISTORICAL TABLES 50 tbl.3.1 (2019), <https://www.whitehouse.gov/wp-content/uploads/2019/03/hist-fy2020.pdf>.

79. See *infra* Section III.C.

80. BDS. OF TRS., *supra* note 22, at 181 tbl.V.B3.

81. See *id.* at 177 tbl.V.B1. (reporting total annual Medicare expenditures); *Population*, FRED, <https://fred.stlouisfed.org/series/B230RC0A052NBEA> (last update July 27, 2018) (reporting annual population).

2000 and 2010 to only 1.37% per year between 2010 and 2016.⁸² Unsurprisingly, the same pattern is seen in total Medicare spending, which grew at 8.6% per year between 2000 and 2010 and only 4.25% between 2010 and 2016.⁸³

The HI Trust Fund has had a long history of predicted insolvency. Since 1970, all but three annual Trustee Reports projected the depletion of the HI fund within thirty years of the report's issuance.⁸⁴ Most of the Trustee Reports (36 out of 49) since 1970 anticipated insolvency in fifteen years or less.⁸⁵ Most recently, the 2017 Medicare Trustees projected that the HI fund, which funds Part A, will become insolvent in twelve years.⁸⁶ Additionally, the ACA created the Independent Payment Advisory Board to make spending reduction recommendations if projected Medicare spending growth exceeds specified target levels.⁸⁷ As of July 2017, the Trustee's Report projected the Independent Payment Advisory Board process will be triggered in 2021.⁸⁸

Likewise, nearly all projections for the next ten to twenty years anticipate significant growth in enrollment and expenditure for Medicare. Despite the recent slowdown in the increase of Medicare spending, according to the 2017 Trustee's report, increasing utilization rates, complexity of services, and the aging of the U.S. population are all expected to drive future Medicare spending at a rate exceeding GDP growth.⁸⁹ The trustees anticipate the growth in payroll tax contributions to the HI Trust Fund will continue to outpace the growth in GDP, while the growth rate in Part B and Part D premiums and the necessary general fund transfers to Medicare will increase faster than both GDP and the HI revenues.⁹⁰

The trustees forecast other grim news. They expect enrollment in Medicare to increase 31.5% over the next ten years, from 57 million in 2016 to 75 million in 2026.⁹¹ Over the same period, they project total Medicare expenditures to more than double from \$674 billion in 2016 to rough-

82. See BDS. OF TRS., *supra* note 22, at 197 tbl.V.D1. (reporting annual average per beneficiary cost).

83. See *id.* at 177 tbl.V.B1. (reporting annual total Medicare expenditures).

84. PATRICIA A. DAVIS, CONG. RESEARCH SERV., RS20946, MEDICARE: INSOLVENCY PROJECTIONS 4 tbl.I (2017).

85. *Id.*

86. *Id.* at 6; BDS. OF TRS., *supra* note 22, at 7.

87. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3043(a), 124 Stat. 119, 489 (2010).

88. BDS. OF TRS., *supra* note 22, at 179.

89. *Id.* at 160–61.

90. *Id.* at 21–22.

91. *Id.* at 183 tbl.V.B4.

ly \$1.4 billion in 2026.⁹² Similarly, between 2026 and 2036, they predict total Medicare spending to increase another 82% to nearly \$2.5 billion.⁹³ They also expect spending per beneficiary to increase by 54.79% between 2016 and 2026, more than double the growth rate over the prior decade.⁹⁴

All the above will cause the federal government's required contribution to Medicare to nearly double over the next decade, increasing from \$674 billion in 2016 to \$1.4 trillion in 2026.⁹⁵ The trustees predict Medicare spending will grow at 7.6% per year between 2016 and 2026, significantly outpacing the expected 4.9% growth in private health insurance.⁹⁶ In summary, revenues from the NIIT, as with the other sources of revenues, seem pivotal to support the program.

III. ANALYSIS OF THE NIIT

The prior Section described the financial needs of Medicare. This Section explains the NIIT: its improbable journey to enactment, how the NIIT operates, and the revenues the NIIT has generated.

A. *The Road to the NIIT's Creation*

The origin of the NIIT followed a circuitous path of policy initiatives and congressional deal-making. Perhaps the path was simply an example of the sausage factory that sardonic folks attribute to legislation.⁹⁷ Or perhaps there was an inchoate intention to add a tax on capital. Regardless, the NIIT's creation followed a particularly interesting adventure.

The story began *ex nihilo*. After President George W. Bush's eight years in office, President Barack Obama began his first term in January

92. BDS. OF TRS., FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS., *HI and SMI Incurred Expenditures as a Percentage of Gross Domestic Product*, in 2017 EXPANDED AND SUPPLEMENTARY TABLES AND FIGURES, *supra* note 71.

93. *Id.*

94. BDS. OF TRS., FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS., *HI and SMI Average per Beneficiary Costs*, in 2017 EXPANDED AND SUPPLEMENTARY TABLES AND FIGURES, *supra* note 71.

95. BDS. OF TRS., FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS., *Medicare Sources of Non Interest Income and Expenditures as a Percentage of Total Income and as a Percentage of Gross Domestic Product*, in 2017 EXPANDED AND SUPPLEMENTARY TABLES AND FIGURES, *supra* note 71.

96. *Id.*

97. The famous quotation, "Laws, like sausages, cease to inspire respect in proportion as we know how they are made," often attributed to German Chancellor Otto Von Bismarck, apparently originated with the lawyer-poet John Godfrey Saxe. *An Impeachment Trial*, U. CHRON. (Mich.), Mar. 27, 1869, at 4. In a humorous take, a news writer quoted the president of a sausage making business stating that he was insulted by the comparison. See Robert Pear, *If Only Laws Were Like Sausages*, N.Y. TIMES (Dec. 4, 2010), <https://www.nytimes.com/2010/12/05/weekinreview/05pear.html?mtrref=undefined&gwh=063D18012754C0A4271FC7C3C3522451&gwt=pay>.

2009 with a Democrat Party majority in both the House and Senate.⁹⁸ The Democrats stated that one of their main goals was to provide “QUALITY, AFFORDABLE HEALTH CARE FOR ALL AMERICANS.”⁹⁹

As of May 2009, there was no hint of the NIIT in the revenue provisions that President Obama put forth in his budget for fiscal year 2010.¹⁰⁰ While the laws collectively known as the ACA were projected to reduce net direct Medicare spending by \$390 billion over the 2010–2019 period, there remained a clear need to generate significant tax revenue.¹⁰¹ First, according to the 2009 Annual Report of the Board of Trustees, the Medicare HI Trust Fund was expected to become insolvent in 2017 if no additional actions were taken.¹⁰² Second, the ACA contained numerous provisions that would collectively increase federal expenditures by \$311 billion between 2010 and 2019.¹⁰³ The single largest cost within the ACA is the expansion of the medical coverage provision which results in an additional 34 million people with insurance coverage by 2019.¹⁰⁴ The cost of these additional insured individuals resulted in additional net costs of \$828 billion over ten years.¹⁰⁵ Clearly, the ACA required several sources of revenue in addition to the cost increasing provisions.

98. FED. ELECTION COMM’N, FEDERAL ELECTIONS 2008: ELECTION RESULTS FOR THE U.S. PRESIDENT, THE U.S. SENATE AND THE U.S. HOUSE OF REPRESENTATIVES 3–5 (2009). The November 2008 election results for the U.S. Senate were 57 Democrats, 41 Republicans, and 2 Independents; and the U.S. House of Representative results were 257 Democrats, 178 Republicans, and 0 Independents. *Id.* at 3. The results of presidential popular vote were 52.93% for Democrat Barack Obama and 45.65% for Republican John McCain. *Id.* at 5.

99. *See* Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119, 119 (2010) (calling Title I of the Act “Quality, Affordable Health Care for All Americans”); *see also*, e.g., SARA R. COLLINS ET AL., COMMONWEALTH FUND, THE 2008 PRESIDENTIAL CANDIDATES’ HEALTH REFORM PROPOSALS: CHOICES FOR AMERICA (2008) (citing a key difference between then-presidential candidate Senator Obama and Senator McCain as aiming to cover everyone, a.k.a., universal coverage).

100. JOINT COMM. ON TAXATION, JCX-28-09, ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2010 BUDGET PROPOSAL AS DESCRIBED BY THE DEPARTMENT OF THE TREASURY, MAY 2009 (2009).

101. PATRICIA A. DAVIS, ET. AL., CONG. RESEARCH SERV., R41196, MEDICARE PROVISIONS IN THE PATIENT PROTECTION AND AFFORDABLE CARE ACT (PPACA): SUMMARY AND TIMELINE 1 (2010).

102. BDS. OF TRS., FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TR. FUNDS, 2009 ANNUAL REPORT 16, <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2009.pdf>.

103. Memorandum from Richard S. Foster, Chief Actuary, Dep’t of Health & Human Servs., Estimated Financial Effects of the “Patient Protection and Affordable Care Act,” as Amended 4 (Apr. 22, 2010), https://www.cms.gov/Research-Statistics-Data-and-Systems/Research/ActuarialStudies/downloads/ppaca_2010-04-22.pdf.

104. *Id.* at 3.

105. *Id.* at 4.

On July 14, 2009, however, the first foreshadowing of the NIIT occurred.¹⁰⁶ The House Committee on Ways and Means introduced revenue provisions to support the bill, America's Affordable Health Choices Act of 2009.¹⁰⁷ One of the House's proposed revenue provisions was to impose graduated surcharges on high-income taxpayers.¹⁰⁸ The House estimated the surcharges would bring in revenues of \$543.9 billion over ten years spanning 2010–2019.¹⁰⁹

By September 16, 2009, the Senate proposed a comparable health-care reform plan but with different revenue streams.¹¹⁰ The Senate's proposal did not include the income surcharges.¹¹¹ Instead, the Senate proposed many smaller health-care revenue provisions.¹¹² The largest one was a 35% excise tax on insurance companies for issuing high-cost health insurance plans, which the bill defined as insurance premiums exceeding \$8,000 single and \$21,000 family, indexed for inflation.¹¹³ The proposal set a delayed implementation date of January 1, 2013.¹¹⁴ This excise tax became known as the so-called "Cadillac tax" on high-cost health insurance plans.¹¹⁵ At this time, the Senate estimated the Cadillac tax would bring in revenues of \$214.9 billion during the seven years of its implementation, 2013–2019, within the ten-year budgeting window.¹¹⁶

106. See STAFF OF JOINT COMM. ON TAXATION, JCX-30-09, DESCRIPTION OF THE REVENUE PROVISIONS OF H.R. 3200, THE "AMERICA'S AFFORDABLE HEALTH CHOICES ACT OF 2009," at 23–25 (2009).

107. *Id.* at 1, 24. Later versions of this bill, H.R. 3590 and H.R. 4872, would, taken together, become the ACA. H.R. 3590, 111th Cong. (2009); H.R. 4872, 111th Cong. (2010).

108. JCX-30-09, *supra* note 106, at 24. The proposal sought 1%, 1.5%, and 5.4% on married filing joint filers with modified adjusted gross incomes ("AGI") of inflation-indexed floors of \$350,000, \$500,000, and \$1,000,000, respectively. *Id.* Taxpayers filing as single or head of household were to incur those surcharges at thresholds of 80% of those amounts, or \$280,000, \$400,000, and \$800,000, respectively. *Id.*

109. See JOINT COMM. ON TAXATION, JCX-31-09, ESTIMATED EFFECTS OF THE REVENUE PROVISIONS OF H.R. 3200, THE "AMERICA'S AFFORDABLE HEALTH CHOICES ACT OF 2009," at 2 (2009).

110. See JOINT COMM. ON TAXATION, JCX-35-09, ESTIMATED EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN THE CHAIRMAN'S MARK OF THE "AMERICA'S AFFORDABLE HEALTH CHOICES ACT OF 2009," at 1–2 (2009).

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* A reader can infer the delay by observing the JCT did not estimate revenue inflows for years 2010–2012. *Id.*

115. For an early mention of Cadillac tax name, see, for example, 156 CONG. REC. 2622 (2010), for Dan Burton's (R-IN) statement decrying the President's proposed exemption decreasing revenues by \$60 billion to exempt unions from the Cadillac tax.

116. JCX-35-09, *supra* note 110, at 1.

On October 29, 2009, the House modified its surcharge proposal.¹¹⁷ The House recommended imposing the 5.4% surcharge solely on individuals with incomes above \$1,000,000 for married filing joint, and \$500,000 for other filing statuses.¹¹⁸ The changes still allowed the proposed surtax to generate an aggregate estimated revenue inflow of \$460.5 billion over the ten-year window.¹¹⁹

On November 18, 2009, the Senate increased the proposed excise tax rate on Cadillac health insurance plans from 35% to 40%.¹²⁰ The Senate also increased the definition of a high-cost insurance plan to \$8,500 single/\$23,000 married, and indexed those premiums for inflation.¹²¹ The combination of changes decreased the projected revenue from the Cadillac tax to \$149.1 billion.¹²² While the proposal contained various revenue provisions, the Senate still did not mention a Medicare surtax on high-income taxpayers.¹²³

On December 19, 2009, the Senate's proposal maintained the 40% Cadillac tax, though the revenue estimate decreased slightly to \$148.9.¹²⁴ For the first time, however, the Senate proposal included the 0.9% Medicare hospital insurance tax on earned income.¹²⁵ The Joint Committee on Taxation ("JCT") estimated that the revenues from the 0.9% Medicare surtax over the ten-year budget window would produce receipts of \$86.8 billion.¹²⁶

On February 22, 2010, President Obama issued a proposal to converge the House and Senate health care plans.¹²⁷ In his proposal, presaging the final ACA legislation, the President made two recommendations to require higher-income people to pay more taxes toward Medicare hospital insur-

117. See JOINT COMM. ON TAXATION, JCX-43-09, ESTIMATED REVENUE EFFECTS OF POSSIBLE MODIFICATIONS TO THE REVENUE PROVISIONS OF H.R. 3962, THE "AFFORDABLE HEALTH CARE FOR AMERICA ACT" 1 (2009).

118. *Id.* at 2. The House explicitly did not index those thresholds for inflation. *Id.*

119. *Id.*

120. JOINT COMM. ON TAXATION, JCX-55-09, ESTIMATED REVENUE EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT," at 1 (2009).

121. *Id.*

122. *Id.*

123. *Id.*

124. JOINT COMM. ON TAXATION, JCX-61-09, ESTIMATED REVENUE EFFECTS OF THE MANAGER'S AMENDMENT TO THE REVENUE PROVISIONS CONTAINED IN THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT," at 1 (2009).

125. *Id.* at 2. Presaging its final implementation, the proposal targeted wages and self-employment income and set thresholds of \$250,000/\$200,000 with no inflation adjustment. *Id.* The proposal set January 1, 2013, as the effective date for the 0.9% Medicare surcharge to begin. *Id.*

126. *Id.*

127. *Full Text: Obama's Health Care Proposal*, KAISER HEALTH NEWS (Feb. 22, 2010), <https://khn.org/news/obama-health-care-proposal/>; Sheryl Gay Stolberg & David M. Herszenhorn, *Obama's Health Bill Plan Largely Follows Senate Version*, N.Y. TIMES (Feb. 22, 2010), <https://www.nytimes.com/2010/02/23/health/policy/23health.html>.

ance.¹²⁸ First, the President endorsed the additional 0.9% surcharge on earned income that the Senate had put forward.¹²⁹ Second, in a clear precursor to the NIIT, President Obama recommended an additional 2.9% tax on unearned income, such as income from interest, dividends, and annuities.¹³⁰ President Obama proposed that the taxes begin at the \$250,000/\$200,000 thresholds.¹³¹ The President recommended that Congress dedicate the revenues from the unearned income to Medicare's SMI Trust Fund.¹³²

The following narrative focuses on the ACA's reconciliation process from March 11, 2010 through March 18, 2010, which was the mechanism that led to the NIIT's enactment.¹³³ To begin, on March 11, 2010, the JCT provided another new revenue estimate.¹³⁴ The report was similar to the December 19, 2009, report, with the 40% Cadillac tax revenue estimate at \$148.9 billion and the 0.9% Medicare HI surcharge revenue projection at \$86.8 billion.¹³⁵ Again, those two taxes were the two largest revenue producers, generating nearly 60% of the legislation's total \$398.8 billion in projected new revenues.¹³⁶

A week later, on March 18, 2010, the JCT again issued a new revenue estimate.¹³⁷ The March 18th report reflected an increase in the thresholds for Cadillac plans to \$10,200/\$27,500.¹³⁸ The March 18, 2010, report also delayed the imposition of the 40% Cadillac tax from 2013 to 2018.¹³⁹ The two changes cut the Cadillac tax's estimated revenues from \$148.9 to \$32 billion, a total reduction of \$116.9 billion.¹⁴⁰

Apparently in response, the March 18th report included for the first time the NIIT. Similar to the President's February 22, 2010, proposal, un-

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. *See* Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1402(a), 124 Stat. 1029, 1060-63 (2010) (enacting 26 U.S.C. § 1411, which imposed the 3.8% NIIT).

134. JOINT COMM. ON TAXATION, JCX-10-10, ESTIMATED REVENUE EFFECTS OF THE MANAGER'S AMENDMENT TO THE REVENUE PROVISIONS CONTAINED IN THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT," AS PASSED BY THE SENATE ON DECEMBER 24, 2009, at 1 (2010).

135. *Id.* at 1-2.

136. *Id.*

137. JOINT COMM. ON TAXATION, JCX-16-10, ESTIMATED REVENUE EFFECTS OF THE AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 4872, THE "RECONCILIATION ACT OF 2010," IN COMBINATION WITH THE REVENUE EFFECTS OF H.R. 3590, THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT ('PPACA')," AS PASSED BY THE SENATE 1(2010).

138. *Id.*

139. *Id.*

140. *Id.*

der the banner of broadening the Medicare HI tax base for high-income taxpayers, the reconciliation combined the 0.9% surtax with the NIIT included at a 3.8% rate.¹⁴¹ The estimated combined revenues for the two surtaxes was \$210.2 billion.¹⁴² That was \$123.4 billion more than the March 11th proposal. In summary, the inclusion of the NIIT appears to have been a direct \$120 billion tradeoff to fund Congress's delayed implementation of the tax on Cadillac plans.

A swap was necessary because of the so-called Byrd parliamentary rules. When a party has the majority in the Senate, but does not have sixty votes to prevent filibuster, as was the Democrats' situation then, the Byrd rules required the legislation to be revenue neutral within the ten-year forecast window.¹⁴³

On March 20, 2010, the Manager's Amendment to the reconciliation changed the provision's name from Medicare Tax to Unearned Income Medicare Contribution.¹⁴⁴ The Amendment also excluded the President's February 22nd and the reconciliation's March 18th references to Medicare's trust funds.¹⁴⁵ Afterwards, with those final changes, Congress and the President enacted the Patient Protection and Affordable Care Act ("PPACA") and Health Care and Education Reconciliation Act ("HCERA") on March 23 and March 30, 2010, respectively, implementing the NIIT.¹⁴⁶

In summary, the NIIT arose as a last-minute revenue replacement to offset the revenue loss from Congress's delayed implementation of the 40% excise tax on high-cost, or Cadillac, health insurance plans. As a direct

141. *Id.* at 2. In contrast, however, the President's February 22, 2010, proposal sought to obtain the unearned income tax revenues for Medicare's SMI Trust Fund, not for Medicare's HI Trust Fund. See *Full Text: Obama's Health Care Proposal supra* note 127. The provision repeated the \$250,000/\$200,000 floors, with a continued lack of indexing. See JCX-61-09 *supra* note 125, at 2.

142. JCX-16-10 *supra* note 137, at 2.

143. See, e.g., BILL HENIFF JR., CONG. RESEARCH SERV., RL30862, THE BUDGET RECONCILIATION PROCESS: THE SENATE'S "BYRD RULE" 4-5 (2016). In brief, § 313 of the 1974 Congressional Budget Act, Pub. L. No. 93-344, 88 Stat. 297 (as amended at 2 U.S.C. § 644), created the Byrd rule, named after its main proponent, Senator Robert C. Byrd (D-WV). HENIFF, *supra*, at 1, 3. In summary, the Byrd rule prohibits an "extraneous matter" in reconciliation legislation. *Id.* at 2. The upshot is that when a party cannot achieve sixty votes to prevent a filibuster, legislation can still pass with a fifty-vote majority as long as the bill does not forecast an increase in the budget deficit during the ten-year window following the legislation. *Id.* at 4-5.

144. John Cannan, *A Legislative History of the Affordable Care Act: How Legislative Procedure Shapes Legislative History*, 105 L. LIBR. J., 131, 164 (2013).

145. H.R. REP. NO. 111-488, at 80-83 (2010).

146. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010); Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029; STAFF OF JOINT COMM. ON TAXATION, JCX-18-10, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE "RECONCILIATION ACT OF 2010," AS AMENDED, IN COMBINATION WITH THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT," 57, 60-66, 134-36 (2010) (explaining the new "Excise Tax on High Cost Employer-Sponsored Health Coverage," otherwise known as the Cadillac tax, and the "Unearned Income Medicare Contribution," otherwise known as the NIIT).

substitute for the Cadillac tax's general fund revenues, the receipts from the NIIT needed to flow into the Treasury's general fund instead of being dedicated to either of Medicare's trust funds. In other words, while helpful to supporting federal expenditures, including Medicare, the ACA did not directly link the NIIT to Medicare.¹⁴⁷

B. How the NIIT Operates

The ACA created many new taxes or revenue sources. As relevant here, the ACA created two new taxes for Medicare: a new federal payroll tax and a new federal income tax.¹⁴⁸

For the payroll tax, the PPACA, imposed a 0.9% payroll tax surcharge on higher-level wages and self-employment income.¹⁴⁹ The PPACA dedicated those proceeds to Medicare, specifically Medicare's HI Trust Fund, to fund Medicare Part A.¹⁵⁰ A week later, the HCERA, imposed a new and separate 3.8% income tax on net investment income, again for higher-

147. See Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1402(a), 124 Stat. 1029, 1060-63 (enacting 26 U.S.C. § 1411, imposing the 3.8% NIIT); see also STAFF OF JOINT COMM. ON TAXATION, JCS-2-11, GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN THE 111TH CONGRESS 363 (2011) ("No provision is made for the transfer of the tax imposed by this provision from the General Fund of the United States Treasury to any Trust Fund."); BDS. OF TRS., *supra* note 22, at 21 n.18 ("The ACA also specifies that individuals with incomes greater than \$200,000 per year and couples above \$250,000 pay an additional Medicare contribution of 3.8 percent on some or all of their non-work income (such as investment earnings). However, the revenues from this tax are not allocated to the Medicare trust funds." (emphasis added)).

148. Broadly speaking, a payroll tax is a self-funding social insurance mechanism, consisting of Social Security, meaning Old Age, Survivors, and Disability Income ("OASDI"), and Medicare. STAFF OF JOINT COMM. ON TAXATION, JCX-6-13, PRESENT LAW AND BACKGROUND RELATING TO THE TAX-RELATED PROVISIONS IN THE AFFORDABLE CARE ACT 23 (2013). An income tax, on the other hand, generates revenues for the Treasury's general fund based on the taxpayer's taxable income. MARGOT L. CRANDALL-HOLLICK, CONG. RESEARCH SERV., IN11015, THE FEDERAL INCOME TAX: HOW DO MARGINAL INCOME TAX RATES WORK? 1-2 (2019). Examples of other revenue generators from the ACA, not tied to the level of wages or profits, include limiting to \$2500 the annual amount that each employee may elect to contribute to pretax health flexible spending arrangements ("FSA") within an employer's cafeteria plan and a 10% retail sales tax imposed on consumers, really an excise tax, on the amount customers pay for indoor tanning services. JCX-6-13, *supra* note 148, at 9, 43.

149. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, §§ 9015, 10906, 124 Stat. 119, 870-72, 1020 (2010). Entitled Additional Hospital Insurance Tax on High-Income Taxpayers, the Act initially imposed the payroll tax surcharge at 0.5%, then within the Act itself modified to 0.9% on wages under the Federal Insurance Contributions Act ("FICA"), 26 U.S.C. § 3101(b)(2) (2012), and on self-employment income under the Self-Employment Contributions Act ("SECA"), 26 U.S.C. § 1401(b)(2)(A). *Id.*

150. *Id.*

income individuals.¹⁵¹ The Acts set January 1, 2013, as the effective date for both new taxes to begin.¹⁵²

As noted, the two new Medicare taxes apply only to higher-income taxpayers with adjusted gross income above non-inflation-adjusted thresholds.¹⁵³ Those floors remain at \$250,000 married filing joint, \$200,000 single and head of household, and \$125,000 married filing separately.¹⁵⁴ The two taxes are symmetrical in that they each result in the imposition of a 3.8% tax rate on income.¹⁵⁵ The formulations, however, are distinct, as explained below.

The 0.9% surcharge aggregates to a 3.8% tax from *earned* income as part of a multifaceted payroll tax system. Employees owe a Medicare HI tax of 1.45% on their wages.¹⁵⁶ Similarly, the employer owes a parallel 1.45% HI tax on the employees' wages.¹⁵⁷ Congress and President William J. Clinton removed the limit on the HI contribution base effective beginning in 1993.¹⁵⁸ That means employees and employers each pay 1.45% on the employees' entire compensation, not as before limited to the Social Security wage base, which was \$128,400 in 2018.¹⁵⁹ Mathematically, the two 1.45% HI tax impositions, on the employee and the employer, total a combined 2.9% tax.

Individuals earn self-employment income by, for instance, owning an unincorporated sole proprietorship business, or certain pass-through entities. These taxpayers owe the combined 2.9% HI tax on their self-employment income.¹⁶⁰ Mirroring the tax on employee earnings, the 2.9%

151. Health Care and Education Reconciliation Act of 2010 § 1402(a), 124 Stat. at 1060–63 (enacting 26 U.S.C. § 1411). The provision established a 3.8% tax on net investment income for incomes above non-inflation adjusted thresholds. *Id.*

152. *See id.* (setting the effective date for the 3.8% NIIT); Patient Protection and Affordable Care Act § 10906, 124 Stat. at 1020 (setting the effective date for the 0.9% tax in § 10906(c)).

153. 26 U.S.C. §§ 1401(b)(2)(A), 1411(b) (2012).

154. *Id.*

155. *Id.*

156. *Id.* § 3101(b)(1). This code section details the employee's FICA contribution of 7.65%, which consists of 6.2% for OASDI, commonly called Social Security, and 1.45% for Medicare HI tax. *Id.*

157. *Id.* § 3111(b). Similar to the arrangement for employees detailed in section 3101(b)(1), employers likewise owe 7.65% in FICA taxes. *Id.* § 3111.

158. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103–66, § 13207, 107 Stat. 312, 467–68; *see also Contribution and Benefit Base, SOC. SECURITY ADMIN.*, <https://www.ssa.gov/oact/COLA/cbb.html#Series> (last visited Oct. 30, 2018) (showing that the HI tax for employees and employers began in 1966 at 0.35% and over time rose to the 1.45% in 1986–1987, where it remains today, thirty years later).

159. *Contribution and Benefit Base, supra* note 158.

160. *See* 26 U.S.C. § 1401(b)(1) (imposing the 2.9% tax on every self-employed taxpayer).

tax on self-employment income has an unlimited contributions base.¹⁶¹ In plain language that means the law imposes no cap on the 2.9% tax.

The PPACA added the 0.9% surcharge on employees and self-employed persons, not on employers.¹⁶² Therefore, in sum, combining the tax percentages of 1.45%, 1.45%, and 0.9%, totals 3.8%. In other words, the 0.9% PPACA Medicare surcharge established the aggregate tax on earned income at 3.8%. The rate is parallel to HCERA's imposition of the NIIT's direct tax of 3.8% on unearned income.

HCERA set the NIIT to tax *unearned* income directly at the 3.8% rate.¹⁶³ Unearned income or net investment income in this context means an individual's gross earnings from interest, dividends, rents, royalties, capital gains on investments, and similar non-business and non-compensation-related sources minus any applicable deductions.¹⁶⁴

In conclusion, PPACA and HCERA both enacted limitless taxes for Medicare, or health care spending generally, on earned and unearned income. Under different mechanisms, they both result in a surtax of 3.8% for each type of income.

C. Revenues Generated by the NIIT

This Section describes the revenue generated by the ACA's two Medicare-related taxes. For the first tax, the Internal Revenue Service ("IRS") Statistics of Income reported that the number of taxpayers who filed Form 8959, entitled *Additional Medicare Tax*, to report the additional 0.9% Medicare Tax were as follows: 2,815,530 returns in 2013, 3,116,486 returns in 2014, and 3,486,938 returns in 2015.¹⁶⁵ Those returns raised an estimated \$6.3 billion, \$7.3 billion, and \$8.1 billion, in 2013–2015, respectively.¹⁶⁶

161. See *Contribution and Benefit Base*, *supra* note 158 (showing that the self-employment rate, which likewise began in 1966, did not double the employee rate until 1984).

162. See 26 U.S.C. §§ 3101(b)(2), 1401(b)(2)(A) (imposing the additional 0.9% surcharge on wages and self-employment income, respectively); *id.* § 1411(b) (defining the threshold amount for income subject to the 3.8 tax).

163. See *id.* § 1411(a)(1) (imposing the tax at a 3.8% rate).

164. See *id.* § 1411(c) (defining net investment income and applicable deductions).

165. IRS, *Form 8959*, in INDIVIDUAL INCOME TAX RETURNS LINE ITEM ESTIMATES 220, 220 (2013), <https://www.irs.gov/pub/irs-soi/13inlinecount.pdf> [hereinafter 2013 LINE ITEM ESTIMATES]; IRS, *Form 8959*, in INDIVIDUAL INCOME TAX RETURNS LINE ITEM ESTIMATES 216, 216 (2014), <https://www.irs.gov/pub/irs-soi/14inlinecount.pdf> [hereinafter 2014 LINE ITEM ESTIMATES]; IRS, *Form 8959*, in INDIVIDUAL INCOME TAX RETURNS LINE ITEM ESTIMATES 208, 208 (2015), <https://www.irs.gov/pub/irs-soi/15inlinecount.pdf> [hereinafter 2015 LINE ITEM ESTIMATES].

166. See sources cited *supra* note 165.

In comparison, the 3.8% NIIT has brought in even greater tax receipts than the 0.9% additional Medicare tax.¹⁶⁷ Additionally, the NIIT's actual revenues have been greater than the Congressional Research Service's initial projections.¹⁶⁸ The number of taxpayers that filed Form 8960, entitled *Net Investment Income Tax—Individuals, Estates, and Trusts*, totaled 3,090,498 tax returns in 2013, 3,591,314 tax returns in 2014, and 3,828,608 tax returns in 2015.¹⁶⁹ Those returns generated \$16.5 billion, \$22.5 billion, and \$22.0 billion in tax revenues for 2013–2015, respectively.¹⁷⁰

True, the revenue from the NIIT pales as a fraction of the total annual taxes the U.S. Treasury collects.¹⁷¹ Still, the projected ten-year \$172 billion revenue loss from eliminating the NIIT would not be inconsequential.¹⁷² The ten-year NIIT revenue would be nearly large enough to pay for, for example, the aggregate of the next five years of the U.S. Navy's acquisition programs for the: (1) CVN 78 Gerald R. Ford-class nuclear aircraft carriers; (2) the D-5 Trident II sea-launched ballistic missile system; and (3) the SSN 774 Virginia-class submarines.¹⁷³

IV. ADDITIONAL PUBLIC POLICY CONSIDERATIONS

As mentioned at the start of this story, the NIIT implicates additional public policy issues. Those issues include the taxation of capital as opposed to labor, and the exclusion from gross income of employer-provided health care premiums. Below is an explanation of those two issues.

A. *Taxation of Capital Versus Labor*

Taxes are generally interchangeable in the sense that money is fungible. As mentioned from the outset, however, one of the main unique aspects of the NIIT is that it is a tax on unearned income, meaning a tax on

167. IRS, *Form 8960, in 2013 LINE ITEM ESTIMATES*, *supra* note 165, at 222, 222; IRS, *Form 8960, in 2014 LINE ITEM ESTIMATES*, *supra* note 165, at 218, 218; IRS, *Form 8960, in 2015 LINE ITEM ESTIMATES*, *supra* note 165, at 210, 210.

168. JANEMARIE MULVEY, CONG. RESEARCH SERV., R41128, HEALTH-RELATED REVENUE PROVISIONS IN THE PATIENT PROTECTION AND AFFORDABLE CARE ACT (P.L. 111-148 7) (2010). The CRS expected the tax to bring in roughly \$123.4 billion during its first 10 years. *Id.* at 7.

169. *See* sources cited *supra* note 167.

170. IRS, *Form 8960, in 2013 LINE ITEM ESTIMATES*, *supra* note 165, at 223; IRS, *Form 8960, in 2014 LINE ITEM ESTIMATES*, *supra* note 165, at 219; IRS, *Form 8960, in 2015 LINE ITEM ESTIMATES*, *supra* note 165, at 211.

171. OFFICE OF MGMT. & BUDGET, *supra* note 78, at 24 tbl.1.1. In comparison, the United States collected a total of \$3.3 trillion in revenue in 2017. *Id.* at 25 tbl.1-1.

172. *See supra* note 10.

173. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-17-333SP, DEFENSE ACQUISITIONS ASSESSMENTS OF SELECTED WEAPON PROGRAMS 184–87 (2017) (detailing the projected expenditures at \$37.5 billion for the CVN 78 Gerald R. Ford-class nuclear aircraft carriers, \$58.5 for the D-5 Trident II Sea-Launched Ballistic Missile system, and \$95.6 billion for the SSN 774 Virginia-class submarines, for a grand total price tag of \$191.6 billion).

the owners of capital, as opposed to labor. The federal income tax system generally taxes capital at favorable rates vis-à-vis labor. For instance, as early as 1921, Uncle Sam taxed capital gains at a favorable rate.¹⁷⁴ The theory, which critics dispute, is that the boost in economic growth from lower tax rates on returns to capital outweighs the revenue loss.¹⁷⁵

Correspondingly, on January 13, 2010, the JCT, at Congress's request, issued a report entitled *Present Law and Background Data Related to the Individual Income and Social Insurance Taxes as in Effect for 2010 and 2011*.¹⁷⁶ The report determined that 81% of all federal income tax returns had taxpayers who paid more in federal payroll taxes than income taxes.¹⁷⁷ The reason was because payroll taxes are generally fixed percentages, meaning a proportional tax, not a progressive tax.¹⁷⁸ Therefore, the average income tax rate exceeded the payroll tax rate only at higher income brackets.¹⁷⁹ In fact, the report showed that only when the income level was \$200,000 or higher did income taxes exceed social insurance taxes.¹⁸⁰ Similarly, a separate set of tables in the report showed that the averaged combined marginal income and employment tax rate on labor, 28.3%, was nearly double the average 14.7% marginal income tax rate on capital income for 2010.¹⁸¹ In other words, the report showed that public tax policy greatly favored returns to capital over earnings from labor.

The preferential treatment for returns to capital continues to this day. In the new tax law formerly named the Tax Cut and Jobs Act, Congress set

174. For 1921, the federal government set the top capital gains rate at 12.5%, in contrast to the regular top tax rate of 73% on ordinary or earned income. See JANE G. GRAVELLE, CONG. RESEARCH SERV., 96-769, CAPITAL GAINS TAXES: AN OVERVIEW 1 (2018). The states had made federal income taxation constitutional only eight years earlier with their ratification of the Sixteenth Amendment in 1913. U.S. CONST. amend XVI. The Sixteenth Amendment was necessary to supersede *Pollack v. Farmers' Loan & Tr. Co.*, 157 U.S. 429 (1895), in which the Supreme Court ruled that the federal government's prior attempt at federal income taxation was unconstitutional because the tax violated Article I's requirement for a direct tax. Joseph R. Fishkin et al., *The Sixteenth Amendment*, NAT'L CONST. CTR. <https://constitutioncenter.org/interactive-constitution/amendments/amendment-xvi> (last visited Apr. 11, 2019).

175. *Id.*; see *supra* Part I. For an example of the inverse theory, see, Harald Uhlig & Noriyuki Yanagawa, *Increasing the Capital Income Tax May Lead to Faster Growth*, 40 EUR. ECON. REV. 1521 (1996); see also GRAVELLE, *supra* note 174 (stating in the Summary that critics claim lower capital gains rates have detrimental impacts, including disagreement on the magnitude of growth, lower rates benefit the wealthy, decrease government revenues, encourage tax shelters, and further complicate the tax code).

176. STAFF OF JOINT COMM. ON TAXATION, JCX-1-10, PRESENT LAW AND BACKGROUND DATA RELATED TO THE INDIVIDUAL INCOME AND SOCIAL INSURANCE TAXES AS IN EFFECT FOR 2010 AND 2011 (2010). Based on the timing, this January report may have influenced President Obama's February 22, 2010 proposal to effectively add the NIIT as part of the ACA legislation. See text accompanying *supra* note 129.

177. JCX-1-10, *supra* note 176, at 32.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.* at 34.

the top income tax rate for individuals at 37%, effective beginning after December 31, 2017.¹⁸² In contrast, the Act maintained the general maximum income tax rate on long-term capital gains at 20%.¹⁸³ Similarly, seven of the top ten largest federal tax expenditures are tax breaks for owners of capital.¹⁸⁴ In summary, any decision on the NIIT's future should weigh costs and benefits of taxing capital versus labor. In other words, while the NIIT is a relatively small revenue generator, the NIIT cuts against the grain from most taxes in that the NIIT burdens returns to capital, which traditionally the federal government has favored.

B. Taxation of Employer-Paid Health Insurance

As this Article previously explained, Congress implemented the NIIT as a last-minute Byrd rule substitute for the delayed-implementation of the Cadillac tax on high-cost health insurance plans. Part of the motivation in imposing the Cadillac tax is that employer-paid health insurance premiums have been excluded from federal income taxation since the 1920s.¹⁸⁵ The impact of this policy was strengthened by the Stabilization Act of 1942, which froze wages during World War II.¹⁸⁶ While wages were frozen, benefits were not, thus more employers began offering health benefits in an attempt to attract employees.¹⁸⁷ Post-World War II, the growth in fringe benefits, led by health coverage, continued until the mid-1960s when demand for fringe benefits leveled off.¹⁸⁸ Despite demand flattening out in the second half of the twentieth century, employer-sponsored health insurance

182. Individual Tax Reform and Alternative Minimum Tax, Pub. L. No. 115-97, § 11001, 131 Stat. 2054, 2054–55 (2017).

183. 26 U.S.C. § 1(h)(1)(D) (2012).

184. See U.S. DEP'T OF THE TREASURY, OFF. OF TAX ANALYSIS, TAX EXPENDITURES 34 (2017). In brief, tax expenditures are provisions in the Internal Revenue Code that cause revenue losses because they allow exclusions, exemptions, deductions, credit, preferential rate, or deferral of tax payment. *Id.* at 1. The top ten, in declining order over a ten-year window, with their estimated 2019 revenue loss, and in parentheses, benefiting capital versus labor, were: (1) exclusion of employer-provided health insurance premiums (labor) \$243 million; (2) exclusion of net imputed rental income on home ownership (capital) \$131 million; (3) deferral of income from controlled foreign corporations (capital) \$118 million; (4) preferential rates on capital gains (capital) \$110 million; (5) defined contribution retirement plan benefits (income-based but a benefit for capital as savings) \$80 million; (6) deduction for comity of state and local income taxes paid (labor) \$80 million; (7) deduction for mortgage interest on owner-occupied homes (capital) \$75 million; (8) defined benefit retirement plans (similar to their defined contribution cousins; income-based but a benefit for capital as savings) \$77 million; (9) deduction for charitable contributions (labor) \$55 million; and (10) deduction for real property taxes on owner-occupied homes (capital) \$38 million. *Id.* at 34.

185. SEAN LOWRY, CONG. RESEARCH SERV., R44160, THE EXCISE TAX ON HIGH-COST EMPLOYER-SPONSORED HEALTH COVERAGE: BACKGROUND AND ECONOMIC ANALYSIS 4 (2015).

186. *Id.*; Stabilization Act of 1942, ch. 578, 56 Stat. 765.

187. LOWRY, *supra* note 185, at 4.

188. *Id.*

plans continued to account for the largest single source of health coverage for the non-elderly population.¹⁸⁹ As of 2012, of the 65.8% of the non-elderly population that have private health insurance, 88.9% are covered by an employer-sponsored insurance plan.¹⁹⁰ This employer-provided coverage remains excluded from federal income tax.¹⁹¹ As noted previously, the non-taxation of employer-sponsored health coverage is the single largest federal tax expenditure, costing taxpayers an estimated \$243 billion in 2019.¹⁹²

Starting in 2009 during the legislative process that eventually led to the ACA, Congress debated eliminating the employer-sponsored health coverage exemption.¹⁹³ For instance, in its original draft as part of the America's Healthy Future Act of 2009, the Cadillac tax imposed a 35% tax on plans with premiums above \$8000 for single plans and \$21,000 for family plans starting in 2013.¹⁹⁴ This original incarnation of the Cadillac tax on employer-sponsored insurance included inflation adjusted thresholds and was estimated to raise \$215 billion over its first seven years.¹⁹⁵ A few weeks after its debut, the tax rate was increased to 40% and the thresholds were indexed to inflation plus 1%.¹⁹⁶ These changes reduced the estimated revenue from this tax by \$14 billion to \$201 billion over its first seven years.¹⁹⁷ When the ACA passed the House in December 2009, its version of the Cadillac tax remained at 40% but increased the thresholds to \$8500 for singles and \$23,000 for family policies, while also keeping inflation plus 1% indexing.¹⁹⁸ This version would be signed into law on March 21, 2010 as part of the PPACA.¹⁹⁹ Just ten days later, the HCERA revised the Cadillac tax by increasing its thresholds yet again, this time to \$10,200 for single and \$27,500 for families, and delayed its implementation to 2018.²⁰⁰ These changes to the Cadillac tax resulted in revenue expectation of only \$32 billion between 2010 and 2019.²⁰¹ Between its original incarnation in the America's Healthy Future Act and the final version passed as part of the HCERA, expected revenue fell by \$183 billion.²⁰² In December of 2015,

189. *Id.*

190. *Id.*

191. *Id.*

192. *See supra* note 184 (discussing tax expenditures).

193. LOWRY, *supra* note 185, at 5–6.

194. *Id.* at 6; S. 1796, 111th Cong. (2009).

195. LOWRY, *supra* note 185, at 6.

196. *Id.*

197. *Id.*

198. *Id.* at 6–7.

199. *Id.* at 7.

200. *Id.*

201. *Id.*

202. *Id.* at 6–7.

with the passage of the Consolidated Appropriations Act of 2016, the 40% tax on high-cost employee-sponsored health insurance plans was further delayed from 2018 until 2020.²⁰³ Finally, in January of 2018, the actions taken to cease the government shutdown included yet another delay in the implementation of the Cadillac tax; it will now take effect in 2022.²⁰⁴ While delayed until 2022, the thresholds for the tax are still indexed to inflation and are estimated to impact 30% of employers by 2023 and 42% of employers by 2028.²⁰⁵

The proposed tax on employer-sponsored Cadillac health plans has created strange bedfellows by uniting labor and employers in their opposition.²⁰⁶ Labor unions have long negotiated expensive healthcare benefits for their members. In 2014, health insurance costs for unionized employees was more than twice that of non-unionized employees.²⁰⁷ In March of 2017, the International Brotherhood of Teamsters sent a letter to the Chairmen and Ranking Members of the Committee on Ways and Means and the Committee on Energy and Commerce expressing their disapproval that the Cadillac tax was delayed and not repealed.²⁰⁸ In a July 21, 2015 article, the *New York Times* pointed out that the Cadillac tax on employer sponsored health insurance is “galvanizing many employers and their unions” in opposition to the tax.²⁰⁹ A cadre of large corporations and union groups formed the Alliance to Fight the 40, a coalition to fight for the repeal of the 40% Cadillac tax.²¹⁰ In other words, the Cadillac tax has proven to be a political hot potato. As of the date of this writing, Congress still has not enacted a Cadillac tax. Consequently, the NIIT continues to fulfill its original role as a substitute revenue source for the Cadillac tax.

203. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, § 101(a), 129 Stat. 3037, 3037 (2015).

204. Fourth Continuing Appropriations for Fiscal Year 2018, Federal Register Printing Savings, Healthy Kids, Health-Related Taxes, and Budgetary Effects, Pub. L. No. 115-120, § 4001(c), 132 Stat. 28, 38 (2018) (delaying implementation date until after “December 31, 2021”).

205. Gary Claxton & Larry Levitt, *How Many Employers Could Be Affected by the Cadillac Plan Tax?*, KAISER FAM. FOUND. (Aug. 25, 2015), <https://www.kff.org/health-costs/issue-brief/how-many-employers-could-be-affected-by-the-cadillac-plan-tax/>.

206. Reed Abelson, *Health Care Tax Faces United Opposition from Labor and Employers*, N.Y. TIMES (July 21, 2015), www.nytimes.com/2015/07/22/business/labor-and-employers-join-in-opposition-to-a-health-care-tax.html.

207. *Employer Costs for Union Workers Averaged \$46.50 per Hour Worked in December 2014*, U.S. BUREAU OF LAB. & STAT. (Mar. 13, 2015), <https://www.bls.gov/opub/ted/2015/employer-costs-for-union-and-nonunion-workers-in-december-2014.htm>.

208. 163 CONG. REC. H4162 (2017).

209. Abelson, *supra* note 206.

210. *Id.*

V. CONCLUSION

In conclusion, the financial trends in Medicare are troubling and the financing needs of Medicare from the U.S. Treasury's general fund are growing fast.²¹¹ Seniors are enrolling in Medicare faster than the growth in the number of workers contributing to the program.²¹² Medicare expenditures are rising at full tilt, faster than inflation.²¹³ All these trends are causing federal expenditures on Medicare to consume an ever-growing share of the federal budget, crowding out other important programs, such as the defense budget.²¹⁴

The NIIT provides revenue to alleviate the Medicare funding problem. True, taxes are fungible, and the amount is relatively minor, but to the extent legislators want to tax capital instead of income, the NIIT serves that role. Additionally, the excise tax on Cadillac health care plans could serve as an alternative tax source, albeit more labor-related than capital-centric. The Cadillac tax would whittle away at the nation's largest tax expenditure, employer-provided health care, however, as with any revenue source, it too has its own pros and cons. In retrospect, although Congress added the NIIT as simply a Byrd-rule last minute substitute, and despite attempts to repeal, the NIIT has survived with its own unique public policy implications. Consequently, the NIIT continues to embody the sentiment of what a long strange trip it's been.

211. *See supra* Figure 1.

212. *See supra* Figure 2.

213. *See supra* Figure 3.

214. *See supra* Figure 4.