

Key Elements of the U.S. Tax System

What tax provisions subsidize the cost of health care?

TAXES AND HEALTH CARE
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Q. What tax provisions subsidize the cost of health care?

A. A host of tax preferences for health care cost the federal government roughly \$225 billion in income tax revenue in 2018. The largest is the exclusion from taxable income of employer contributions for health insurance premiums.

In 2018, the federal government lost roughly \$225 billion in income tax revenue from at least eight tax preferences for health care. By far the most costly is the exclusion of employer contributions for health insurance premiums from taxable income.

EXCLUSION FOR EMPLOYER CONTRIBUTIONS TO HEALTH INSURANCE

Employer and most employee contributions to health insurance premiums are excluded from income taxes. The Joint Committee on Taxation estimates that the income tax expenditure on the exclusion for employer-sponsored health insurance was over \$146 billion in fiscal year 2018. Employer contributions for health insurance premiums are also excluded from employees' taxable wages when calculating payroll taxes. Including its impact on both income and payroll taxes, the exclusion reduced government revenue by \$280 billion in 2018.

OTHER MAJOR TAX EXPENDITURES FOR HEALTH CARE

Table 1 outlines the other major federal tax expenditures for health care:

- Individuals ineligible for employer-sponsored or public health insurance may receive subsidies to purchase insurance on Affordable Care Act Marketplaces (\$49 billion).
- Individuals may claim as an itemized deduction out-of-pocket medical expenses and health insurance premiums paid with after-tax dollars and exceeding 7.5 percent of their adjusted gross income in 2018 and 10 percent of their income in subsequent years (\$9 billion).
- Self-employed individuals may deduct health insurance premiums from their income (\$6 billion).
- Individuals younger than 65 covered by high-deductible health insurance plans may take an income tax deduction for contributions to health savings accounts (HSAs). Employers may make HSA contributions that are excluded from income and payroll taxes. Additionally, HSA balances grow tax-free, and withdrawals for medical expenses are not subject to income tax (\$5 billion).
- Medical benefits provided by workers' compensation insurance are excluded from taxable income (\$5 billion).
- Coverage for military retirees and dependents is excluded from taxable income (\$3 billion).
- Small employers who pay low average wages may take a credit when providing employees with health insurance. The credit phases out as firm size and average wages increase; it can only be taken for two years (\$1 billion).

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TABLE 1

Estimated Tax Expenditures Fiscal Year 2018



Program	Cost (millions of dollars)
Exclusion of employer contributions for medical insurance premiums and medical care ^a	\$146,100
Premium tax credit for insurance purchased through ACA marketplaces	\$49,200
Deductibility of medical expenses by individuals	\$9,400
Deductibility of medical insurance premiums for self-employed	\$6,400
Health Savings Accounts ^b	\$5,300
Exclusion of workers' compensation medical benefits	\$4,600
Exclusion of medical care for military dependents and retirees	\$3,000
Tax credit for small businesses purchasing health insurance	\$600

Sources: Congressional Budget Office (2018a); Joint Committee on Taxation (2018); and Office of Management and Budget (2018).

Note: The Joint Committee on Taxation no longer classifies excluding Medicare benefits from taxable income as a tax expenditure.

(a) Only includes lost income tax revenues. Including income and payroll taxes, the exclusion reduced government revenue by \$280 billion.

Further Reading

Congressional Budget Office. 2018. *The Budget and Economic Outlook: 2018 to 2028*. Washington, DC: Congressional Budget Office.

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