FACTS from EBRI

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Tax Expenditures and Employee Benefits: An Update From the FY 2005 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 programs) rather than "tax exempt" (such as employment-based health insurance). (*EBRI Issue Brief* no. 134, February 1993, provides a full review of this controversy.)

- For the next fiscal year (2005), all employee benefit-related tax expenditures ($314.080 billion) will account for 43.3 percent of the $725.265 billion tax expenditures in the budget. Tax-favored employment-based retirement benefits will account for the largest tax expenditure presented in the budget ($120.650 billion, or 16.6 percent of the total amount and 38.4 percent of all employee benefit-related tax expenditures), followed closely by health insurance ($112.940 billion, or 15.6 percent of the total amount and 36.0 percent of all employee benefit-related tax expenditures).

- The following is a listing of the employee benefit tax expenditures, as published in President Bush's Fiscal Year 2005 budget, prepared by the White House Office of Management and Budget, using a methodology that is imperfect but mandated by Congress.

Tax Expenditures, by Fiscal Year

	2004[a]	2005[a]	2009[a]	2005–2009[a]
	($ millions)			
Transportation				
Exclusion of reimbursed employee parking expenses	$ 2,240	$ 2,360	$ 2,880	$ 13,080
Exclusion for employer-provided transit passes	380	450	730	2,950
Education, Training, Employment, and Social Services				
Exclusion of employer educational assistance	530	560	690	3,120
State pre-paid tuition plans	150	320	660	2,510
Exclusion of employer-provided child care	620	770	1,010	4,530
Employer-provided child care credit	130	140	180	800
Exclusion of employee meals and lodging (other than military)	810	850	1,000	4,640
Health				
Exclusion of employer contributions for medical insurance premiums and medical care	106,720	112,940	150,300	653,670
Self-employed medical insurance premiums	3,740	3,780	5,150	22,140
Medical Savings Accounts	-140	-570	-2,180	-7,010

Exclusion of Social Security Benefits				
Old-Age and Survivors Insurance benefits for retired workers	19,600	19,040	19,910	98,420
Benefits for dependents and survivors	4,380	4,310	4,040	20,730
Disability insurance benefits	3,570	3,720	4,500	20,420
Income Security				
Exclusion of railroad retirement system benefits	400	400	400	2,000
Exclusion of workers' compensation benefits	6,460	6,850	8,690	38,710
Exclusion of special benefits for disabled coal miners	60	50	40	230
Exclusion of military disability pensions	110	110	120	570
Net Exclusion of Pension Contributions and Earnings				
Employment-based plans	116,220	120,650	135,880	642,520
Employer plans	59,480	61,740	60,440	309,530
401(k) plans	56,740	58,910	75,440	332,520
Individual retirement accounts	19,810	20,090	19,490	100,050
Keogh plans	8,730	9,260	12,500	53,630
Special ESOP rules (other than investment credit)	1,920	2,060	2,780	12,040
Exclusion of Other Employee Benefits				
Premiums on group term life insurance	1,830	1,860	1,990	9,610
Premiums on accident and disability insurance	240	250	290	1,350
Income of trust to finance supplementary unemployment benefits	30	30	30	150
Small business retirement plan credit	80	100	150	670
Veterans' Benefits and Services				
Exclusion of veterans' disability compensation and death benefits	3,330	3,600	4,560	20,560
Exclusion of veterans' pensions	100	100	120	550
Total	$302,050	$314,080	$375,910	$1,722,170

[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 2005 budget, the tax exemption for employment-based health insurance is projected to cost the federal government $653.7 billion from 2005 through 2009. 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 retirement accounts (IRAs). According to the president's 2004 budget, the tax exemption for employer plans is projected to cost the federal government $642.5 billion from 2005 through 2009. When IRAs and Keoghs are added, the tax revenue loss estimate is $796.2 billion for 2005–2009.

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 2005 budget, the tax exemption for employment-based life insurance is projected to cost the federal government $9.6 billion from 2005 through 2009.

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/fy2004/index.html

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