

FACTS from EBRI

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Tax Expenditures and Employee Benefits: An Update From the FY 2003 Budget

The federal government supports the provision of employee benefits through preferential tax treatment in the Internal Revenue Code. The Congressional Budget Act of 1974 (P. L. 93-344) requires that a list of “tax expenditures” (federal tax revenue forgone due to preferential provisions) be included in the budget. The concept of “tax expenditures” has always been controversial, particularly as it relates to programs that are “tax deferred” rather than “tax exempt,” like retirement programs (*EBRI Issue Brief* no. 134, February 1993, provides a full review of this controversy). For the next fiscal year (2003), tax-favored employment-based retirement benefits will account for the largest tax expenditure presented in the budget (\$112.59 billion, or 39 percent of the total amount), followed by health insurance (\$99.26 billion, or 34 percent). The following is a listing of the employee benefits tax expenditures, as published in President Bush’s Fiscal Year 2003 budget, prepared by the White House Office of Management and Budget, using a methodology that is flawed but mandated by Congress.

	Tax Expenditures, by Fiscal Year			
	2001	2003 ^a	2007 ^a	2003–2007 ^a
	(\$ millions)			
Transportation				
Exclusion of reimbursed employee parking expenses	\$ 1,980	\$ 2,190	\$ 2,670	\$ 12,130
Exclusion for employer-provided transit passes	220	360	600	2,380
Education, Training, Employment, and Social Services				
Exclusion of employer educational assistance	260	500	620	2,800
Exclusion of employer-provided child care	720	770	1,080	4,610
Exclusion of employee meals and lodging (other than military)	710	780	930	4,260
Health				
Exclusion of employer contributions for medical insurance premiums and medical care	82,800	99,260	134,960	580,590
Self-employed medical insurance premiums	1,520	2,420	4,430	18,460
Workers’ compensation insurance premiums	4,730	5,080	5,790	27,080
Medical Savings Accounts	20	20	20	100
Exclusion of Social Security Benefits				
Old-Age and Survivors Insurance benefits for retired workers	17,830	18,180	20,890	96,200
Benefits for dependents and survivors	3,720	4,060	5,170	22,930
Disability insurance benefits	2,690	3,240	5,020	20,380

^a Projected.

	Tax Expenditures, by Fiscal Year			
	2001	2003 ^a	2007 ^a	2003–2007 ^a
	(\$ millions)			
Income Security				
Exclusion of railroad retirement system benefits	380	400	400	2,000
Exclusion of workers' compensation benefits	5,560	6,070	7,200	33,090
Exclusion of special benefits for disabled coal miners	70	60	50	280
Exclusion of military disability pensions	110	120	140	640
Net Exclusion of Pension Contributions and Earnings				
Employment-based plans	86,150	112,590	136,640	615,630
Employer plans	42,070	53,080	63,320	285,510
401(k) plans	44,080	59,510	73,320	330,120
Individual retirement accounts	18,680	18,660	18,330	94,200
Keogh plans	6,160	6,770	7,730	36,280
Special ESOP rules (other than investment credit)	1,290	1,420	1,730	7,850
Exclusion of Other Employee Benefits				
Premiums on group term life insurance	1,750	1,800	1,920	9,300
Premiums on accident and disability insurance	210	230	270	1,250
Income of trust to finance supplementary unemployment benefits	20	30	30	150
Small business retirement plan credit	0	50	150	540
Veterans' Benefits and Services				
Exclusion of veterans' disability compensation and death benefits	3,150	3,300	4,080	18,420
Exclusion of veterans' pensions	70	80	100	440
Total	\$240,800	\$288,440	\$360,950	\$1,611,990

^a Projected.

There are three types of tax treatments for employee benefits: tax exemption, tax deferral, and other preferential treatment:

- *Tax-exempt* treatment in the tax code means that the benefit is not considered taxable income to the individual. Examples of employee benefits that receive this type of tax treatment are health insurance, educational assistance, legal assistance, child-care, discounts, flexible spending accounts, parking, cafeteria facility, and meals. The largest of these is health insurance. According to the president's 2003 budget, the tax exemption for employment-based health insurance is projected to cost the federal government \$580.6 billion from 2003 through 2007. This is tax revenue the federal government will not recoup at some later point.
- *Tax-deferred* treatment means that the employee is not immediately taxed on (1) the contributions the employer and/or the employee makes to the plan, and/or (2) on the earnings on plan assets as they accumulate, but will typically be taxed on portions not previously taxed when the benefit is paid. Examples of employee benefits that receive this type of tax treatment are Keogh plans, defined benefit

^a Projected.

pension plans, defined contribution plans (such as 401(k) plans), and individual retirement accounts (IRAs). According to the president's 2003 budget, the tax exemption for employer plans is projected to cost the federal government \$615.6 billion from 2003 through 2007. When IRAs and Keoghs are added, the tax revenue loss estimate is \$746.1 billion for 2003–2007.

- The revenue loss estimate for pension contributions and earnings is different from health insurance. The tax revenue loss estimate is actually a *deferral* of taxation, rather than an exemption. At some point in the future, when the individual starts drawing a benefit from the plan, the federal government will receive some tax revenue from the benefit payment.
- *Other benefits* are subject to limits and/or provisions with respect to tax treatment. For example, employer payments to the premium of life insurance are tax-exempt to the employee up to a benefit of \$50,000; any premium amount for a benefit greater than \$50,000 is taxable income to the employee. The benefit payout from a life insurance policy is not taxable income to the beneficiary. According to the president's 2003 budget, the tax exemption for employment-based life insurance is projected to cost the federal government \$9.3 billion from 2003 through 2007.

For more information, contact Ken McDonnell, (202) 775-6342, or see EBRI's Web site at www.ebri.org. Source: *EBRI Databook on Employee Benefits*, fourth edition, 1997; and Executive Office of the President, Office of Management and Budget, www.whitehouse.gov/omb/budget/fy2002/text/bud22_4.html