



Funding Health Care with Pre-Tax Dollars is Too Good a Deal to Ignore

By Ivan J. Miller

Universal health care systems gain a huge financial boost by using the provisions in Federal law that allow employers and employees to pay health care premiums with pre-tax dollars. For every \$100 employers spend on insurance using pre-tax dollars, employees would need their employers to an increase payroll expenses between \$119 and \$165 dollars for the employee to have enough left, after taxes, to purchase the same \$100 of health care insurance. How can this advantage be so large?

The pre-tax advantage for funding health care is far larger than a simple reduction in income tax, the tax that is most commonly discussed. When employers budget money to pay employees, employers must budget enough to pay the employer's share of Social Security and Medicare taxes and unemployment taxes. Paychecks are further reduced by the employee's share of Social Security and Medicare taxes. The resulting effective rate of taxation on payroll expenses (employer and employee combined), for an employee who does not earn enough to start paying income tax, is 16.3%.

Effective rate of taxation on \$100 payroll expenses (employer and employee combined)

Line Item	\$ taken out for tax	Remaining for employee
Employer's payroll expense funds, \$100	n/a	Only accountant and employer, not the employee are aware of the total payroll expense funds
Based on the taxable paycheck, the employer sets aside 6.2% for employer's share of Social Security, .0145 for employer's share of Medicare, and an estimated (varies greatly by state, occupation, and history) 2.5% for unemployment tax. The result of \$100 of payroll expense funding is a taxable paycheck that lists pay at \$90.78.	\$9.22	Employee only sees the taxable paycheck amount \$90.78
Employee must pay (as of 1/1/13) 6.2% for employee share of Social Security and .0145% for employee share of Medicare based on this taxable paycheck.	\$6.94	Employee sees on paycheck, \$6.94 of payroll taxes but is unaware of the additional \$9.22% that employer has set aside for taxes in the payroll expense line item.
Combination of employer's payroll expense taxes and employee's share of payroll taxes results in the employee receiving \$16.30 less than the employer sets aside for every \$100 of payroll expense funds. This is a taxation on payroll expenses of 16.3%.	\$16.16	After taxation on payroll expenses the employee sees a check that is \$83.84. The taxation on payroll expenses has removed 16.16%.

If health care premiums are paid with pre-tax dollars, none of these taxes are levied on the premiums. While the self-employed and individuals are not allowed to pay for health care with pre-tax dollars, employers are. For employees to obtain the pre-tax advantage, employers need to enroll in the Section 125, Pre-Tax program. The

table below shows how this huge advantage for employees grows when income tax in addition to payroll expense taxes are considered.

Pre-tax payroll expense funds needed to obtain \$100 increase in post-tax income

Income range	Wage earners and salaried people's effective tax rate on payroll expenses: Medicare+ SS + unemployment + income tax	Increase in employee after-tax income when employer increases payroll by \$100	Pre-tax dollars needed to equal post-tax \$100 dollars
From \$0 to the IRS adjustable gross income that begins the 10% income tax range.	16.16%	\$83.84	\$119
0 – \$8700 (10% IRS income tax range)	25.24%	\$74.76	\$134
\$3,5351 –\$85,350 (IRS 15% income tax range)	29.78%	\$70.22	\$142
\$85,351–\$110,100 (IRS 25% income tax range, no unemployment tax at higher income levels	37.44%	\$62.56	\$160
\$110,101–\$178.650 (IRS 25% income tax range, earners over \$110,000 do not pay additional Social Security tax	27.29%	\$72.71	\$138
\$178.651–\$200,000 (33% IRS income tax range)	35.47%	\$64.53	\$155
\$200,000–\$388,350 (33% IRS income tax range plus .9% Medicare surtax at incomes above \$200,000)	36.36%	\$63.64	\$157
\$388,351+ (35% IRS income tax range plus .9% Medicare surtax)	39.23%	60.77	\$165
Wealthy persons who pay only Capital Gains tax, 15%, and exercises options for loopholes or credits	15% or less	No pre-tax option available	No pre-tax option available

This table shows something different than what people usually look at in taxes. This is not the overall tax rate that an individual pays because it does not consider any deductions, which substantially lower overall taxes. However, what it spotlights is the amount of taxation that is added on every time an employer increases payroll expenses. If an employee had to pay for health insurance by an increase in pay, it would require that the employer increase pay equivalent to the far right column to leave the employee with enough money to buy \$100 worth of health care insurance.

Pre-tax contributions for health are a great deal. For employers, collecting these funds through payroll is a minor administrative task. Employers already pay Social Security, Medicare, and unemployment payroll taxes and easily include insurance premiums based on payroll. Compared to the current system in which employers have responsibility for purchasing, managing and educating about health care, a simple pre-tax contribution is a major reduction in administrative/regulatory burden.