1. The Bill Raids Medicare

The bill diverts $6 billion in funds that would otherwise go to Medicare, which is facing a $36 trillion unfunded liability and insolvency by 2024, to offset the $6 billion cost of temporary student loan spending. (“A Democratic aide said the loan extension would take $6 billion over 10 years that would otherwise go toward Medicare....” Baker & Wasson, Dem student loan bill uses $6B that would otherwise go to Medicare, THE HILL (Apr. 26, 2012).)

2. The Bill Links a Permanent Medicare Tax Increase with Temporary Spending

3. The Bill Singles Out Certain Businesses

The bill picks winners and losers by targeting only S corporations and partnerships engaged in certain types of professional services. As is typical, the Democratic Leadership targets politically unpopular businesses for special tax increases. In a twist, this proposal would exempt certain businesses uniquely associated with states represented by the Democratic Leadership.

Example: Although the Senate Democrats’ bill specifically targets more traditional businesses such as actuarial, accounting, and engineering firms, it exempts escort services and gaming establishments.

4. The Bill Continues Obama’s Assault on Job-Creating Small Businesses

The bill targets job creating small business S corporations in which 75 percent of more of the income is attributable to three or fewer shareholders.

The bill increases marginal tax rates by over 100% in certain situations, creating an extreme “cliff” effect.
Example: In some cases a single extra dollar of earnings will trigger thousands of dollars of additional taxes, punishing business success, suppressing business activity and killing jobs.

5. The bill also hurts family-owned business.

The bill says that the S corporation earnings of one family member should be attributed to other family members’ that perform services for the business. That means the family member performing services will pay Medicare taxes on the earnings of other family members as well as their own.

Example: An S Corporation is owned 1/3 by a father, 1/3 by his son, and 1/3 by his daughter. The father does not contribute substantial services to the business, but both the son and daughter do. The S Corporation has $900,000 of income. Under current law, for income tax purposes, $300,000 of income would be attributed to the father, $300,000 to the son, and $300,000 to the daughter. However, for payroll tax purposes, under the Democratic proposal, the father’s $300,000 of income would be entirely attributed to the son and entirely attributed to the daughter. In other words, the son will have $600,000 subject to payroll tax and the daughter will have $600,000 subject to payroll tax. Therefore, a total of $1.2 million will be subject to payroll tax, even though S Corporation’s income was only $900,000. The father’s $300,000 of income would be subjected to payroll tax twice.
6. **The Bill Should Have Been Processed in Regular Order in The Finance Committee**

   Instead of being rushed to the Senate floor at the last minute just to score political points, this bill should have been marked up in a hearing in the Finance Committee, which is the Senate committee with jurisdiction over all tax issues. This would have given members of the Finance Committee an opportunity to offer amendments on this legislation, including replacing this poorly conceived tax increase with spending restraint instead. If the bill had gone through the Finance Committee, many of the flaws noted above would have been examined. When tax bills are not properly vetted, the unintended consequences can be severe.