

## Incidence of Payroll Taxes is Fully on Employees

While payroll taxes are levied equally between employers and employees, the broad consensus among economists is that payroll taxes unduly burden the worker. That the distribution of tax incidence does not correspond with the actual levying of taxes is generally accepted.<sup>1</sup> Time and time again, economists have shown that employers account for their share of payroll taxes when setting wages for the employee, essentially passing on the tax to workers in the form of lower wages.

Joint Committee on Taxation:

“Most analysts conclude that **both the employee’s and employer’s share of the payroll tax is borne by the employee** and that therefore the marginal payroll tax rate would include both the employee’s and employer’s share.”

“Overview of Present Law and Economic Analysis Relating to Marginal Tax Rates and the President’s Individual Income Tax Rate Proposals.” Joint Committee on Taxation, 6 March 2001.

Congressional Budget Office:

“CBO’s analysis of effective tax rates assumes that households bear the burden of the taxes that they pay directly, such as individual income taxes and employees’ share of payroll taxes. **CBO assumes—as do most economists—that employers’ share of payroll taxes is passed on to employees in the form of lower wages than would otherwise be paid.** Therefore, the amount of taxes is included in employees’ income, and the taxes are counted as part of employees’ tax burden.”

“Historical Effective Federal Tax Rates: 1979 to 2004.” Congressional Budget Office, December 2006.

“Public finance theorists generally agree that **the employer’s share of [payroll] taxes is passed on to workers in the form of lower wages.** CBO follows that assumption and treats payroll taxes as if employees paid both shares.”

“Effective Marginal Tax Rates on Labor Income.” Congressional Budget Office, November 2005.

John Brittain:

“This [his analysis] shows a **direct and complete trade off between the basic wage rate and the tax per worker, or a 100 percent shifting of the tax burden at the expense of labor’s basic wage**...the presence of a payroll tax on employers tends to reduce the wage in dollar by roughly the amount of the tax.”

“The Incidence of Social Security Payroll Taxes.” *The American Economic Review*, Vol. 61, No. 1, March 1971.

Okner and Pechman:

“It can be shown that, under perfect competition price flexibility, perfect factor mobility and inelasticity of the supplies of labor and capital...**payroll tax is born entirely by wage earners.**”

“Who Paid the Taxes in 1966?” *The American Economic Review*, Volume 64, No. 2, Papers and Proceedings of the Eighty-sixth Annual Meeting of the American Economic Association, May 1974.

Davies, St-Hilaire and Whalley:

“Social security is treated either exclusively or predominantly as a payroll tax on labor...”

“Some Calculations of Lifetime Tax Incidence.” *The American Economic Review*, Vol. 74, No. 4, September 1984.

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<sup>1</sup> Fullerton, Don and Gilbert E. Metcalf. “Tax Incidence.” National Bureau of Economic Research Working Paper 8829. NBER, March 2002.

## Employer-Sponsored Insurance Premiums Reduce Wages

The cost of health insurance is ultimately paid by workers, even if their employer writes the check to the insurer. Employers compensate workers based on their skills and contributions to the firm's productivity. That compensation includes wages, health insurance, and other fringe benefits. When an employer pays more for health insurance, she/he has less money for wages and other benefits. The cost of employer-based insurance thus ultimately comes out of workers' paychecks. This is a broad consensus among economists, and is born out in real-world studies, not just theory.

### **Policy Analysts and Economists Across the Spectrum Agree:**

Congressional Budget Office Testimony of Rosemary D. Marcuss: "A key point to understand, however, is that **health insurance is not a gift, but something employees pay for with reduced wages.** Even the most generous employer cannot for very long pay its employees more than the value of what they produce. Competitive pressures would force the employer either to reduce compensation or eventually go out of business. Thus, when an employer chooses to pay for health insurance, it has to reduce compensation in other forms. As the price of that health insurance increases, wage growth lags to compensate."

Statement of Assistant Director for Tax Analysis on The Tax Treatment of Employment-Based Health Insurance before the Committee on Finance United States Senate April 26, 1994

Jonathan Gruber: "The primary lesson from this literature is that...the costs of health insurance are fully shifted to wages."

"Health Insurance and the Labor Market," in Anthony J. Culyer and Joseph P. Newhouse, eds., Handbook of Health Economics, Volume 1a, New York: North-Holland, 2000.

Dana Goldman, Neeraj Sood, and Arleen Leibowitz: "...higher health insurance premiums must induce changes in the composition of total compensation—either in lower after-tax wages or in decreased contributions to other benefits—and we observe these tradeoffs. The results suggest that about two-thirds of the premium increase is financed out of cash wages and the remaining one-third is financed by a reduction in benefits."

"Wage and Benefit Changes in Response to Rising Health Insurance Costs" NBER Working Paper No. 11063, 2005.

Louise Sheiner: "The **regression results provide strong evidence that workers bear the costs of their health insurance through reduced wages.**"

"This study has found **strong evidence that workers pay for their health costs in the form of reduced compensation,** and that they do so contemporaneously with those costs. These results add to the growing body of evidence that wages reflect health insurance costs, and that labor markets do indeed conform to the predictions of a competitive model, at least at the group level."

"Health Care Costs, Wages, and Aging" (January 14, 1999). FEDS Discussion Paper No. 99-19.

Anna D. Sinaiko: "The cost to employ any worker in terms of total compensation is the sum of cash wages and fringe benefits. **Employers will offset increases in labor costs from providing health insurance by shifting the cost to workers through lower wages** or to consumers through higher prices, or by changing the composition of their workforces."

"Previous studies report that in general, 83–100 percent of the costs of health insurance are shifted to employees through reduced wages."

"Employers' Responses To A Pay-Or-Pay Mandate: An Analysis Of California's Health Insurance Act Of 2003" Health Affairs Web Exclusive, October 13, 2004