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Tax Benefits for Health Insurance
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Various proposals are before Congress for new or expanded tax benefits for health insurance. President Bush has proposed that individuals who make contributions to the newly authorized health savings accounts (HSAs) be allowed to deduct the cost of their health insurance; in addition, the government would make account contributions for lower-income taxpayers. He has also proposed a refundable tax credit to help lower-income families purchase insurance. Proponents of these and other measures generally argue that new tax benefits are needed to extend coverage to the uninsured and to address efficiency and equity problems. Opponents generally claim the measures would primarily benefit higher income taxpayers and do little for those now without coverage. Whether the tax measures would protect or erode employment-based insurance is also a consideration.

Current law contains significant tax benefits for health insurance.

(1) Employer-paid health insurance is excluded from the income and employment tax base; thus, workers are not taxed on it. Over two-thirds of all people under age 65 (170 million people) receive employment-based insurance coverage. Employers typically pay about 80% of its cost, though some pay more and others pay less.

(2) Self-employed taxpayers may deduct 100% of their health insurance cost; about 3 million taxpayers, primarily small business owners, take this deduction.

(3) Taxpayers who itemize deductions may deduct after-tax insurance payments to the extent they and other medical expenses exceed 7.5% of adjusted gross income.

(4) Workers who have lost manufacturing jobs due to increased foreign imports or shifts in production overseas or who are receiving a pension paid by the Pension Benefit Guaranty Corporation may receive a refundable tax credit to purchase certain types of health insurance. The tax credit is worth 65% of the cost of insurance and can be received as premiums are paid by the worker.

(5) Medicare and Medicaid coverage is not considered taxable income; together these programs cover over 70 million people.

(6) With some exceptions, benefits actually received from insurance are not considered taxable income.

By lowering the after-tax cost of insurance, tax benefits encourage comprehensive coverage that provides reimbursement for routine services; they also extend coverage to more people. In addition, tax benefits influence the way in which coverage is acquired: the uncapped exclusion for employer-paid insurance, in contrast to a restricted itemized deduction, is one reason that employment-based coverage is so common. Regardless of the employer contribution, this insurance has both advantages and disadvantages for the typical worker. Generally it costs less than individual market insurance, and usually premiums do not vary by age or risk. (In contrast, individual market insurance has limited risk pooling, though states may limit premium variations.) However, plans chosen by employers may not meet individual workers' needs, particularly if there are limited options, and changing jobs may require both new insurance and doctors. Many smaller employers do not offer health insurance, and their workers can have difficulty finding affordable coverage.

The tax benefits also increase the demand for health care by enabling insured people to obtain services at lower effective prices. Moreover, since many people would likely obtain some insurance without the tax benefits, they can be an inefficient use of public dollars. The benefits raise questions of equity, largely because the tax savings they generate vary directly with the taxpayer's marginal tax rate. For an analysis of these issues, see CRS Report RL30762, *Tax Subsidies for Health Insurance for the Uninsured: An Economic Analysis of Selected Policy Issues for Congress*, by Gary Guenther.

The Medicare prescription drug bill signed by President Bush in December 2003 (P.L. 108-173) allows employers to exclude from gross income the Medicare subsidy payments they receive to maintain prescription drug coverage for their retirees. The law also includes authorization for new tax-advantaged health savings accounts. Many employers have expressed interest in these accounts, though how widely and rapidly they spread remains to be seen. See CRS Report RL32467(pdf), *Health Savings Accounts,* by Bob Lyke, Chris Peterson, and Neela Ranade.

For more information about current law provisions and new legislation, see CRS Issue Brief IB98037, *Tax Benefits for Health Insurance: Current Legislation*, by Bob Lyke.