

## **For the Congressional Record**

**January 31, 2012**

### **Statement of Congressman Pete Stark Introducing the Narrowing Exceptions for Withholding Taxes Act**

MR. STARK: Mr. Speaker, I rise today to introduce the Narrowing Exceptions for Withholding Taxes Act. This legislation will close a loophole in existing tax law that allows certain self-employed individuals to avoid paying their fair share of Medicare payroll taxes.

Medicare is financed in part by a payroll tax paid by employers and employees. The total tax is 2.9 percent split between workers and employers. Self-employed individuals pay the full 2.9 percent themselves.

Under current law, the S corporation structure allows certain self-employed individuals a way to avoid paying full Medicare taxes. Income received as compensation for services to that S corporation will be subject to the Medicare payroll tax, but any income classified as a distribution of profits will be exempt. This loophole in our tax law encourages income manipulation. These individuals pay themselves a nominal income for their services to the S corporation and classify most of their income as profits and dividends, to avoid paying the 2.9 percent payroll tax.

The House Democrats first tried to close this loophole in December 2009 with H.R. 4213, the American Jobs and Closing Tax Loopholes Act. That bill passed the House, but did not pass the Senate. At the time, the Joint Committee on Taxation scored this provision as raising \$11.2 billion in revenue over ten years.

The IRS does not have the resources to audit all 4 million S corporations to ensure that there is no underreporting of income. The Treasury Inspector General for Tax Administration, the Joint Committee on Taxation and the GAO have all highlighted the systematic underreporting of income. The GAO estimated that pass-through organizations underpaid \$15 billion in 2001, with a median payroll tax underpayment of \$20,127.

Teachers, firefighters, and nurses can't structure their income to avoid payroll taxes. This is a strategy for lawyers, lobbyists, and investment managers. This legislation would close this loophole by targeting the individuals most likely to take advantage of this loophole. These are professional service businesses built on the reputation and skill of three or fewer employees in the field of health, law, lobbying, engineering, architecture, accounting, investment advice or management, or brokerage services. Under this provision, all of the profits someone gets from an S-corporation they own would be subject to the payroll tax. These shareholders will

no longer be able to underreport wage income to exclude the rest of their earnings from the payroll tax.

Former House Speaker Newt Gingrich took advantage of this loophole. When he filed his 2010 taxes, he reported earnings from his two S Corporations of just \$444,327 in income but \$2.4 million in profits and dividends. This nearly \$3 million was just earnings in the same year from the same two organizations. However, by choosing to report only \$444,327 as wage income, the Wall Street Journal estimated that Mr. Gingrich saved himself \$69,000 in Medicare payroll taxes. His \$2.4 million in profits and dividends was exempt from the 2.9 percent payroll taxes due to a flaw in our tax laws.

This legislation would put our workers on an even playing field. Self-employed individuals would no longer have the option avoid the taxes with the creative use of a pass-through entity. Just like those individuals who work in an ordinary partnership or sole-proprietorship, or work for a larger institution, every taxpayer would pay his or her fair share toward the Medicare trust fund.