

## The Tax Treatment of Health Insurance and Employment-Based Health Benefits

by Paul Fronstin, EBRI

- **Tax treatment of health benefits**—Various proposals have been made to change the tax treatment of health coverage, which currently is tax free to both employers and workers. Proponents of these changes argue, among other things, that current tax rules are unfair and contribute to unnecessary spending for health care. This *Issue Brief* examines changes that policymakers are discussing, explores the history of tax laws concerning the tax treatment of health benefits and the cost to the federal government in foregone taxes because of these laws, and examines some the advantages and disadvantages that could result from the proposed changes.
- **Estimated cost in tax revenue**—Health benefits account for one of the largest tax expenditures in the U.S. budget. Estimates for personal federal foregone tax revenue in 2006 related to the exclusion from individual income of employer contributions to health benefits ranged from \$91 billion (Joint Committee on Taxation) to \$133 billion (Office of Management and the Budget).
- **Major proposals**—The most significant proposals for changing the tax status of health benefits are:
  - ▶ **Limiting the tax exclusion for health benefits** to \$5,000 for individual coverage and \$11,500 for family coverage obtained through an employer or purchased directly from an insurer. This proposal was included among the recommendations of a 2005 presidential advisory panel.
  - ▶ **Expanding health savings accounts (HSAs) and high-deductible health plans (HDHPs)**. Under this plan, which President Bush advocates, individuals would be able to deduct the full premium for a HDHP used in conjunction with an HAS, even if purchased directly from an insurer.
  - ▶ **Allowing full tax deductibility of health care expenses** from income. Under this proposal, individuals would be able to deduct all out-of-pocket health care expenses as a way to encourage more people to adopt less comprehensive coverage with more cost sharing.
- **Assessing the trade-offs**—Since health insurance coverage produces a number of positive external societal benefits, withdrawing the current tax incentive implicitly would suggest that individuals would obtain less-than-optimal medical care. Currently, that incentive is provided through an employment-based system that has systemic efficiencies that an individual-based system would not be able to equal. Any honest debate of overhauling the federal tax treatment of health coverage in the United States needs to address not just what a new system might do, but what the trade-offs and unintended consequences might be, and who would be likely to be most affected by the change.



























































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