Center for American Progress

Repealing the Medical Expense Deduction Would Harm Some Middle-Class Families

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November 3, 2017

In their unified framework tax plan released in September, President Donald Trump and congressional Republican leaders proposed substantial tax cuts, nearly 80 percent of which will benefit the top 1 percent of taxpayers when fully implemented.[1] To partially offset the cost of the proposed tax cuts, their plan would eliminate all itemized deductions except for the mortgage interest deduction and the charitable deduction. The tax bill introduced recently by House Republicans follows a similar approach, eliminating most itemized deductions.

Among the itemized deductions that would be eliminated under these tax plans is the deduction for medical expenses not compensated for by insurance.[2] Currently, individuals can claim an itemized deduction for medical expenses that exceed 10 percent of their income. If this deduction is eliminated, many families with very high medical bills would also face higher tax bills.

The medical expense deduction, while imperfect, is consistent with the principle of taxation based on ability to pay

From the inception of the individual income tax, policymakers have agreed that the tax system should account for an individual's ability to pay.[3] For this reason, the tax code is progressive, requiring those who have higher income to pay a larger share of their income in taxes. Similarly, the medical expense deduction recognizes that unexpected high medical expenses can affect a person's or family's ability to pay. While many more health costs are covered due to the enactment of the Affordable Care Act (ACA), situations still exist in which families may be required to cover significant out-of-pocket costs, such as when a life-threatening diagnosis requires out-of-network specialty care or when an aging spouse requires long-term care—scenarios that may not be covered under Medicare or private insurance.[4] These costs are largely out of the taxpayer's control and can undermine their ability to pay taxes. For middle-income families who find themselves in these kinds of health care situations, eliminating the deduction is like hitting these families when they are down.

The medical expense deduction, unlike other itemized deductions, is claimed most often by middle-income families

Most other itemized deductions are claimed by a larger share of itemizing tax filers at higher income levels.[5] But the medical expense deduction is claimed by a larger share of itemizing tax filers at income ranges below $200,000, with the largest share claimed by those in the $50,000 to $100,000 annual income range.[6] In 2014, 9 percent of itemizing filers in the latter range claimed the deduction. Yet, for filers in these income ranges, the average deduction tends to be larger for the medical expense deduction than the amount claimed for other itemized deductions. Among high-income taxpayers who itemize, a smaller share takes the medical expense deduction but the average amount claimed is much higher.

The medical expense deduction, while not needed by many, is critical to some middle-income families

Prior to the enactment of the ACA, in 2009, about 10 million households claimed the medical expense deduction.[7] That number declined to 8.8 million in 2015[8]—the most recent year for which data are available— due to two specific reasons. First, the ACA removed most limits on coverage and thus protected the insured from most catastrophic health care costs. Second, the ACA raised the threshold over which medical expenses can be deducted, from 7.5 percent to 10 percent of adjusted gross income, which took effect in 2013 for those younger than 65 and in 2016 for those 65 or older.[9] Thus, the deduction remains important to those individuals who, for example, seek lifesaving treatment outside of their plan or face essential health services costs not covered by Medicare, such as long-term care of a spouse experiencing advanced dementia who can no longer be cared for at home. Such sudden and high costs can financially cripple middle-income families and could even put some at risk of falling out of the middle class.

For the middle-class taxpayers who do use the deduction, eliminating it would exacerbate the financial pressures resulting from medical expenses. While there is no substitute for adequate health care coverage, the deduction for medical expenses, including long-term care expenses, is one way to close the remaining gap and is inexpensive compared to other itemized deductions, especially when weighed against its public benefit.

Rather than eliminating the medical expense deduction, Congress could reform it to better target it to those in need

While the medical expense deduction provides needed tax relief for many in the middle class, it fails to help those at lower income levels and provides unnecessary relief for high-income households. Congress could consider reforming the deduction to address both of these shortcomings. For example, the deduction could be turned into a comparable tax credit that is partially or fully refundable in order to extend the tax relief to a greater number of lower-income tax filers. At the same time, the credit could phase out at higher-income levels, where presumably taxpayers have more generous health care coverage and, in any event, are better positioned to absorb the extra costs.

Examples show that the medical expense deduction can make a huge difference for the few families who need it

There are a number of reasons why someone with a life-threatening diagnosis might have substantial out-of-pocket costs—costs that would far exceed even the higher standard deduction called for in the proposed tax plan. For example, the patient may require surgery by an out-of-network surgeon not in the patient's area; the patient may require complex surgery by a surgeon with specific expertise not available in network; or the patient's surgeon may be in network but the anesthesiologist, radiologist, or pathologist involved in the patient's surgery is not.[10] Sometimes certain treatments are not covered by the patient's insurance plan, or the patient's plan may require a high copay on unique and expensive prescription medications.[11] Another significant expense for which many people lack coverage is the cost of long-term care—a problem commonly faced by the elderly. These costs can vary significantly but on average approach $7,000 per month.[12]

To see the difference that the medical expense deduction can make, it helps to consider a couple of hypothetical but illustrative examples. The first is a family of four with a child who has been diagnosed with a brain tumor—one of more than 4,500 new cases each year.[13] In this scenario, the parents both work, making a combined annual income of $95,000. While the costs of treating brain cancer can exceed $100,000 in the first year, not all of this cost will be covered by insurance. In this example, the family lives in a rural area and must seek care from an out-of-network specialist who performs surgery at a cost to the family of $46,000.

In the second example, an aging married couple is dealing with the husband's dementia, and his wife finds that she can no longer care for her husband at home. The couple receives $34,000 in Social Security benefits—$17,050 of which are taxable—and $40,000 in additional taxable retirement income. The wife's cost of placing her husband in a long-term care facility costs more than $6,500 per month—a financial hardship.

What's more, under the tax plan, all families, including the ones in the examples, would lose their personal and dependent exemptions. Families would receive a larger standard deduction, increased Child Tax Credit, and a new temporary tax credit of $300 per filer, which expires after 2022. The calculations in Table 1 include these additional fundamental changes. While these families might have other forms of income or tax deductions or credits, these simplified examples serve to demonstrate the impact of losing the medical expense deduction. As the table shows, the loss of the medical expense deduction imposes a significant additional hardship at a time when these families are struggling.

TABLE 1

The medical expense deduction helps middle-class households facing unusual medical expenses

Comparing two families under current law and under the House GOP tax plan

	Example 1		Example 2	
	Married couple with two children, AGI of $95,000, out-of-network specialized procedure costing $46,000		Elderly couple, AGI of $57,050, long-term nursing home care costing $80,000 a year	
	Current law	House GOP plan	Current law	House GOP plan
Personal exemptions	$16,600	$0	$8,300	$0
Itemized deductions				
Medical expense deduction	$36,500	$0	$74,295	$0
Mortgage interest deduction	$6,000	$6,000	$0	$0
State and local tax deduction	$4,000	$1,500	$1,500	$500
Total itemized deductions	$46,500	$7,500	$75,795	$500
Standard deduction	$13,000	$24,400	$15,600	$24,400
Larger of itemized and standard deductions	$46,500	$24,400	$75,795	$24,400
Taxable income	$31,900	$70,600	$0	$32,650
Child Tax Credit	$2,000	$3,200	$0	$0
Family Tax Credit, expires after 2022*		$600		$600
Tax liability	$1,833	$4,672	$0	$3,318
Tax increase under the GOP plan	**$2,839**		**$3,318**	

***Note: Without the Family Tax Credit, which expires after 2022, the tax increase in Example 1 would total $3,439. The tax increase in Example 2 would total $3,918.**

Source: Authors' calculations are for the 2018 tax year.

The parents who are grappling with the financial burden of dealing with a catastrophic illness of a child are able to deduct $36,500 of the $46,000 cost of surgery, while also having the benefit of the personal exemptions for themselves and their children. After taking additional deductions for their mortgage interest and state and local taxes paid, their tax liability for the year is reduced to $1,833 under current law. Under the House GOP tax plan, however, they would lose the medical expense deduction and the state and local income tax deduction, as well as personal exemptions worth $16,600. Without these deductions, they would no longer itemize and would not deduct their mortgage interest—instead opting for the larger standard deduction. But the increased standard deduction, a temporary $300-per-person Family Tax Credit, and a $600 expansion of the Child Tax Credit would not even come close to making up the difference. Under the majority's plan, they would experience a tax increase of $2,839. Without the Family Tax Credit, which expires after 2022, this family would see a tax increase of $3,439.

Meanwhile, under current law, the older couple facing long-term care costs would see their income zeroed out—thanks to being able to deduct $74,295 of the $80,000 spent on nursing home costs—and while not optimal, at least they would owe no tax under current law. Meanwhile, the congressional GOP plan would add to their financial woes by hitting them with a $3,318 tax increase. Without the temporary Family Tax Credit, the couple would see a $3,918 tax hike.

Clearly some middle-class families could easily find themselves in financial jeopardy as a result of catastrophic medical expenses that are not covered by insurance. While these circumstances are less frequent given the many gaps filled by the ACA, the medical expense deduction is still an important part of the health safety net. Policymakers should not eliminate this deduction in order to offset major tax cuts for corporations and the wealthy.

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Endnotes

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2 Cornell Law School Legal Information Institute, "26 U.S. Code **§** 213 – Medical, dental, etc., expenses," available at https://www.law.cornell.edu/uscode/text/26/213 (last accessed October 2017).

3 Edward D. Kleinbard, *We Are Better Than This: How Government Should Spend Our Money* (New York: Oxford University Press, 2015), p. 338.

4 See Medicare.gov, "Your Medicare Coverage," available at https://www.medicare.gov/coverage/long-term-care.html (last accessed October 2017).

5 Sean Lowry, "Itemized Tax Deductions for Individuals: Data Analysis," Table 2 (Washington: Congressional Research Service, 2017), available at https://fas.org/sgp/crs/misc/R43012.pdf.

6 Ibid.

7 Authors' analysis of Internal Revenue Service, "Table 2.1 Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2009," available for download at https://www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income (last accessed October 2017).

8 Authors' analysis of Internal Revenue Service, "Table 2.1 Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions, and Tax Items, by Size of Adjusted Gross Income, Tax Year 2015," available for download at https://www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income (last accessed October 2017).

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11 Ibid.

12 LongTermCare.gov, "Costs of Care," available at https://longtermcare.acl.gov/costs-how-to-pay/costs-of-care.html (last accessed October 2017).

13 Central Brain Tumor Registry of the United States, "2016 CBTRUS Fact Sheet," available at http://www.cbtrus.org/factsheet/factsheet.html (last accessed October 2017).