

Who Pays Medicare-Related Taxes, Who Doesn't, and Potential Revenue Reforms

Gordon Mermin, Bowen Garrett, Robert McClelland, and Eugene Steuerle

March 2026

Medicare faces significant short-term and longer-term financing challenges. Over the decade 2025 to 2034, the program's Hospital Insurance (HI) spending is projected to exceed revenues by a cumulative amount of \$369 billion (Medicare Trustees 2025). Reserves in the HI trust fund, which amount to about 52 percent of this year's projected spending, will cover annual deficits until it is depleted, which is projected to happen in 2033 according to the Medicare trustees. At that point, without legislative action, Medicare would not be able to make full and timely payments to providers of hospital care. Incoming HI revenues would only cover about 89 percent of projected spending.

Yet near-term HI financing is only part of the problem. Medicare also pays for physician services and prescription drugs. Longer term, total Medicare spending net of offsetting receipts (i.e., beneficiary premiums and state contributions) is projected to increase from 3.1 percent of GDP (or 18 percent of federal revenues) in 2025 to 4.8 percent of GDP (25 percent of federal revenues) in 2045 (CBO 2025).

Addressing both short- and long-term financial pressures on Medicare will likely require a combination of reduced spending and increased revenues. To help inform revenue options policymakers may consider, this brief reviews the evolution of the HI tax on earnings, Medicare's largest dedicated funding source, and the Net Investment Income Tax (NIIT), which is viewed by some as partially extending Medicare taxes to capital income, though it does not fund the program under current law. We use the Tax Policy Center microsimulation model to compare the size and distribution of income sources subject to HI taxes or NIIT with those that are not. We identify two potential gaps in the HI

tax/NIIT base and use the microsimulation model to analyze the revenue and distributional impacts of extending taxes to those income streams. See the appendix for information on the Tax Policy Center microsimulation model.

The key findings from our analysis are as follows:

- Medicare HI relies heavily on taxes tied to earnings, and the NIIT covers selected investment income, yet only about 60 percent of total income is subject to the HI tax or NIIT under current law. Significant categories of compensation and business income remain untaxed.
- Employer-provided health and retirement benefits represent a large gap in the Medicare tax base. Nearly \$2.8 trillion in employer contributions to health insurance, pensions, and payroll taxes are excluded from HI taxes despite being forms of compensation similar to wages.
- Roughly \$1 trillion in certain active pass-through income is not subject to HI taxes or the NIIT, even though similar income is covered by self-employment taxes.
- The distribution of untaxed income varies sharply by source. Untaxed employer benefits are spread broadly across the income distribution. Untaxed active pass-through income is highly concentrated among top-income households, especially within the top 1 percent.
- Extending HI taxes to employer-provided benefits could raise as much as \$600 billion over 10 years and affects middle-income households the most, as they currently receive the largest share of untaxed benefits. Expansion along these lines would improve horizontal equity (the concept that people of equal well-being should have the same tax burden) but may reduce take-up of generous health plans and dampen retirement saving incentives.
- Extending the NIIT or self-employment taxes to certain active pass-through business income could raise as much as \$330 billion and \$540 billion over 10 years, similar in magnitude to Medicare Part A's near-term but not long-term financing gap. The burden would fall overwhelmingly on high-income households, increasing overall tax progressivity and reducing incentives for tax-motivated business organizational choices.

Both types of base-broadening significantly increase revenues, but they differ markedly in distributional effects, economic incentives, and administrative considerations. Policymakers' choices will involve trade-offs between fairness, efficiency, and potential impacts on compensation practices, business organization incentives, and labor supply. This study does not address the balance between tax increases and benefit reductions, nor whether any tax increases should be dedicated to the HI trust fund.

Background

In 2026, Medicare will provide health insurance coverage to more than 69 million Americans. It is funded mainly by a combination of dedicated payroll taxes; general revenues from income taxes, borrowing, and other sources; and beneficiary premiums.

The Hospital Insurance (HI) tax on wages and self-employment income is Medicare's largest dedicated funding stream. Revenues flow into the HI trust fund financing Medicare Part A, which primarily covers hospital care.

Medicare Part B (largely physician services) and Part D (prescription drugs) are funded primarily by general federal tax revenues (which finance 75 percent of both) and secondarily by beneficiary premiums and state contributions. Premiums cover the remaining 25 percent for Part B. For Part D, about 13 percent is funded by premiums and 12 percent is funded by state contributions (Cubanski 2025).

The HI tax is levied on earnings at a rate of 2.9 percent, split evenly between employers and employees. The self-employed pay both portions of the tax through Self-Employed Contributions Act (SECA) taxes. Unlike the Social Security payroll tax, there is no upper limit to the earnings subject to the HI tax. Single households earning more than \$200,000 and married households earning more than \$250,000 pay the Additional Medicare Tax, an additional 0.9 percent HI tax on earnings over those thresholds.¹ Along with a portion of income tax on Social Security benefits, the HI tax is deposited in the trust fund, which pays for the portion of Medicare that provides hospital and institutional services. HI tax receipts are projected to be \$395 billion in 2025 (Medicare Trustees 2025).

The NIIT, enacted as part of the Affordable Care Act (ACA), is a 3.8 percent tax on interest, dividends, capital gains, rents, royalties, and passive business income² of taxpayers with incomes exceeding \$200,000 for single filers and \$250,000 for married filers. Some view the NIIT, which has the same combined rate as the HI tax, as partially extending Medicare taxes to capital income, though it is not a dedicated source of funding under current law. Although intended to fund Medicare, because of procedural issues related to the congressional reconciliation process, the ACA did not dedicate NIIT revenue toward the HI trust fund (Van de Water 2020). Some note that dedicating NIIT revenues to the HI trust fund would be double-counting, as it also funds the ACA.³ NIIT tax receipts are projected to be \$49.4 billion in 2025.⁴

The Medicare tax treatment of business income depends on the type of organization and form of payment to owners. Some businesses, called C corporations, pay corporate income taxes, and some, called pass-through businesses, are taxed solely at the individual owner level.⁵ Owners of C corporations pay HI taxes on wages from their businesses and may pay NIIT on dividends and capital gains from the sale of stock.

Owners of pass-through businesses pay HI tax on their wages, self-employment income, and certain other forms of guaranteed payments. Pass-through owners are potentially subject to the NIIT depending on whether their business income is considered "active" (meaning the owner materially participates in the business) or "passive" (if they don't). Passive pass-through business income generally is subject to the NIIT but not to self-employment taxes. Since active pass-through income is not covered by the NIIT and only some kinds are covered by self-employment taxes, portions of active pass-through business income are subject to neither HI taxes nor the NIIT.⁶

Evolution of Medicare-Related Tax Base (HI/NIIT base)

The HI tax was enacted by the Social Security Amendments of 1965 and was first collected in 1966. The rationale was modeled after Social Security. Workers and their employers would each contribute to the Medicare system to pay for benefits in retirement. The initial combined employer-employee rate of 0.7 percent was applied to the first \$6,600 of earnings, the same earnings base as Social Security.⁷

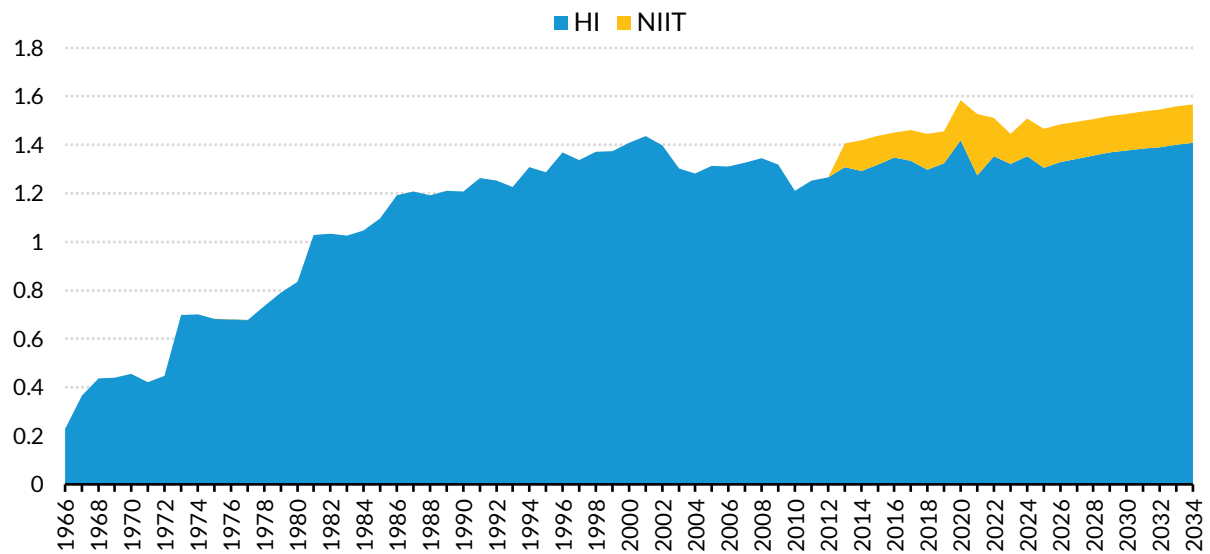
Congress periodically increased the rate, reaching the current combined rate of 2.9 percent in 1986. The ACA added a 0.9 percent Additional Medicare Tax on earnings above certain thresholds starting in 2013, increasing the total HI rate on those earnings to 3.8 percent.

Congress also periodically increased maximum taxable earnings for Social Security and Medicare taxes and then enacted automatic wage indexing of the earnings limit starting in 1975. From 1966 to 1990, maximum taxable earnings for Medicare were the same as for Social Security. In 1991, Congress substantially increased the maximum taxable earnings for the HI tax, then applied the HI tax to all earnings without limit starting in 1994.⁸

The ACA created the NIIT, extending an HI-like tax to many kinds of investment income for high-income taxpayers starting in 2013. Although the HI tax was intended as a tax on workers, it always taxed capital to some degree by covering self-employment earnings, including the labor income of business owners and returns to their investments. According to one estimate, over 40 percent of self-employment income derives from capital (CBO 2012).

Because of rate increases and base expansions, HI revenues increased steadily relative to the size of the economy from 0.2 percent of GDP in 1966 to 1.3 percent of GDP in 1994 (figure 1). Since that time, growth in HI revenue has ebbed, and HI revenues remain at about 1.3 percent of GDP. NIIT revenues were 0.10 percent of GDP in 2013 and have grown in recent years to 0.16 percent of GDP. The NIIT will likely grow over time as a percentage of GDP, as its income thresholds are not indexed for inflation.²

FIGURE 1
Historical and Projected HI Taxes and NIIT as a Percent of GDP



URBAN INSTITUTE

Source: “Trustees Report & Trust Funds: 2025 Expanded and Supplementary Tables and Figures,” CMS.gov, accessed January 23, 2026, <https://www.cms.gov/data-research/statistics-trends-and-reports/trustees-report-trust-funds>; Internal Revenue Service Statistics of Income, “Soi Tax Stats - Individual Statistical Tables by Size of Adjusted Gross Income,” published as: “Individual Complete Report (Publication 1304), Table 3.3, Years 2014–22,” accessed January 29, 2026, <https://www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income>; Supplemental tables from “The Budget and Economic Outlook: 2025 to 2035,” CBO, January 17, 2025, www.cbo.gov/publication/60870; “Key Budget and Economic Data,” CBO, accessed January 23, 2026, <https://www.cbo.gov/data/budget-economic-data#3>; and “National Income and Product Accounts, Table 1.1.5,” Bureau of Economic Analysis, accessed January 23, 2026, <https://apps.bea.gov/iTable/>.

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; GDP = gross domestic product.

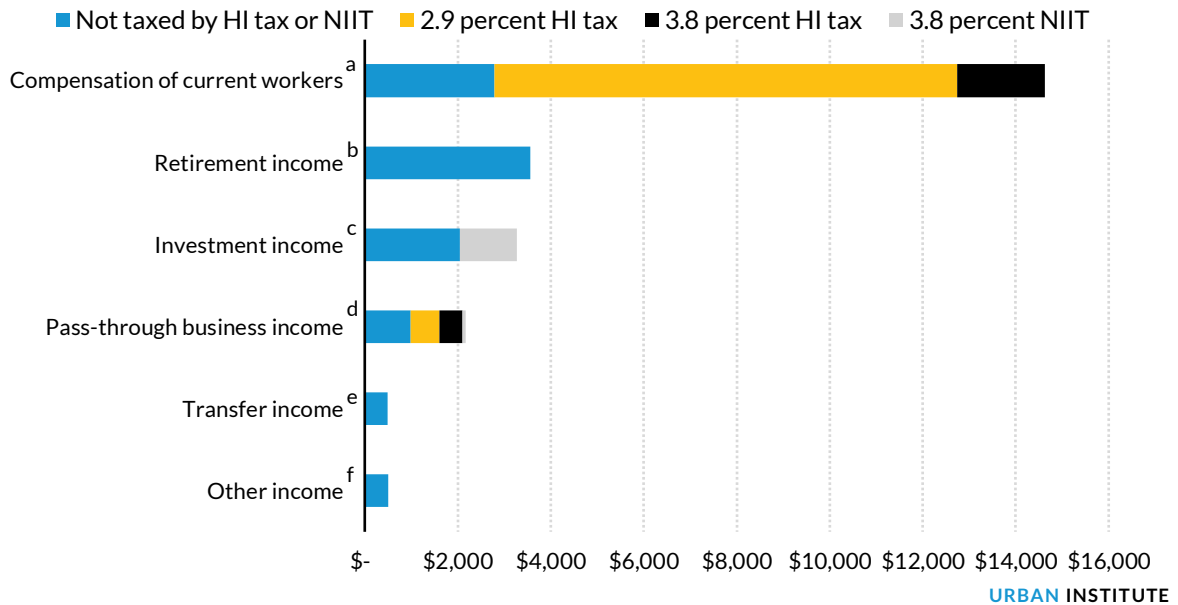
Medicare-Related Tax Treatment of Various Sources of Income

Total household income in the US was \$24.6 trillion in 2025, of which 58 percent was subject to HI taxes or NIIT (figure 2 and table 1). The HI tax covered 43 percent of income at the 2.9 percent rate and about 10 percent of income at the 3.8 percent rate. The NIIT covered about 5 percent of total income at a rate of 3.8 percent.

FIGURE 2

Income of US Households by Medicare-Related Tax Treatment, 2025

Billions of dollars



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax. The order of inclusion affects the amount of each income item taxed at 2.9 and 3.8 percent. The stacking order for HI taxes is wages and then self-employment income. The stacking order for NIIT is investment income and then passive pass-through income.

- a. Wages and employer contributions for health insurance, pensions, and payroll taxes.
- b. Social Security, pensions, and retiree health insurance.
- c. Includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.
- d. Sole proprietor, farm, partnership, and S corporation income.
- e. Unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans' benefits.
- f. The largest component is the corporate income tax burden, which is assumed to reduce capital income and wages.

TABLE 1

Income of US Households by Medicare-Related Tax Treatment, 2025*Billions of dollars*

Tax Treatment	Labor Income				Capital Income		Partly Labor Income, Partly Capital Income		Transfer and Other Income				Total Income ^g	
	Compensation of Current Workers ^a		Retirement Income ^b		Investment Income ^c		Pass-Through Business Income ^d		Transfer Income ^e		Other Income ^f			
	Dollars	Share	Dollars	Share	Dollars	Share	Dollars	Share	Dollars	Share	Dollars	Share	Dollars	Share
Not taxed by HI tax or NIIT	2,795	19.1	3,562	100.0	2,047	62.6	983	45.2	485	100.0	505	100.0	10,378	42.1
2.9 percent HI tax	9,951	68.0	-	-	-	-	628	28.9	-	-	-	-	10,578	43.0
3.8 percent HI tax	1,882	12.9	-	-	-	-	498	22.9	-	-	-	-	2,380	9.7
3.8 percent NIIT	-	-	-	-	1,222	37.4	66	3.0	-	-	-	-	1,288	5.2
All	14,628	100.0	3,562	100.0	3,269	100.0	2,174	100.0	485	100.0	505	100.0	24,624	100.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax. The order of inclusion affects the amount of each income item taxed at 2.9 and 3.8 percent. The stacking order for HI taxes is wages and then self-employment income. The stacking order for NIIT is investment income and then passive pass-through income.

a. Wages and employer contributions for health insurance, pensions, and payroll taxes.

b. Social Security, pensions, and retiree health insurance.

c. Includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.

d. Sole proprietor, farm, partnership, and S corporation income.

e. Unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans benefits.

f. The largest component of other income is the corporate income tax burden, which is assumed to reduce capital income and wages.

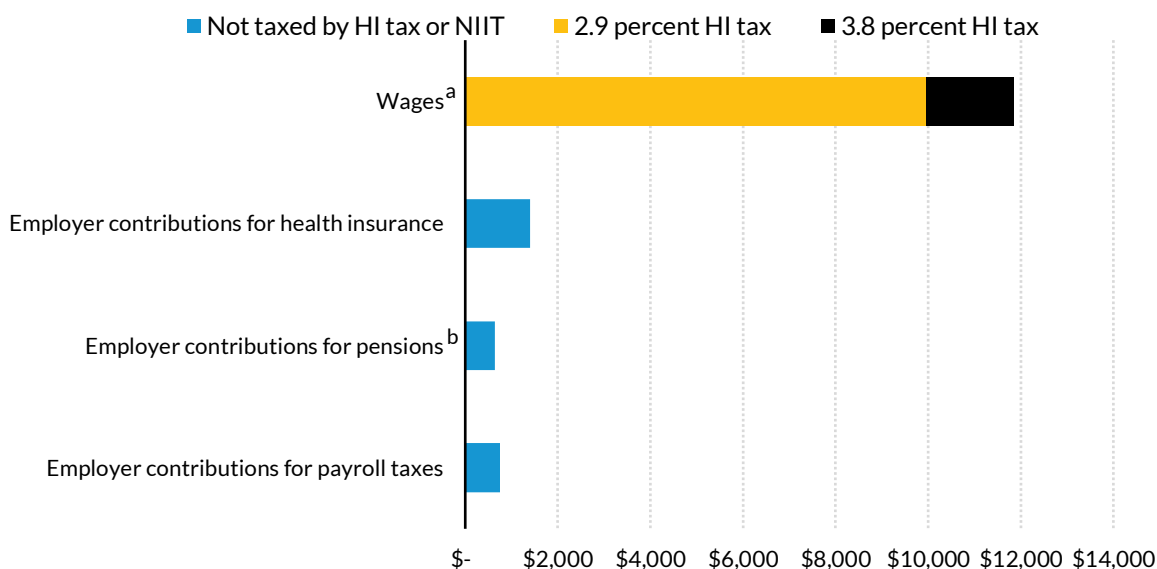
g. Equals expanded cash income, the comprehensive measure TPC uses to classify income and calculate tax rates.

Labor income of current and former employees was an estimated \$18.2 trillion in 2025, comprising about three-quarters of all income. This figure includes \$14.6 trillion in compensation of current employees and \$3.6 trillion in retirement income of former employees, including Social Security benefits and pension income (money that constitutes deferred labor income).

Over 80 percent of current compensation is subject to HI taxes, with 68 percent taxed at 2.9 percent and 13 percent taxed at 3.8 percent (figure 3). The nearly 20 percent of compensation not covered by Medicare taxes includes employer contributions to health insurance, pensions, and payroll taxes. These forms of compensation total about \$2.8 trillion and could be included in the HI tax base due to their similarity to wages.^{10 11}

Investment income, such as interest, dividends, and capital gains, was \$3.3 trillion in 2025, comprising 13 percent of all income (table 1).¹² About 37 percent of investment income is subject to the NIIT. The uncovered portion includes investment income of households with adjusted gross incomes below the NIIT thresholds (250,000 for joint filers and 200,000 for single filers), investment income offset by deductions allowed under the NIIT, and investment income inside retirement accounts.

FIGURE 3
Components of Compensation by Medicare-Related Tax Treatment, 2025
Billions of dollars



URBAN INSTITUTE

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

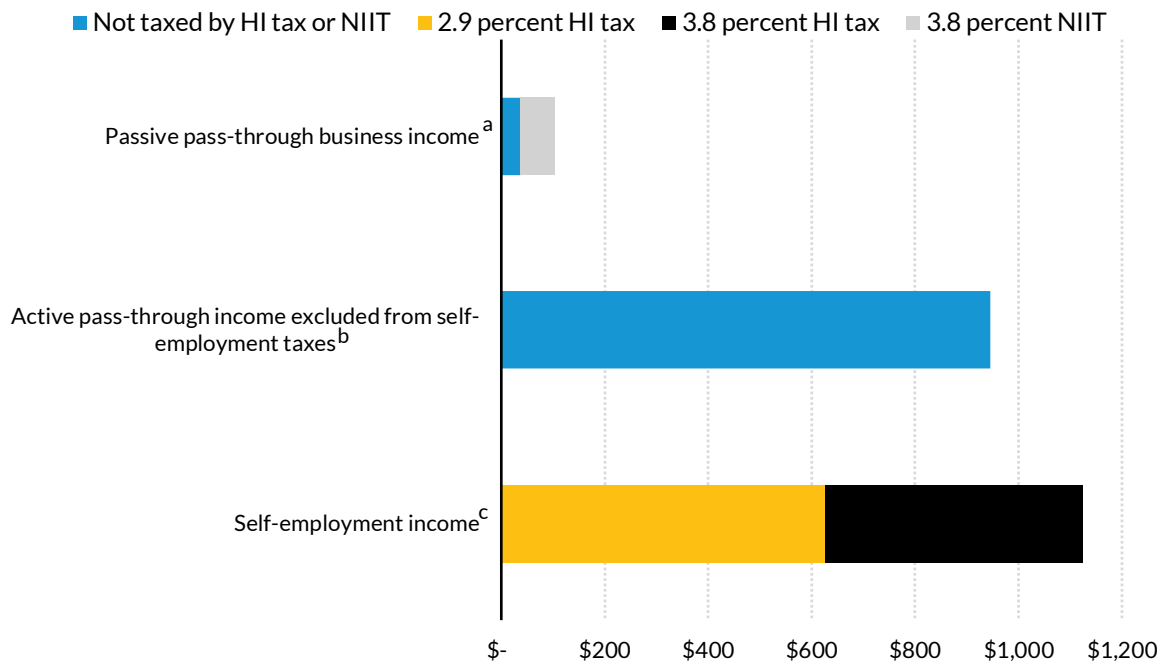
Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax. The order of inclusion affects the amount of each income item taxed at 2.9 and 3.8 percent. The stacking order for HI taxes is wages and then self-employment income. The stacking order for NIIT is investment income and then passive pass-through income.

a. Wages before reduction for elective DC pension contributions, i.e., Medicare Wages.

b. Includes contributions for defined contribution pensions (such as 401[k]s) and contributions for defined benefit pensions, e.g., traditional pension based on earnings history and years of service.

Pass-through business income, which is partly labor and partly capital income, was \$2.1 trillion in 2025, comprising 9 percent of all income. Twenty-nine percent of this income is subject to the 2.9 percent HI tax, 23 percent to the 3.8 percent HI tax, and 3 percent to the NIIT (figure 4). Almost \$1 trillion is subject to neither HI tax nor NIIT, nearly all of which is active income (table 2). This income in many ways resembles self-employment income, which is covered by HI taxes, since owners with both types of income are active participants in running their businesses. The similarity to self-employment income makes this income another candidate for addition to HI/NIIT base.

FIGURE 4
Components of Pass-Through Business Income by Medicare-Related Tax Treatment, 2025
Billions of dollars



URBAN INSTITUTE

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax. The order of inclusion affects the amount of each income item taxed at 2.9 and 3.8 percent. The stacking order for HI taxes is wages and then self-employment income. The stacking order for NIIT is investment income and then passive pass-through income.

a. Passive partnership and passive S corporation income.

b. Certain active income for limited partners and S corporation owners.

c. Includes sole proprietor income, farm income, active partnership income for general partners, and active partnership income for labor services for limited partners.

TABLE 2

Components of Compensation and Pass-Through Business Income by Medicare-Related Tax Treatment, 2025

Billions of dollars

Tax treatment	Compensation of Current Workers					Pass-Through Business Income					
	Wages ^a	Employer ESI contributions ^b	Employer pension contributions ^c	Employer payroll tax contributions	Total		Passive pass-through income ^d	Active pass-through income excluded from SECA taxes ^e	SECA income ^f	Total	
					Dollars	Share				Dollars	Dollars
Not taxed by HI tax or NIIT	-	1,401	639	756	2,795	19.1	38	945	-	983	45.2
2.9 percent HI tax	9,951	-	-	-	9,951	68.0	-	-	628	628	28.9
3.8 percent HI tax	1,882	-	-	-	1,882	12.9	-	-	498	498	22.9
3.8 percent NIIT	-	-	-	-	-	-	66	-	-	66	3.0
All	11,832	1,401	639	756	14,628	100.0	104	945	1,125	2,174	100.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; ESI = employer-sponsored insurance; SECA = Self-Employed Contributions Act. The order of inclusion affects the amount of each income item taxed at 2.9 and 3.8 percent. The stacking order for HI taxes is wages and then self-employment income. The stacking order for NIIT is investment income and then passive pass-through income.

a. Wages before reduction for elective DC pension contributions, i.e., Medicare Wages.

b. Includes employer contributions for health insurance and tax-excluded employee contributions through cafeteria plans.

c. Includes contributions for defined contribution pensions (such as 401[k]s) and contributions for defined benefit pensions, e.g., traditional pension based on earnings history and years of service.

d. Passive partnership and passive S corporation income.

e. Certain active income for limited partners and S corporation owners.

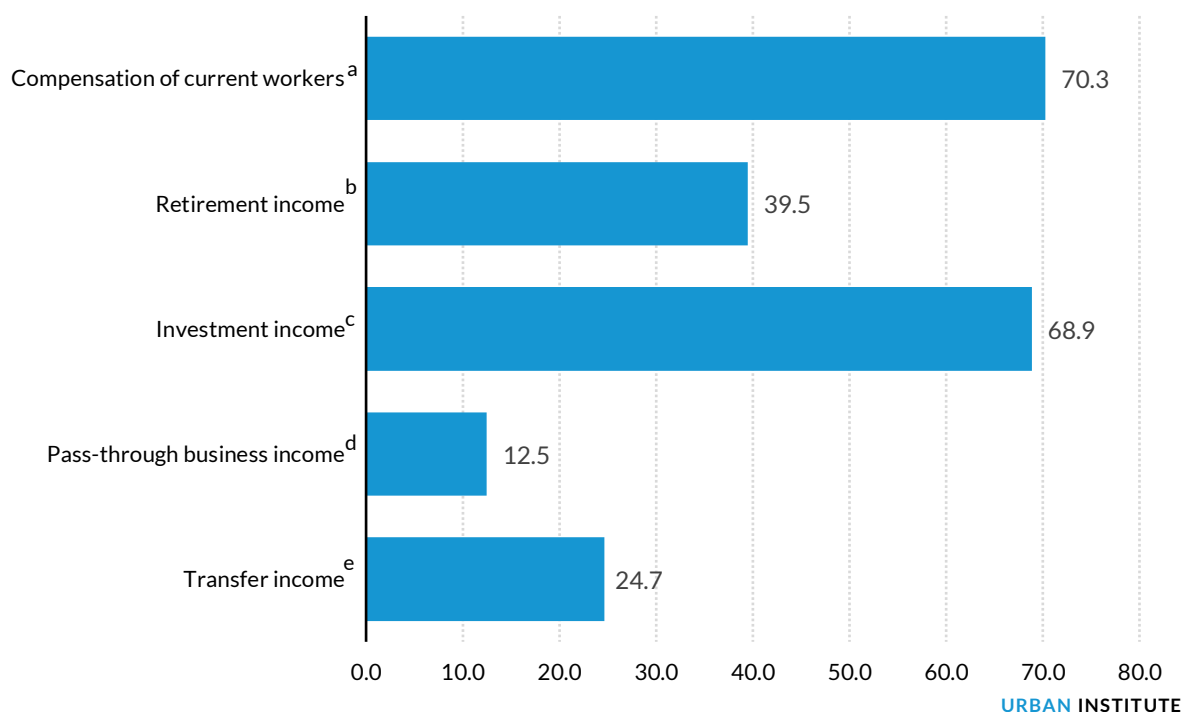
f. Includes sole proprietor income, farm income, active partnership income for general partners, and active partnership income for labor services for limited partners.

Prevalence of Various Sources of Income

About 70 percent of tax units¹³ have compensation, and about the same share have investment income (figure 5). About 40 percent have retirement income, 25 percent have transfer¹⁴ income, and 12.5 percent have pass-through business income.¹⁵ Over 75 percent of tax units have some income included in the HI or NIIT bases (table 3).

Of the two income sources identified above for possible HI/NIIT expansion, employer-provided benefits are far more prevalent than pass-through business income. About 40 percent of tax units have untaxed health benefits, and 36 percent have untaxed pension contributions (table 4).¹⁶ But only 2 percent of tax units have active pass-through business income subject to neither HI taxes nor NIIT. The presence of this income increases substantially at high income levels. Almost 36 percent of tax units in the top 1 percent of income have active pass-through business income not subject to HI or NIIT taxes (figure 6).

FIGURE 5
Percent of Tax Units with Various Sources of Income, 2025



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: a. Wages and employer contributions for health insurance, pensions, and payroll taxes.

b. Social Security, pensions, and retiree health insurance.

c. Includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.

d. Self-employment income, partnership income, and S Corporation income.

e. Unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans' benefits.

TABLE 3

Percent of Tax Units with Various Sources of Income, by Income Quintile, 2025

Expanded cash income percentile ^a	Compensation of current workers ^b	Retirement income ^c	Investment income ^d	Pass-through business income ^e	Transfer income ^f	Other income ^g	Some income subject to HI tax or NIIT
Percent of units							
Lowest quintile	54.0	35.6	36.6	9.0	35.5	86.5	60.3
Second quintile	66.6	40.7	64.4	9.0	29.1	95.5	71.7
Middle quintile	74.5	41.9	80.9	9.3	21.6	94.9	77.8
Fourth quintile	82.5	43.0	89.1	13.6	16.8	93.4	85.2
Top quintile	88.0	35.9	95.4	27.6	11.1	91.9	95.1
All	70.3	39.5	68.9	12.5	24.7	91.6	75.2
Addendum							
80–90	87.3	37.7	93.3	19.8	12.2	92.3	91.8
90–95	89.8	34.1	97.0	26.1	10.4	91.1	97.9
95–99	88.5	33.7	98.1	41.3	9.4	92.1	99.3
Top 1 percent	83.5	33.7	99.2	65.8	9.9	91.9	99.8
Top 0.1 percent	80.4	37.6	99.6	73.2	9.5	88.5	99.9

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax.

a. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2025 dollars): 20 percent: \$34,000; 40 percent: \$65,800; 60 percent: \$117,100; 80 percent: \$213,000; 90 percent: \$312,000; 95 percent: \$453,100; 99 percent: \$1,125,700; 99.9 percent: \$5,225,500.

b. Wages and employer contributions for health insurance, pensions, and payroll taxes.

c. Social Security, pensions, and retiree health insurance.

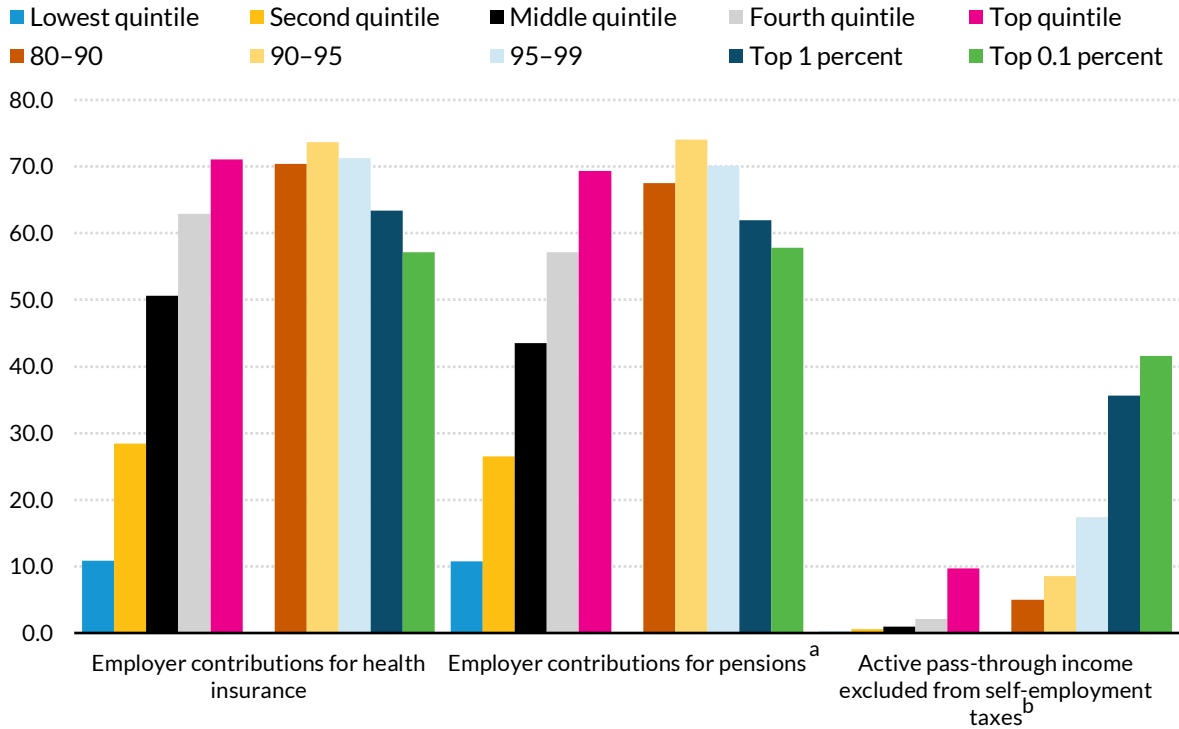
d. Includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.

e. Self-employment income, partnership income, and S Corporation income.

f. Unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans' benefits.

g. The largest component is the corporate income tax burden, which is assumed to reduce capital income and wages.

FIGURE 6
Percent of Tax Units with Income Sources Not Subject to HI Tax or NIIT, by Income Quintile, 2025



URBAN INSTITUTE

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax.

a. Includes contributions for defined contribution pensions, such as 401(k)s, and contributions for defined benefit pensions, e.g., traditional pensions based on earnings history and years of service.

b. Certain active income for limited partners and S corporation owners.

TABLE 4

Percent of Tax Units with Compensation and Pass-Through Business Income by Income Quintile, 2025

Expanded cash income percentile ^a	Compensation of Current Workers			Pass-Through Business Income			Addendum	
	Wages/any compensation ^b	Employer contributions for health insurance	Employer contributions for pensions ^c	Passive pass-through business income ^d	Active pass-through income excluded from self-employment taxes ^e	Self-employment income ^f	Any pass-through business income	Some income subject to HI tax or NIIT
Percent of units								
Lowest quintile	54.0	10.9	10.8	0.1	0.2	8.7	9.0	60.3
Second quintile	66.6	28.4	26.5	0.3	0.5	8.4	9.0	71.7
Middle quintile	74.5	50.6	43.5	0.6	1.0	8.2	9.3	77.8
Fourth quintile	82.5	62.9	57.2	1.5	2.1	11.1	13.6	85.2
Top quintile	87.8	71.1	69.4	5.3	9.7	18.9	27.6	95.1
All	70.2	39.8	36.7	1.2	2.1	10.4	12.5	75.2
Addendum								
80–90	87.2	70.4	67.5	2.4	5.0	15.0	19.8	91.8
90–95	89.6	73.7	74.1	4.3	8.6	17.5	26.1	97.9
95–99	88.3	71.2	70.1	10.3	17.4	25.8	41.3	99.3
Top 1 percent	81.7	63.4	62.0	23.1	35.6	40.9	65.8	99.8
Top 0.1 percent	77.9	57.2	57.8	30.6	41.6	43.9	73.2	99.9

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax.

a. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2025 dollars): 20 percent: \$34,000; 40 percent: \$65,800; 60 percent: \$117,100; 80 percent: \$213,000; 90 percent: \$312,000; 95 percent: \$453,100; 99 percent: \$1,125,700; 99.9 percent: \$5,225,500.

b. All tax units with compensation for current workers have wages and employer contributions for payroll taxes.

c. Includes contributions for defined contribution pensions, such as 401(k)s, and contributions for defined benefit pensions, e.g., traditional pension based on earnings history and years of service.

d. Passive partnership and passive S corporation income.

e. Certain active income for limited partners and S corporation owners.

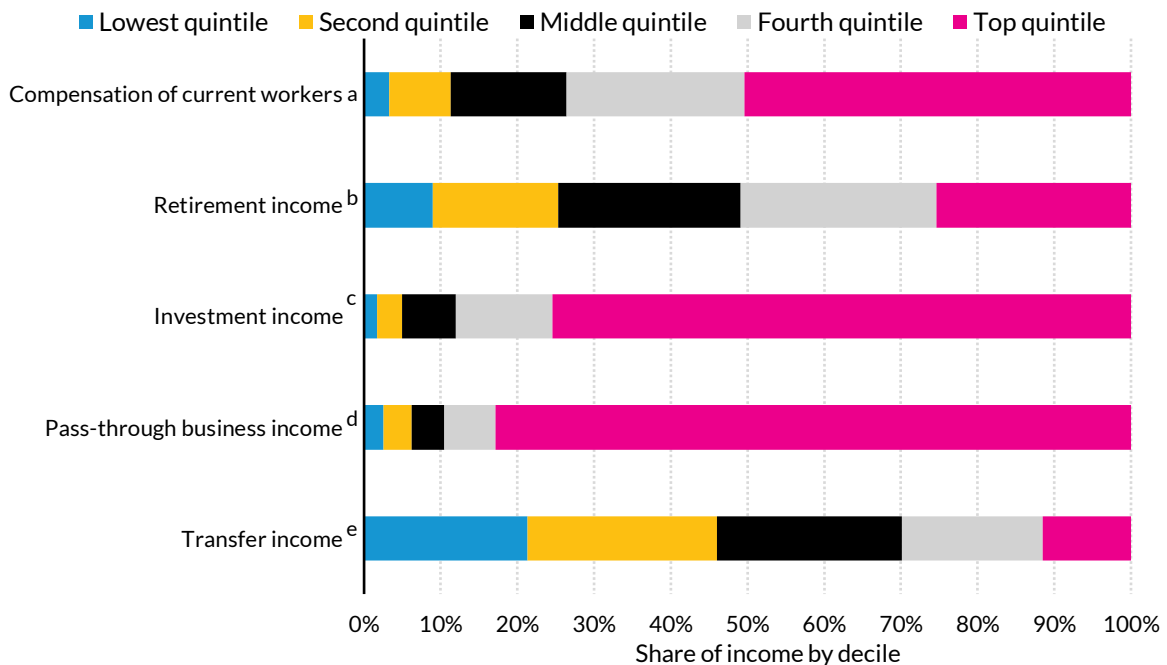
f. Includes sole proprietor income, farm income, active partnership income for general partners, and active partnership income for labor services for limited partners.

Distribution of Various Income Sources

Compensation, retirement income, and transfer income are distributed more evenly than investment income and pass-through business income. The top income quintile receives nearly 75 percent of investment income and over 80 percent of pass-through business income compared with 50 percent of compensation, 25 percent of retirement income, and 11 percent of transfer income (table 5 and figure 7).

HI-excluded pass-through business income is far more concentrated at the highest income levels than HI-excluded benefits. Tax units in the top 1 percent of income account for 65 percent of active pass-through income not subject to Medicare taxes, compared with 1.5 percent of health benefits and 7 percent of pension contributions (table 6 and figure 8). In contrast, the middle three income quintiles receive 60 percent of health benefits and 40 percent of pension contributions, but only 1 percent of Medicare tax-excluded pass-through business income.

FIGURE 7
Distribution of Selected Income Sources, 2025



URBAN INSTITUTE

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: a. Wages and employer contributions for health insurance, pensions, and payroll taxes.

b. Social Security, pensions, and retiree health insurance.

c. Includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.

d. Self-employment income, partnership income, and S Corporation income.

e. Unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans' benefits.

TABLE 5

Distribution of Income Sources, 2025*Share of income by quintile*

	Expanded cash income percentile ^a	Compensation of current workers ^b	Retirement income ^c	Investment income ^d	Pass-through business income ^e	Transfer income ^f	Other income ^g	Total income ^h	Addendum Income subject to HI tax or NIIT
Percent of units									
Lowest quintile		3.3	8.9	1.6	2.5	21.0	-9.4	3.9	3.2
Second quintile		8.0	16.1	3.2	3.7	24.4	4.7	8.4	7.1
Middle quintile		15.1	23.6	6.9	4.2	23.8	8.2	14.3	12.6
Fourth quintile		23.2	25.3	12.4	6.6	18.0	16.3	20.3	19.2
Top quintile		50.2	25.0	74.4	82.1	11.4	108.7	53.0	57.5
All		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Addendum									
80–90		16.6	11.6	10.5	6.9	6.2	15.5	14.0	14.3
90–95		11.5	6.2	9.4	6.6	2.9	12.1	9.8	10.5
95–99		13.4	4.9	16.1	20.2	1.9	24.1	13.1	14.9
Top 1 percent		8.7	2.4	38.4	48.4	0.4	57.1	16.1	17.8
Top 0.1 percent		2.6	0.6	24.4	21.6	0.0	26.2	7.3	8.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax.

a. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2025 dollars): 20 percent: \$34,000; 40 percent: \$65,800; 60 percent: \$117,100; 80 percent: \$213,000; 90 percent: \$312,000; 95 percent: \$453,100; 99 percent: \$1,125,700; 99.9 percent: \$5,225,500.

b. Wages and employer contributions for health insurance, pensions, and payroll taxes.

c. Social Security, pensions, and retiree health insurance.

d. Includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.

e. Self-employment income, partnership income, and S Corporation income.

f. Unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans benefits.

g. The largest component is the corporate income tax burden, which is assumed to reduce capital income and wages.

h. Equals expanded cash income, the comprehensive measure TPC uses to classify income and calculate tax rates.

TABLE 6

Distribution of Compensation and Pass-Through Business Income, 2025*Share of income by quintile*

Expanded cash income percentile ^a	Compensation of Current Workers					Pass-Through Business Income				Addendum	
	Wages ^b	Employer contributions for health insurance	Employer contributions for pensions ^c	Employer contributions for payroll taxes	Total	Passive pass-through business income ^d	Active pass-through income excluded from self-employment taxes ^e	Self-employment income ^f	Total	Income subject to HI tax or NIIT	All income ^g
Percent of units											
Lowest quintile	3.4	3.6	0.9	3.9	3.3	-5.6	0.2	5.2	2.5	3.2	3.9
Second quintile	7.9	9.4	4.2	9.2	8.0	1.4	0.4	6.7	3.7	7.1	8.4
Middle quintile	14.5	20.8	12.0	16.7	15.1	1.8	1.0	7.0	4.2	12.6	14.3
Fourth quintile	22.2	30.1	23.3	25.4	23.2	5.0	2.6	10.2	6.6	19.2	20.3
Top quintile	51.8	36.0	59.5	44.5	50.2	99.1	94.8	69.9	82.1	57.5	53.0
All	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Addendum						4.8	4.6	9.1	6.9	14.3	14.0
80-90	16.2	17.5	20.3	18.1	16.6	6.8	4.8	8.1	6.6	10.5	9.8
90-95	11.4	9.6	16.1	11.6	11.5	26.2	20.5	19.5	20.2	14.9	13.1
95-99	14.1	7.3	16.3	10.8	13.4	61.4	64.9	33.3	48.4	17.8	16.1
Top 1 percent	10.0	1.5	6.7	4.0	8.7	23.7	34.4	10.7	21.6	8.0	7.3
Top 0.1 percent	3.1	0.1	0.9	0.9	2.6	4.8	4.6	9.1	6.9	14.3	14.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax.

a. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2025 dollars): 20 percent: \$34,000; 40 percent: \$65,800; 60 percent: \$117,100; 80 percent: \$213,000; 90 percent: \$312,000; 95 percent: \$453,100; 99 percent: \$1,125,700; 99.9 percent: \$5,225,500.

b. Wages before reduction for elective DC pension contributions, i.e., Medicare Wages.

c. Includes contributions for defined contribution pensions, such as 401(k)s, and contributions for defined benefit pensions, e.g., traditional pension based on earnings history and years of service.

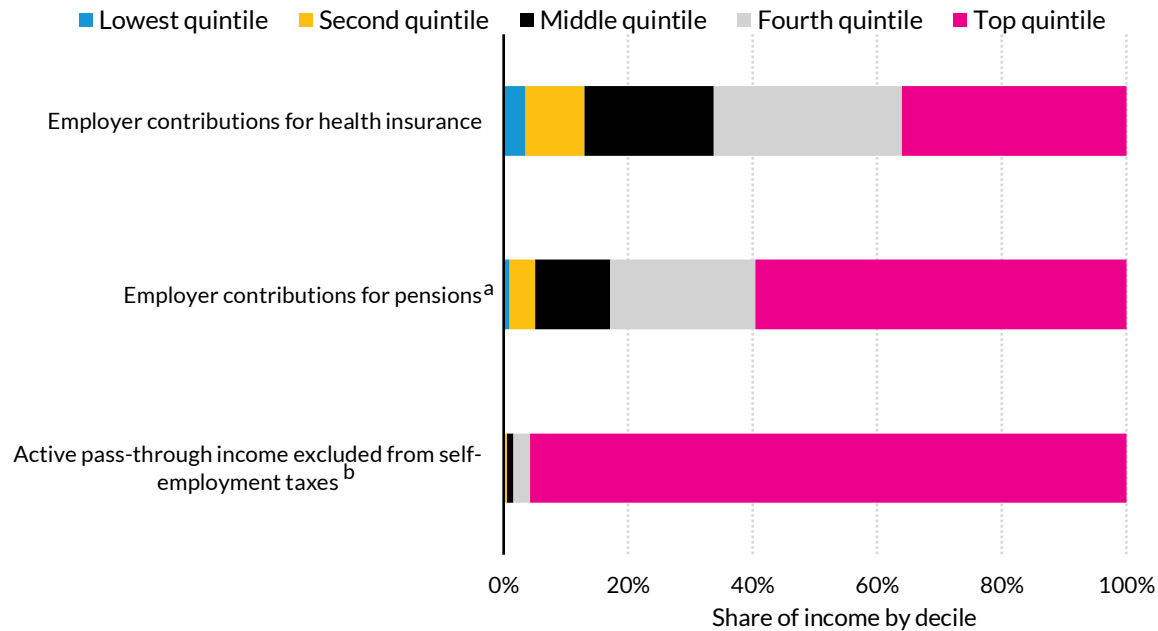
d. Passive partnership and passive S corporation income.

e. Certain active income for limited partners and S corporation owners.

f. Includes sole proprietor income, farm income, active partnership income for general partners, and active partnership income for labor services for limited partners.

g. Equals expanded cash income, the comprehensive measure TPC uses to classify income and calculate tax rates.

FIGURE 8
Distribution of Income Sources Not Subject to HI Tax or NIIT, by Income Quintile, 2025



URBAN INSTITUTE

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax.

a. Includes contributions for defined contribution pensions, such as 401(k)s, and contributions for defined benefit pensions, e.g., traditional pension based on earnings history and years of service.

b. Certain active income for limited partners and S corporation owners.

Analysis of Options for Expanding the HI/NIIT Base

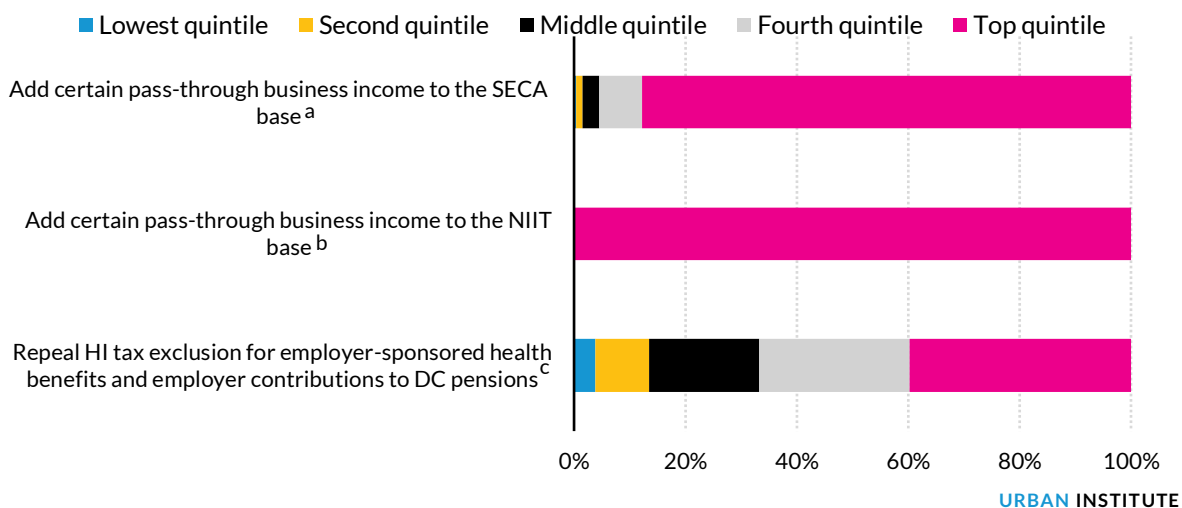
Two sources of income that might be added to the HI/NIIT base are employer-provided benefits and certain active pass-through business income. Inclusion of either would raise substantial revenues, and there are efficiency arguments for including both in the base.

Add Employer-Sponsored Health Benefits and Employer Contributions to DC Pensions to the HI Tax Base

This option would subject employer contributions for health benefits and defined-contribution pensions to HI taxes. Taxed health benefits would include employer contributions for health, dental, and vision insurance premiums and contributions to health-related spending accounts.¹⁷ This policy would add employer contributions to DC pensions to the HI tax base, but not contributions to defined benefit (DB) pensions, because taxing the latter is difficult in practice.¹⁸

Adding health and DC pension contributions to the HI tax base would increase revenues by over \$600 billion over 10 years (table 7) and increase average tax burden by \$270 in 2026 (table 8). Measured as a percent change in after-tax income, the proposal impacts middle-income tax units the most. The reform would reduce after-tax income by 0.3 percent for the middle three income quintiles, compared with 0.2 percent for the bottom and top quintiles (table 9). About 57 percent of the tax increase goes to the middle three income groups (figure 9).

FIGURE 9
Share of Federal Tax Change by Income Quintile for Options to Expand HI/NIIT Base, 2026



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; SECA = Self-Employed Contributions Act.

a. Proposal would add active partnership and S corporation income not currently subject to NIIT or SECA to the SECA base.

b. Proposal would add active partnership and S corporation income not currently subject to NIIT or SECA to the NIIT base.

c. Proposal would subject employer contributions for health benefits and defined-contribution pensions to HI taxes. Taxed health benefits include employer contributions for health, dental, and vision insurance premiums; Health Savings Accounts; Health Reimbursement Arrangements; and Medical Flexible Spending Accounts.

TABLE 7

Options to Expand the HI Tax / NIIT Base, Baseline: Current Law ^a*Impact on tax revenue (billions of current dollars), FY 2026–35*

Proposal	Fiscal Years										
	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2026–35
Repeal HI tax exclusion for employer-sponsored health benefits and employer contributions to DC pensions ^b	38.7	53.4	55.9	58.5	61.3	64.1	67.0	69.8	72.6	75.5	616.8
Add certain pass-through business income to the NIIT base ^c	22.4	30.4	31.0	31.4	32.2	33.3	34.6	36.2	37.8	39.6	328.9
Add certain pass-through business income to the SECA base ^d	35.9	48.8	49.7	50.7	52.4	54.6	57.2	60.3	63.7	67.8	541.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; SECA = Self-Employed Contributions Act.

a. Baseline is the law currently in place as of July 5, 2025. Estimates include microdynamic behavioral responses. Proposals would take effect on January 1, 2026. Estimates assume a fiscal split of 65–35 (65 percent of calendar year revenue is received by the Treasury in the current fiscal year and 35 percent in the following fiscal year). The actual effect on receipts could differ.

b. Proposal would subject employer contributions for health benefits and defined-contribution pensions to HI taxes. Taxed health benefits include employer contributions for health, dental, and vision insurance premiums; Health Savings Accounts; Health Reimbursement Arrangements; and Medical Flexible Spending Accounts.

c. Proposal would add active partnerships and S corporation income not currently subject to NIIT or SECA to the NIIT base.

d. Proposal would add active partnerships and S corporation income not currently subject to NIIT or SECA to the SECA base.

TABLE 8

Average Federal Tax Change by Income Quintile for Options to Expand HI/NIIT Base, 2026, Baseline: Current Law^a

Proposal	Expanded Cash Income Percentile ^b										
	All	Lowest quintile	Second quintile	Middle quintile	Fourth quintile	Top quintile	80–90	90–95	95–99	Top 1 percent	Top 0.1 percent
Repeal HI tax exclusion for employer-sponsored health benefits and employer contributions to DC pensions ^c	270	40	120	250	430	770	620	870	990	1,070	1,180
Add certain pass-through business income to the NIIT base ^d	150	0	0	0	0	1,130	10	100	1,300	18,530	94,300
Add certain pass-through business income to the SECA base ^e	250	0	10	40	110	1,560	400	620	2,080	17,420	84,990

Source: Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; SECA = Self-Employed Contributions Act.

a. Baseline is the law currently in place as of July 5, 2025. Policies assumed effective January 1, 2026.

b. Includes both filing and non-filing tax units. For a description of expanded cash income, see “Income Measure Used in Distributional Analyses by the Tax Policy Center,” Tax Policy Center, accessed January 23, 2026, <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

c. Proposal would subject employer contributions for health benefits and defined-contribution pensions to HI taxes. Taxed health benefits include employer contributions for health, dental, and vision insurance premiums; Health Savings Accounts; Health Reimbursement Arrangements; and Medical Flexible Spending Accounts.

d. Proposal would add active partnership and S corporation income not currently subject to NIIT or SECA to the NIIT base.

e. Proposal would add active partnership and S corporation income not currently subject to NIIT or SECA to the SECA base.

The proposal would increase horizontal equity by applying the same HI tax treatment to workers with the same total compensation, regardless of whether it is in the form of wages, health insurance, or DC pension contributions.¹⁹ But it would introduce a new tax distortion to the extent DB pensions are not taxed under this proposal, while DC pensions would be. By reducing the tax subsidy for additional health benefits, the proposal might modestly reduce overall health care costs by reducing incentives to buy higher-cost insurance. However, switching to lower-cost health plans might result in cost-sharing that would add to financial burdens for low-wage workers. Additionally, the proposal might also reduce pension contributions and retirement income adequacy, though some studies suggest tax incentives for DC pensions mostly subsidize savings that would happen anyway (Engen, Gale, and Scholz 1996).

Add Certain Pass-Through Business Income to the NIIT or SECA Base

This proposal would extend the NIIT or self-employment taxes to certain active pass-through business income not currently subject to either tax. Adding that income to the NIIT base would only affect tax units with adjusted gross income over \$250,000 for joint filers (\$200,000 for single filers). Adding to the SECA base would affect tax units at all income levels and would subject the income to Social Security taxes, along with HI taxes. However, the potentially very large impact of those differences is moderated by two factors: active pass-through business income is highly concentrated at higher income levels, and most pass-through business owners already have earnings above the Social Security maximum taxable earnings. In addition, some of the additional revenue from expanding the SECA base would be offset by reductions in individual income taxes because of increases in the self-employment tax deduction and increases in outlays for future Social Security benefits.

Preliminary estimates suggest adding certain active pass-through business income to the NIIT base would raise as much as \$330 billion over 10 years and increase average tax burden by \$150 in 2026 (tables 7 and 8). Adding to the SECA base would increase ten-year revenues by as much as \$540 billion and increase average tax burden by \$250.²⁰ The proposals primarily impact the highest-income tax units. NIIT expansion would only measurably affect after-tax income for tax units in the top five percent of the income distribution, and SECA expansion only measurably affects taxable income for the top income quintile (table 9). The top 1 percent of tax units sees 75 percent of the tax increase under NIIT expansion and 45 percent of the increase under SECA expansion (table 10).

TABLE 9

Percent Change in After-Tax Income by Income Quintile for Options to Expand HI/NIIT Base, 2026, Baseline: Current Law^a

Proposal	Expanded Cash Income Percentile ^b										
	All	Lowest quintile	Second quintile	Middle quintile	Fourth quintile	Top quintile	80–90	90–95	95–99	Top 1 percent	Top 0.1 percent
Repeal HI tax exclusion for employer-sponsored health benefits and employer contributions to DC pensions ^c	-0.3	-0.2	-0.3	-0.3	-0.3	-0.2	-0.3	-0.3	-0.2	-0.1	0.0
Add certain pass-through business income to the NIIT base ^d	-0.1	0.0	0.0	0.0	0.0	-0.3	0.0	0.0	-0.3	-0.8	-1.0
Add certain pass-through business income to the SECA base ^e	-0.2	0.0	0.0	0.0	-0.1	-0.4	-0.2	-0.2	-0.4	-0.8	-0.9

Source: Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; SECA = Self-Employed Contributions Act.

a. Baseline is the law currently in place as of July 5, 2025. Policies assumed effective January 1, 2026.

b. Includes both filing and non-filing tax units. For a description of expanded cash income, see “Income Measure Used in Distributional Analyses by the Tax Policy Center,” Tax Policy Center, accessed January 23, 2026, <http://www.taxpolicycenter.org/TaxModel/income.cfm>.

c. Proposal would subject employer contributions for health benefits and defined-contribution pensions to HI taxes. Taxed health benefits include employer contributions for health, dental, and vision insurance premiums; Health Savings Accounts; Health Reimbursement Arrangements; and Medical Flexible Spending Accounts.

d. Proposal would add active partnership and S corporation income not currently subject to NIIT or SECA to the NIIT base.

e. Proposal would add active partnership and S corporation income not currently subject to NIIT or SECA to the SECA base.

TABLE 10

Distribution of Changes in After-Tax Income by Income Quintile for Options to Expand HI/NIIT Base, 2026, Baseline: Current Law^a

Proposal	Expanded Cash Income Percentile ^b										
	All	Lowest quintile	Second quintile	Middle quintile	Fourth quintile	Top quintile	80–90	90–95	95–99	Top 1 percent	Top 0.1 percent
Repeal HI tax exclusion for employer-sponsored health benefits and employer contributions to DC pensions ^c	100.0	3.8	9.7	19.7	26.9	39.7	16.2	11.1	9.7	2.5	0.3
Add certain pass-through business income to the NIIT base ^d	100.0	0.0	0.0	0.0	0.0	100.0	0.4	2.2	22.0	75.4	39.5
Add certain pass-through business income to the SECA base ^e	100.0	0.4	1.1	2.9	7.6	86.2	11.3	8.5	22.1	44.3	22.2

Source: Tax Policy Center Microsimulation Model (version 0325-4).

Notes: HI = Hospital Insurance; NIIT = Net Investment Income Tax; SECA = Self-Employed Contributions Act.

a. Baseline is the law currently in place as of July 5, 2025. Policies assumed effective January 1, 2026.

b. Includes both filing and non-filing tax units. For a description of expanded cash income, see “Income Measure Used in Distributional Analyses by the Tax Policy Center,” Tax Policy Center, accessed January 23, 2026, <https://www.taxpolicycenter.org/TaxModel/income.cfm>.

c. Proposal would subject employer contributions for health benefits and defined-contribution pensions to HI taxes. Taxed health benefits include employer contributions for health, dental, and vision insurance premiums; Health Savings Accounts; Health Reimbursement Arrangements; and Medical Flexible Spending Accounts.

d. Proposal would add active partnerships and S corporation income not currently subject to NIIT or SECA to the NIIT base.

e. Proposal would add active partnerships and S corporation income not currently subject to NIIT or SECA to the SECA base.

This policy would increase horizontal equity by subjecting all active pass-through income to Medicare-related taxes. Along with increasing tax progressivity, this policy could reduce distortion in the choice of business organization and in the form of payout to business owners.²¹ To the extent the active pass-through business income reflects returns to capital, the tax could modestly reduce investment, like any other tax on capital. To the extent this income is labor income, the tax would modestly reduce incentives to work, though research suggests taxes play only a modest role in labor supply decisions for most workers (McClelland and Mok 2012).

Conclusion

The financial challenges to Medicare and the nation's rising debt will likely be addressed at least in part through increased revenues. One way to increase revenues would be to extend the HI or NIIT tax bases. Of course, to the extent that those increased revenues merely delay dealing with Medicare's unsustainable rate of growth in health costs, then the financial challenges will remain.

The HI tax base has expanded over time. Congress increased the maximum taxable earnings several times before indexing the threshold, and then eliminated it entirely in 1994. Starting in 2013, the NIIT extended an HI-like tax to investment income for high-income households to limit increases in the nation's overall debt due to adoption of the Affordable Care Act.

Currently, about 60 percent of all income is subject to HI taxes or NIIT, and about the same percentage of households pay some HI tax or NIIT. Employer-provided benefits and certain active pass-through business income stand out as sources of income that might be added to the HI/NIIT tax base. Horizontal equity, the principle that similar types of income should be taxed the same, argues for applying HI taxes to benefits, which are a form of compensation like wages. The same principle suggests extending the NIIT or SECA to active pass-through business income that is similar to self-employment income.

Both extending HI taxes to benefits or HI taxes/NIIT to active pass-through business income would raise substantial revenues. But the policies would have very different distributional implications. Taxing benefits would affect a broad swath of households, and 57 percent of the tax change would be paid for the middle three income quintiles. Taxing pass-through business income would affect 1 to 2 percent of households, with nearly all the burden on the top income quintile.

Beyond revenue and distributional impacts, there would be other pros and cons to extending Medicare taxes to these income sources. These include impacts on health care costs, out-of-pocket medical spending, retirement income adequacy, choice of business organization, investment, and labor supply. Policymakers considering expanding the HI/NIIT base will need to make value judgments and weigh tradeoffs between simplicity, equity, and efficiency.

Appendix

The Tax Policy Center Microsimulation Model

The Urban-Brookings Tax Policy Center (TPC) large-scale microsimulation model produces estimates of how current and proposed tax policies will affect federal revenues and the distribution of tax burdens by income. The model is similar to those used by the Congressional Budget Office, the Joint Committee on Taxation of the US Congress, and the Department of the Treasury’s Office of Tax Analysis. The version of the TPC tax model used in this report (TM25v4) produces revenue and distributional estimates for each individual year from 2011 to 2034 (covering the 10-year budget window starting in 2025).

The model’s primary data source is the 2006 public-use file (PUF) produced by the Statistics of Income Division of the Internal Revenue Service (IRS). The 2006 PUF contains 145,858 records with detailed information from federal individual income tax returns from tax years 2003 to 2006 filed in calendar year 2007. The data are aged forward to match characteristics of the 2011 tax filing population based on information from the IRS.

We add information on other demographic characteristics and sources of income that are not reported on tax returns to the resulting data through a constrained statistical match with data from the US Census Bureau’s March Current Population Survey (CPS). That match also generates a sample of individuals who do not file individual income tax returns (nonfilers).

We then augment the tax model database by imputing wealth, education, consumption, health, retirement, and other variables for each record in the matched PUF-CPS file. These imputations allow us to analyze a wide variety of policy proposals. Finally, to extend the database to more recent and future years, we “age” the 2011 data using the actual 2012 through 2022 tax data as well as projections from various sources.

The simulation of the proposal to extend the HI tax to employer-sponsored health benefits uses the model’s health module, which includes imputations for health insurance status and employer-provided health benefits. We impute health insurance status and health insurance premiums using a statistical match with the Urban Institute’s Health Insurance Policy Simulation Model (HIPSM). HIPSM is a detailed microsimulation model of the health care system designed to estimate the cost and coverage effects of proposed health care policy options. We impute other employer-provided health benefits based on regressions estimated in the 2015, 2017, and 2018 annual surveys of employer-sponsored health benefits sponsored by the Kaiser Family Foundation and Health Research and Educational Trust. Other employer-provided health benefits include employer and employee contributions for health, dental, and vision insurance; Health Savings Accounts; Health Reimbursement Arrangements; and Medical Flexible Spending Accounts. We calibrate these imputations, such that simulations align with tax expenditure, revenue, and distributional estimates from the Joint Committee on Taxation, the Congressional Budget Office, and the Treasury’s Office of Tax Analysis.

Notes

- ¹ There is no employer portion of the Additional Medicare Tax.
- ² Income from a business in which a person does not actively participate.
- ³ See McClelland et al. (2022) for a further discussion of the NIIT.
- ⁴ See Revenue Projections, by Category, Jan 2025, at “Key Budget and Economic Data,” CBO, accessed January 29, 2026, <https://www.cbo.gov/data/budget-economic-data>.
- ⁵ In addition to being taxed at the corporate level, C corporation profits are also effectively taxed at the individual level when owners receive dividends or realize capital gains on corporate stock.
- ⁶ Sole proprietors, individuals who own unincorporated businesses by themselves, pay self-employment tax on all their net business income. As do general partners, who share management, profits, and losses of a business with other partners. Other pass-through business owners do not pay self-employment taxes on at least some of their active business income. Employee-owners of S corporations, certain corporations of less than 100 shareholders that pass-through profits to shareholders for tax purposes, pay HI taxes on wages from the corporation but not profits. Similarly, limited partners, owners of partnerships that are not involved in management, pay self-employment taxes on labor services but not on the profit portion of their active income. See CBO (2018, p. 223–4), Department of the Treasury (2016), and Joint Committee on Taxation (2021, p. 71–9).
- ⁷ See Tax Foundation, “Social Security and Medicare Tax Rates, Calendar Years 1937 – 2009,” May 5, 2009, <https://taxfoundation.org/data/all/federal/social-security-and-medicare-tax-rates-calendar-years-1937-2009/>.
- ⁸ See Barry F. Huston, “Before Committee on Ways and Means, Subcommittee on Social Security, U.S. House of Representatives,” Congress.gov, April 26, 2023, <https://www.congress.gov/crs-product/TE10083>; and Whitman and Shoffner (2011).
- ⁹ The income thresholds for the Additional Medicare Tax are also not indexed for inflation.
- ¹⁰ In addition to employer contributions, the \$2.8 trillion includes tax-excluded employee contributions for health benefits, i.e., contributions through cafeteria plans. It does not include employee pension contributions, which are excluded from the income tax base but not the payroll tax base, i.e., elective pension contributions reduce earnings subject to income taxes, but not earnings subject to payroll taxes.
- ¹¹ None of the \$3.6 trillion in retirement income, including Social Security benefits and pension income, is subject to HI taxes when income is paid to retirees. However, to some extent, retirement income constitutes prior worker contributions, which were paid after HI taxes. Unlike employer contributions for pensions and Social Security, worker contributions are not excluded from the HI tax base. There might be a case for extending HI taxes to the portion of retirement income paid from excluded employer contributions, but not if policy also added employer contributions to the base. A policy might either extend HI taxes to employer pension and Social Security contributions or benefits from those contributions, but not both.
- ¹² Investment income includes interest, dividends, capital gains, rent, royalties, and returns to investment inside retirement accounts and defined benefit pension plans.
- ¹³ A tax unit is an individual or a married couple that files a tax return or would file a tax return if their income were high enough, along with all dependents of that individual or married couple.
- ¹⁴ Includes unemployment compensation, Supplemental Security Income, Temporary Assistance for Needy Families, Supplemental Nutrition Assistance Program, workers' compensation, energy assistance, and veterans' benefits.
- ¹⁵ Over 90 percent have other income, which includes corporate income tax burden, which TPC assumes reduces wages and capital income.
- ¹⁶ Fifty-one percent have either untaxed health benefits or untaxed pension contributions.
- ¹⁷ Health-related spending accounts include Health Savings Accounts, Health Reimbursement Arrangements, and Medical Flexible Spending Accounts.

¹⁸ Measuring employer contributions for specific workers is complicated because DB pension benefits are determined by complex formulas based on years of service and earnings histories as opposed to worker-specific contributions. Our modeling measures contributions based on the increment in pension wealth, which is the change in the present value of future benefits from working an additional year. But this would be a complicated calculation to administer. Alternatively, one could measure contributions for specific workers by allocating a portion of the employers' total contributions to plans across workers in firms. But this would also be complicated and potentially differ substantially from the change in pension wealth if plans are under- or over-funded.

¹⁹ Benefits would still be exempt from the individual income tax.

²⁰ Medicare taxes would increase by \$387 billion, Social Security taxes would increase by \$223 billion, and individual income taxes would decline by \$69 billion.

Estimates do not include the impact of adding this income to the NIIT or SECA bases on the form of business organization, e.g., estimates do not incorporate S corporations potentially reorganizing as C corporations.

²¹ Adding this income to the NIIT or SECA bases would reduce incentives for businesses to organize as S corporations and limited partnerships. It would also reduce incentives for active S corporation owners to classify their income as profits rather than wages. See CBO (2018, 2025) and Hemel, Holtzblatt, and Rosenthal (2022).

References

- Carloni, Dorian. 2021. "[Revisiting the Extent to Which Payroll Taxes Are Passed Through to Employees](#)." Working Paper 2021-06. Washington, DC: Congressional Budget Office.
- CBO (Congressional Budget Office). 2012. [The Taxation of Capital and Labor Through the Self-Employment Tax](#). Washington, DC: CBO.
- . 2018. [Options for Reducing the Deficit: 2019 to 2028](#). Washington, DC: CBO.
- . 2025. [The Budget and Economic Outlook: 2025 to 2035](#). Washington, DC: CBO.
- Cubanski, Juliette. 2025. "[A Current Snapshot of the Medicare Part D Prescription Drug Benefit](#)." San Francisco, CA: KFF.
- Department of the Treasury, Office of Tax Analysis. 2016. "[Gaps between the Net Investment Income Tax Base and the Employment Tax Base](#)." Washington, DC: Department of the Treasury.
- Engen, Eric M., William G. Gale, John Karl Scholz. 1996. "[The Illusory Effects of Saving Incentives on Saving](#)." *Journal of Economic Perspectives* 10 (4): 113–38.
- Hemel, Daniel, Janet Holtzblatt, and Steve Rosenthal. 2022. "[The Tax Gap's Many Shades of Gray](#)." Washington, DC: Urban Institute.
- Joint Committee on Taxation. 2021. [Description of The Chairman's Amendment in The Nature of A Substitute to The Committee Print Relating to Infrastructure Financing \(Subtitle F\), Green Energy \(Subtitle G\), The Social Safety Net \(Subtitle H\), And Prescription Drug Pricing \(Subtitle J\)](#). JCX-43-21. Washington, DC: Joint Committee on Taxation.
- Medicare Trustees (Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds). 2025. [2025 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds](#). Washington, DC: Medicare Trustees.
- McClelland, Robert, Bowen Garrett, C. Eugene Steuerle, and Gordon Mermin. 2022. "[Net Investment Income Tax: A Primer](#)." Washington, DC: Urban Institute.
- McClelland, Robert, and Shannon Mok. 2012. "[A Review of Recent Research on Labor Supply Elasticities](#)." Working Paper 2012-12. Washington, DC: Congressional Budget Office.
- Steuerle, C. Eugene, and Bowen Garrett. 2022. "[The Medicare Financing Conundrum: Revenues, Spending, and Short- and Long-Term Fiscal Challenges](#)." Washington, DC: Urban Institute.

Tax Foundation. 2009. "[Social Security and Medicare Tax Rates, Calendar Years 1937 – 2009](#)." Washington, DC: Tax Foundation.

Van de Water, Paul N. 2020. "[Strengthening Medicare Financing General Revenues Should Be Part of the Solutions](#)." Washington, DC: Center on Budget and Policy Priorities.

Whitman, Kevin, and Dave Shoffner. 2011. "[The Evolution of Social Security's Taxable Maximum](#)." Washington, DC: Social Security Administration.

About the Authors

Gordon Mermin is a principal research associate in the Urban-Brookings Tax Policy Center, where he focuses on the tax treatment of health insurance, higher education, and retirement saving. Mermin develops and maintains the Tax Policy Center's microsimulation model of the federal tax system and is part of the effort to extend the model to state-level analysis. He has written extensively on retirement policy and work at older ages. Mermin earned his BA from Stanford University and his MA in economics from the University of Michigan.

Bowen Garrett is an economist and senior fellow in the Health Policy Division at the Urban Institute. His research focuses on health reform and health policy, including health insurance and labor markets, Medicare's prospective payment systems, and Medicare financing. He leads the development of the Urban Institute's Medicare policy simulation model (MCARE-SIM). Garrett received his PhD in economics from Columbia University in 1996 and was a postdoctoral research fellow in the Robert Wood Johnson Foundation's Scholars in Health Policy Research Program at the University of California, Berkeley, from 1996 to 1998.

Robert McClelland is a senior fellow in the Urban-Brookings Tax Policy Center. Previously, he worked in the tax analysis division of the Congressional Budget Office (CBO), where he examined the impact of federal tax policy on charitable giving and bequests, the realization of capital gains, labor supply, and small businesses. He worked for the CBO from 1999 to 2005 and from 2011 to 2016, and in between, he directed the division of price and index number research at the Bureau of Labor Statistics.

McClelland has published articles in journals such as the *American Economic Review*, *Journal of Applied Econometrics*, *Journal of Public Economics*, *National Tax Journal*, and *Review of Income and Wealth*. He and John Greenlees wrote an article in the *Monthly Labor Review* that addressed some of the misconceptions surrounding the Consumer Price Index, and in 2015, he, Tim Dowd, and Athipat Muthitacharoen won the Richard Musgrave Prize for the outstanding article in the *National Tax Journal*.

McClelland is a member of the Conference on Research in Income and Wealth. He has taught econometrics at Johns Hopkins University, where he won an Excellence in Teaching award in 2006. McClelland received a BA in economics and environmental studies from the University of California, Santa Cruz, and a PhD in economics from the University of California, Davis.

Eugene Steuerle is an Institute fellow and the Richard B. Fisher chair at the Urban Institute. Among past positions, he was deputy assistant secretary of the US Department of the Treasury for Tax Analysis

(1987–89), president of the National Tax Association (2001–02), codirector of the Urban-Brookings Tax Policy Center, chair of the 1999 technical panel advising Social Security on its methods and assumptions, and chair of the 2015–16 National Academy of Sciences Committee on Advancing the Power of Economic Evidence to Inform Investments in Children, Youth, and Families. Between 1984 and 1986, he was the economic coordinator and original organizer of the Treasury’s tax reform effort.

Steuerle is the author, coauthor, or coeditor of 19 books, including *Beyond Zombie Rule: Reclaiming Fiscal Sanity in a Broken Congress*, *Dead Men Ruling, Nonprofits and Government (3rd edition)*, and *Contemporary US Tax Policy (2nd edition)*. He is a founder and chair emeritus of ACT for Alexandria, a community foundation, and is or has been an elected, appointed, advisory panel, or board member for the Congressional Budget Office, Comptroller General of the United States, the Joint Committee on Taxation, Venture Philanthropy Partners, and the National Center on Philanthropy and the Law (chair). Steuerle received the first Bruce Davie–Albert Davis Public Service Award from the National Tax Association in 2005, distinguished or outstanding alumnus awards from the University of Dayton and St. Xavier High School, and the TIAA-CREF Paul Samuelson award for his book *Dead Men Ruling*.

Acknowledgments

This brief was supported by Arnold Ventures. We are grateful to them and to all our funders, who make it possible for Urban to advance its mission.

The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders. Funders do not determine research findings or the insights and recommendations of Urban experts. Further information on the Urban Institute’s funding principles is available at urban.org/fundingprinciples.

The authors thank Tracy Gordon, John Holahan, Benjamin Page, Joseph Rosenberg, and Tisamarie Sherry for helpful comments and Sarah LaCorte for editing assistance.



ABOUT THE URBAN INSTITUTE

The Urban Institute is a nonprofit research organization founded on one simple idea: To improve lives and strengthen communities, we need practices and policies that work. For more than 50 years, that has been our charge. By equipping changemakers with evidence and solutions, together we can create a future where every person and community has the opportunity and power to thrive.

Copyright © March 2026. Urban Institute. Permission is granted for reproduction of this file, with attribution to the Urban Institute.