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Lowering the Medical Expense Deduction Threshold Would Do Little to Help Taxpayers Facing High Premiums

By Paul N. Van de Water

Faced with evidence that the House Republican health bill would substantially raise premium costs for low- and moderate-income people nearing retirement, the House leadership has modified the bill to lower the threshold for deducting medical expenses for income tax purposes. But this change would do little to help those most in need of assistance affording health coverage, and would provide an additional tax cut to those who need it least.

Individual income taxpayers may claim as an itemized deduction medical expenses that exceed a specified percentage of their adjusted gross income (AGI). Health insurance premiums are eligible for the deduction, as are out-of-pocket spending for cost sharing and medical expenses not covered by insurance. The Affordable Care Act raised the floor for expenses to qualify for the deduction from 7.5 percent to 10 percent of AGI. The American Health Care Act (ACHA), as reported by the House Budget Committee, would return the floor to 7.5 percent. The updated version of the legislation, released March 20, would lower it further to 5.8 percent.

Reducing the threshold for the medical expense deduction — like any approach relying on itemized deductions — would overwhelmingly benefit higher-income taxpayers. The Tax Policy Center estimates that reducing the floor from 10 percent to 7.5 percent of AGI would deliver over three-quarters of the tax savings to taxpayers with incomes over \$100,000, while less than 3 percent would go to taxpayers with incomes below \$50,000.¹ Further lowering the floor to 5.8 percent would have an almost identical impact.

To see these effects, consider two illustrative taxpayers. The Congressional Budget Office's (CBO) cost estimate for the reported ACHA provided premium estimates for illustrative 64-year-olds at different income levels under current law and the proposal, both before and after premium tax credits.² (See table.) The low-income individual, with income of \$26,500 (175 percent of the federal poverty level) in 2026, would face an after-credit premium of \$14,600, or over half of her income. Even if she could deduct the premium above 5.8 percent of her income as a medical

¹ Tax Policy Center, *Reduce Medical Expense Deduction Threshold (2017)*, Tables T17-0091 and T17-0093, March 22, 2017, <http://www.taxpolicycenter.org/simulations/reduce-medical-expense-deduction-threshold-march-2017>.

² Congressional Budget Office, *Cost Estimate, American Health Care Act*, March 13, 2017, <https://www.cbo.gov/system/files/115th-congress-2017-2018/costestimate/americanhealthcareact.pdf>. The amended House bill has essentially the same effects on premiums and tax credits as the original legislation.

expense, her net premium would still be an unaffordable \$13,800.³ If the individual was retired and received an average Social Security benefit, she would not benefit at all from the medical expense deduction, because she would owe no income taxes.⁴

The higher-income taxpayer in CBO’s example would benefit more from the medical expense deduction than the low-income taxpayer, for two reasons. First, the value of a deduction depends on a taxpayer’s marginal tax rate, and the high-income taxpayer would pay a higher marginal rate. Second, he would likely have larger non-medical itemized deductions. His net premium under the amended House bill, taking into account both the premium credit and medical expense deduction, would be about \$12,800.⁵

TABLE 1

Lowering Medical Expense Deduction Threshold Would Do Little to Offset Large Premium Increases Low-Income Taxpayers Face Under Updated House GOP Health Bill

Health insurance premiums for illustrative 64-year-old single individuals in 2026 under current law and amended House Republican health bill

Income	Current Law		Amended House Bill	
	Premium after Tax Credit	Premium after Tax Credit	Value of Tax Deduction	Premium after Tax Credit and Deduction
\$26,500	\$1,700	\$14,600	\$800	\$13,800
\$68,200	\$15,300	\$14,600	\$1,800	\$12,800

Sources: Premiums and tax credits estimated by the Congressional Budget Office; medical expense deduction estimated by CBPP assuming a threshold of 5.8 percent of adjusted gross income.

Press reports indicate that the change in the threshold for the medical expense deduction, along with other changes contained in the amended bill, would reduce revenues by \$85 billion over ten years. House Republican leaders have suggested that the Senate might instead use these funds to enhance the premium tax credit for those aged 50 to 64 who need additional assistance.⁶ Since House Republicans have been unable to devise a specific improvement in the ACHA’s premium credits, there is no assurance that Senate Republicans will prove more successful. Moreover, the tax credit changes that have been under discussion won’t close the bill’s massive affordability gaps.⁷ The reported version of the bill would cut financial assistance for low- and moderate-income people buying health insurance in the individual market by \$312 billion, and even an additional \$85 billion would fill only about a quarter of that hole.

³ This estimate assumes that the taxpayer’s income is derived from earnings, and that she has \$1,500 in additional out-of-pocket medical expenses and no other itemized deductions.

⁴ Social Security benefits are taxable only above certain income levels.

⁵ This estimate assumes that the taxpayer has \$1,500 in additional out-of-pocket medical expenses and \$16,600 in other itemized deductions.

⁶ House Committee on Ways and Means, *House Republicans Announce Updates to Strengthen American Health Care Act*, March 20, 2017, <https://waysandmeans.house.gov/house-republicans-announce-updates-strengthen-american-health-care-act/>.

⁷ Aviva Aron-Dine and Tara Straw, *House Health Bill Still Cuts Tax Credits, Raises Costs by Thousands of Dollars for Millions of People*, Center on Budget and Policy Priorities, March 22, 2017, <http://www.cbpp.org/research/health/house-gop-health-bill-still-cuts-tax-credits-raises-costs-by-thousands-of-dollars>.