Tax Expenditures and Employee Benefits: Estimates from the FY 2011 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” (such as retirement plans, under which tax revenue ultimately will be collected) rather than “tax exempt” (meaning programs in which no revenue will ever be collected) (EBRI Issue Brief, no. 134, February 1993, provides a full review of this controversy).

• For the next fiscal year (2011), all employee benefits-related tax expenditures ($380.83 billion) will account for 36.0 percent of the $1.06 trillion tax expenditures in the budget. Tax-favored employment-based health insurance benefits will account for the largest tax expenditure presented in the budget ($176.96 billion, or 16.7 percent of the total amount and 46.5 percent of all employee benefits-related tax expenditures), followed by employment-based retirement plans ($111.69 billion, or 10.6 percent of the total amount and 29.3 percent of all employee benefit related tax expenditures) (see figure).

• The following is a listing of the employee benefits tax expenditures, as published in President Obama’s Fiscal Year 2011 budget, prepared by the White House Office of Management and Budget, using a methodology that is flawed but mandated by Congress.

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 2011 budget, the tax exemption for employment-based health insurance is projected to cost the federal government $1.05 trillion from 2011 through 2015. 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 pension plans, defined contribution plans (such as 401(k) plans), and individual
### Employee Benefit Tax Expenditures

**White House Fiscal Year 2011 Budget Estimates**

|---------------------------------|------|------|------|----------|

#### Transportation
- Exclusion of reimbursed employee parking expenses: $3,020, $3,100, $3,590, $16,660
- Exclusion for employer-provided transit passes: 560, 530, 670, 3,000

#### Education, Training, Employment and Social Services

|-----------------|------|------|------|----------|
- Exclusion of employer-provided educational assistance | 690 | 30 | 0 | 30 |
- State pre-paid tuition plans | 1,390 | 1,580 | 2,050 | 9,190 |
- Exclusion of employer-provided child care | 1,210 | 1,370 | 1,630 | 7,440 |
- Employer-provided child care credit | 20 | 10 | 0 | 10 |
- Exclusion of employee meals and lodging (other than military) | 1,060 | 1,110 | 1,370 | 6,180 |

#### Health

|-----------------|------|------|------|----------|
- Exclusion of employer contributions for medical insurance premiums and medical care | 159,868 | 176,964 | 248,600 | 1,053,794 |
- Self-employed medical insurance premiums | 5,250 | 5,740 | 7,780 | 33,370 |
- Medical Savings Accounts/Health Savings Accounts | 2,030 | 2,130 | 2,590 | 11,780 |
- Distributions from Retirement Plans for Premiums for Health and Long-term Care Insurance | 300 | 330 | 490 | 2,020 |

#### Exclusion of Social Security Benefits

|-----------------|------|------|------|----------|
- Old-Age and Survivors Insurance benefits for retired workers | 21,410 | 20,240 | 26,810 | 115,150 |
- Benefits for dependents and survivors | 3,850 | 3,140 | 3,330 | 15,990 |
- Disability Insurance benefits | 6,950 | 7,160 | 8,580 | 39,020 |

#### Income security

|-----------------|------|------|------|----------|
- Exclusion of railroad retirement system benefits | 320 | 300 | 250 | 1,340 |
- Exclusion of workers' compensation benefits | 5,870 | 5,940 | 6,370 | 30,820 |
- Exclusion of special benefits for disabled coal miners | 40 | 40 | 40 | 200 |
- Exclusion of military disability pensions | 110 | 110 | 120 | 560 |

#### Net Exclusion of Pension Contributions

|-----------------|------|------|------|----------|
- Employment-based plans | 94,909 | 111,691 | 130,163 | 608,320 |
- Employer plans | 41,360 | 44,630 | 53,980 | 247,480 |
- 401(k) | 53,549 | 67,061 | 76,183 | 360,840 |
- Individual Retirement Accounts | 12,780 | 14,080 | 16,500 | 78,940 |
- Keoghs plans | 13,890 | 15,120 | 22,610 | 95,760 |
- Special ESOP rules | 1,700 | 1,800 | 2,200 | 10,000 |
- Low and Moderate Income Savers | 1,180 | 1,170 | 960 | 5,320 |

#### Exclusion of Other Employee Benefits

|-----------------|------|------|------|----------|
- Premiums on group term life insurance | 2,110 | 2,160 | 2,390 | 11,500 |
- Premiums on accident and disability insurance | 330 | 340 | 360 | 1,770 |
- Income of trust to finance supplementary unemployment benefits | 40 | 50 | 60 | 260 |

#### Veterans' Benefits and Services

|-----------------|------|------|------|----------|
- Exclusion of veterans' disability compensation and death benefits | 4,130 | 4,370 | 5,510 | 24,620 |
- Exclusion of veterans' pensions | 200 | 220 | 270 | 1,270 |

#### Total

- 345,217
- 380,825
- 495,293
- 2,184,314

#### Addendum

|-----------------|------|------|------|----------|
- Deductibility of mortgage interest on owner-occupied homes | 92,180 | 104,540 | 149,560 | 637,560 |

*Projected.

**Source:** Executive Office of the President, Office of Management and Budget, Analytical Perspectives, Budget of the United States Government, Fiscal Year 2011, www.whitehouse.gov/omb/budget/Analytical_Perspectives/

retirement accounts (IRAs). According to the president's 2011 budget, the tax exemption for employer plans is projected to cost the federal government $608.32 billion from 2011 through 2015. When IRAs and Keoghs are added, the tax revenue loss estimate is $783.02 billion for 2011–2015.
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 2011 budget, the tax exemption for employment-based life insurance is projected to cost the federal government $11.5 billion from 2011 through 2015.

For data for all years 1975–2009, go to EBRI’s Databook on Employee Benefits, Chapter 5. There is also a spreadsheet with inflation-adjusted dollars.

For more information, contact Ken McDonnell, (202) 775-6300, or see EBRI’s Web site at www.ebri.org