Tax Incentives for Health Insurance Premiums

Background

Tax incentives for premium payments are either tax credits or deductions from income for amounts paid for insurance premiums, either by employers or employees.

For federal purposes, generally a self-employed individual can deduct 60% of health insurance premiums paid (for year 2000 tax returns). This percentage will increase to 100% in 2003. There are some net income limitations to the deduction. The remaining 40% can be deducted as a medical expense on federal Schedule A, subject to the 7.5% medical floor. A self-employed person includes Schedule C filers plus partners in a partnership and more than 2% shareholders in an S-Corp. For a partner or shareholder to deduct the premiums, they must include premiums paid for them in taxable income. For example, for a 100% shareholder in an S-corporation, the S-corporation pays $1000 in premiums and deducts them on the corporate tax return. The shareholder includes the $1000 on their federal return as taxable income, then deducts $600 in arriving at adjusted gross income, and $400 on Schedule A. An employee may not deduct any premiums paid, other than on Schedule A.

For Wisconsin purposes, self-employed persons can deduct 100% of their health insurance premiums (subject to net income limitations). Therefore, in the above example, the taxpayer would take a Wisconsin subtraction modification for the $400 that is not deductible on the federal return, and would remove the $400 from medical expenses on Schedule A when calculating the itemized deduction credit. Wisconsin also allows employees to deduct 50% of health insurance premiums, PROVIDED the employer does not contribute any amount of the premium. The 50% deduction is taken as a subtraction modification on Form 1, and medical expenses on Schedule A are reduced accordingly. For example, a state employee who subscribes to the standard plan for health care, or subscribes to an HMO where the state doesn't pay 100% of the premiums, cannot take a 50% deduction for premiums paid because the state contributes some amount to the premiums.

Co-pays and deductibles can only be claimed as a medical expense on Schedule A, subject to the 7.5% floor.

Other states have tried to implement tax credits or incentives regarding health insurance premiums. Kansas enacted a tax credit plan for 2000. The plan gives small employers a $35/employee/month credit that declines after the first year and is gone after the fifth year. Missouri has proposed something similar this year, except that they give a 50% credit that declines to 25% in the fourth year. Their credit does not terminate however. Also, only new health plans will get 50% initially. Existing plans