

## REPORT OF THE COUNCIL ON MEDICAL SERVICE

CMS Report 5 - A-02  
(June 2002)

Subject: Impact of Eliminating the Current Threshold for  
Deductibility of Medical Expenses  
(Resolution 122, A-01)

Presented by: F. Maxton "Mac" Mauney, MD, Chair

Referred to: Reference Committee A  
(Dorothy M. Kahkonen, MD, Chair)

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1 At the 2001 Annual Meeting, the House of Delegates referred Resolution 122 to the Board of  
2 Trustees. Introduced by the Pennsylvania delegation, the resolution calls for the AMA to “seek  
3 appropriate legislative or regulatory action to substantially reduce or to completely eliminate the  
4 7.5% [of adjusted gross income] floor which now exists in the Internal Revenue Service (IRS) tax  
5 code before medical expenses can be taken as an adjustment to taxable income.” Similarly, at the  
6 2001 Interim Meeting, the House adopted Substitute Resolution 108, which calls for the AMA to  
7 study the impact of eliminating the threshold for deductibility of medical expenses on federal  
8 income taxes, and recommend appropriate legislative action. The Board of Trustees referred both  
9 of these resolutions to the Council on Medical Service for a report back at the 2002 Annual  
10 Meeting.

11  
12 This report presents available data on the impact of the tax deduction for medical expenses in  
13 excess of 7.5% of adjusted gross income (AGI), discusses the potential impact of reducing or  
14 eliminating the threshold, and describes arguments for and against doing so.

### 15 16 BACKGROUND

17  
18 Current law allows taxpayers to deduct unreimbursed medical and dental expenses that exceed  
19 7.5% of AGI. For example, a household with an AGI of \$60,000 would be allowed to deduct  
20 expenses that were greater than \$4,500. Thus, if the household paid \$5,000 for qualifying health  
21 care goods and services in 2001, and assuming that the household itemized deductions, taxable  
22 income would be reduced by \$500. The actual amount of tax reduction, however, depends on both  
23 the amount deducted and the household’s tax rate. If the household were in the 27.5% tax bracket,  
24 the medical deduction would confer a reduction in federal income taxes owed of \$137.50 (27.5% of  
25 \$500). However, households can only take advantage of the medical expense tax deduction if they  
26 itemize deductions rather than claiming the standard deduction. In 1999 (the year for which the  
27 most recent data is available), 5.9 million or fewer than 5% of tax-filing households deducted  
28 medical expenses. The average medical deduction was \$6,000. Medical deductions totaled \$35  
29 billion, accounting for 5% of all itemized deductions. According to the Joint Committee on  
30 Taxation, medical deductions translated into tax breaks for households – and loss of federal tax  
31 revenue – of \$4.2 billion in 1999.

32  
33 Expenses that count toward the threshold and deduction are laid out in IRS Publication 502,  
34 “Medical and Dental Expenses.” In addition to out-of-pocket payments for standard medical care,

1 qualifying expenses include any portion of health insurance premiums not paid for with pretax  
2 dollars; payments for transportation to receive medical care; payments for long-term care of  
3 chronically ill individuals, even if not provided by doctors, hospitals or skilled nursing facilities;  
4 limited amounts paid for qualified long-term insurance contracts (varying with age); and, in some  
5 cases, expenses to adapt homes or cars to meet the medical needs of household members. Non-  
6 qualifying expenses include cosmetic surgery, non-prescription drugs, payments made from a  
7 medical savings account (since MSA funds are already tax-exempt), any portion of employment-  
8 based health insurance premiums already subject to exclusion from federal income tax, and pre-tax  
9 contributions to flexible spending accounts. Expenses may be deducted for the year in which they  
10 were paid, regardless of when care was rendered.

11  
12 In addition to the medical expense deduction, other tax relief is available to offset medical  
13 expenses. The blind and people over age 65 may claim a larger standard deduction than others.  
14 Individuals who are disabled may deduct impairment-related work expenses as a business  
15 deduction, as long as the expenses are necessary to enable the person to work and are not required  
16 or used, except incidentally, for personal activities. The self-employed may deduct 70% of health  
17 and long-term care insurance premiums from taxable income. The deductible portion will rise  
18 from 70% to 100% in 2003, at which point the self-employed will enjoy tax parity with those  
19 covered by employment-based health insurance. Finally, MSA contributions are tax deductible,  
20 and MSA funds are not taxed at the time of withdrawal so long as withdrawals are made for  
21 medical purposes.

22  
23 SUMMARY OF ARGUMENTS FOR AND AGAINST A MORE FAVORABLE DEDUCTION  
24

25 The arguments in support of eliminating the 7.5% threshold are that doing so would:

- 26
- 27 • Provide additional subsidy for those with expensive medical conditions and for the uninsured;
  - 28
  - 29 • Result in a financial savings for patients, including Medicare beneficiaries facing high drug  
30 expenses;
  - 31
  - 32 • Serve as an inducement to spend more on health care, including preventive care;
  - 33
  - 34 • Serve as a partial remedy for the unequal tax treatment of employment-based versus health  
35 insurance versus coverage obtained outside the context of employment; and
  - 36
  - 37 • Make tax planning easier, removing the incentive to bunch medical expenses within a  
38 particular calendar year in order to qualify for the deduction.
  - 39

40 On the other hand, arguments against eliminating the 7.5% threshold are that it would:

- 41
- 42 • Decrease federal revenues in the range of \$4 to \$30 billion;
  - 43
  - 44 • Fail to effectively target subsidies to intended groups: those with extraordinary medical  
45 expenses, the low-income, and the uninsured – groups for which other, more targeted forms of  
46 assistance are, or could be made, available;
  - 47

- 1 • Work counter to the equity objective embodied in the AMA proposal for refundable tax credits  
2 that are inversely related to income;  
3
- 4 • Offer no additional assistance to those with extraordinarily high medical expenses relative to  
5 income (i.e., over 107.5% of AGI), since their medical deductions already cancel out their tax  
6 liability; and  
7
- 8 • May make insurance coverage less attractive, thereby likely increasing the number of  
9 uninsured by some amount.

#### 10 EFFECTS OF THE MEDICAL DEDUCTION AND THE THRESHOLD

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12  
13 As explained in detail below, reducing or eliminating the 7.5% threshold would have a number of  
14 effects including providing more benefit for those with higher medical expenses, increasing health  
15 care utilization, increasing out-of-pocket health care expenditures, and reducing federal revenues.  
16 A more favorable deduction would also provide more benefit for higher-income households for two  
17 reasons. First, higher income households would achieve a larger tax reduction per dollar of  
18 medical expense due to their higher tax rates. Second, higher income households would no longer  
19 face higher spending hurdles before their medical expenses could be deducted.

#### 20 21 Effects at the Household Level

22  
23 The tax break that a household derives from the medical deduction depends on out-of-pocket  
24 medical expenses, income, the household's tax bracket (i.e., tax rate), and whether the household  
25 itemizes deductions on its federal income tax returns. The higher a household's out-of-pocket  
26 medical expenses, the greater the potential tax break from the medical deduction – but a household  
27 can only benefit from the medical deduction if its qualifying medical expenses exceed its standard  
28 deduction (Table 1 in the Technical Appendix). The positive relationship between medical  
29 expenses and the tax break holds only up to a point. Households with extremely high medical  
30 expenses relative to income (i.e., over 107.5% of AGI) would not receive any additional tax benefit  
31 by incurring even higher medical expenses because their tax liability has already been completely  
32 cancelled out by the deduction.

33  
34 The size of the tax break a household receives from the medical deduction is affected by income in  
35 two opposite ways (Table 2). On the one hand, the higher the income, the higher the absolute  
36 dollar threshold that must be met before medical expenses exceed 7.5% of AGI and, thus, qualify  
37 for deduction. On the other hand, the higher the income, the higher the tax rate and, thus, the larger  
38 the tax break for every dollar of medical expense that qualifies for deduction. On net, the average  
39 tax break is generally higher for higher-income groups. Data from the IRS annual *Statistics of*  
40 *Income Bulletin* show that, in 1999, the tax break among households claiming medical deductions  
41 averaged roughly \$1,000 among the households with AGI under \$100,000 versus nearly \$30,000  
42 among households with AGI over \$500,000 (Figure 1).

43  
44 Whenever the medical deduction is in force, the tax break lowers the costliness of medical care to  
45 the household by effectively lowering prices the household pays for medical care. Once a  
46 household exceeds its threshold, effective prices for medical care are lowered by the household's  
47 tax rate. Therefore, among those who take medical deductions, effective prices are lowered more

1 for those in higher tax brackets. By lowering effective prices for medical care, the medical  
2 deduction increases health care utilization compared to what it would have otherwise been.

3  
4 The general effect of allowing a more favorable medical deduction would be to magnify the effects  
5 of the existing deduction. Reducing or eliminating the 7.5% threshold would confer greater  
6 additional tax benefit to households with higher medical expenses (Table 1) and higher incomes  
7 (Table 2 and Figures 1 and 2). The number of households qualifying for medical deductions and  
8 total tax break dollars would increase, and the distribution of shares of the subsidy would shift  
9 further toward higher income groups (Figure 3). By lowering households' effective prices for  
10 medical care further and for more households, a more favorable deduction would result in  
11 increased utilization of health care services. However, in some cases, lower effective prices for  
12 medical care could induce individuals to forgo health insurance. Some individuals could decide to  
13 pay out-of-pocket for any medical care they might receive rather than pay insurance premiums,  
14 particularly if they are relatively healthy and are willing to assume some degree of risk.

#### 15 16 Aggregate Impact of Allowing a More Favorable Deduction

17  
18 A limited amount of information is available suggesting what the aggregate impact of reducing or  
19 eliminating the 7.5% AGI threshold might be. The threshold for deductibility of medical expenses,  
20 first introduced in 1942, has been increased several times, most recently in 1983 from 3% of AGI  
21 to 5% of AGI, and again in 1987 to 7.5% of AGI. (Between 1954 and 1983, a separate threshold of  
22 1% of AGI applied for drugs.) In both cases, the number of households claiming medical  
23 deductions dropped by about half. Eliminating the 7.5% threshold would represent a much larger  
24 change in the threshold than prior changes, suggesting that the number of households claiming  
25 medical deductions could easily be expected to at least double. As mentioned earlier, fewer than  
26 5% or 5.3 million households claimed medical deductions in 1999. Accordingly, eliminating the  
27 threshold would likely result in far more than 10% or 10 million households claiming medical  
28 deductions.

29  
30 Estimating the impact of allowing a more favorable deduction in dollar terms is even more  
31 speculative, in part because out-of-pocket medical expenditures are expected to rise by some  
32 unknown amount in response to the more favorable deduction. In 1999, \$54 billion of medical  
33 expenses were itemized, of which \$19 billion fell below the 7.5% threshold and \$35 billion  
34 exceeded the threshold and therefore qualified to be deducted. Thus, eliminating the 7.5%  
35 threshold would result in an absolute minimum of an additional \$19 billion of deductions. This  
36 figure does not account for any increase in the number of households claiming medical deductions,  
37 nor does it account for any increase in the amount of medical spending.

38  
39 Another way to get a sense of how many additional dollars of medical expense might be deducted  
40 is to look at total out-of-pocket medical expenditures reported in National Health Expenditure  
41 (NHE) statistics. In 1999, the NHE showed total out-of-pocket medical expenses of \$187 billion.  
42 This implies that nearly 30% of all out-of-pocket expenditures were itemized and that 20% (\$35  
43 billion) was in excess of the 7.5% threshold and, thus, deducted. Assuming that all households  
44 with out-of-pocket medical expenses chose to itemize rather than claim the standard deduction, and  
45 assuming no increase in out-of-pocket medical spending, eliminating the 7.5% threshold would  
46 result in roughly an additional \$152 billion of deductions. Thus, a crude range for additional  
47 medical deductions resulting from the elimination of the threshold is \$20-150 billion.

48

1 Translating the additional amount deducted into additional tax breaks, corresponding loss in federal  
2 revenues, distributive effects, and changes in health care utilization introduces additional  
3 uncertainty. Ideally, one could determine the numbers of additional households claiming medical  
4 deductions and the amounts of additional dollars deducted for each tax bracket. Assuming an  
5 average “composite” tax bracket of 20%, the additional tax benefit (and corresponding loss of  
6 federal tax revenue) would be in the range of \$4 billion to \$30 billion, again not taking into account  
7 any increase in utilization due to the reduction in effective prices paid by households for medical  
8 care. In addition, reducing effective prices would have economy-wide effects of some magnitude  
9 by shifting spending away from non-medical goods, services, and investments. By reducing  
10 effective prices households pay for medical care further, a more favorable deduction would also  
11 dampen insurance coverage to a marginal degree.

12

### 13 AMA POLICY

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15 Current AMA policy is silent on the issue of reducing or eliminating the 7.5% threshold.  
16 Policy H-165.874(1), AMA Policy Database, seeks immediate tax equity for health insurance costs  
17 of self-employed and unemployed persons. Policy H-180.971 states that the AMA favors equal tax  
18 treatment for out-of-pocket expenses as for premiums. More recent policy supporting the AMA  
19 proposal for health insurance market reform (Policy H-165.865[1i]) states that tax credits should  
20 apply only for the purchase of health insurance, and not for out-of-pocket expenditures.

21

### 22 DISCUSSION

23

24 Reducing or eliminating the threshold of 7.5% of AGI for medical expense deductibility would  
25 have a number of effects including providing more tax benefit for those with higher medical  
26 expenses, increasing health care utilization, increasing out-of-pocket health care expenditures, and  
27 reducing federal revenues. Allowing a more favorable medical expense deduction would channel  
28 some additional assistance to those with expensive medical conditions. Nonetheless, its primary  
29 effect would be to channel greater subsidy to those with higher incomes. As previously discussed,  
30 eliminating the threshold would decrease federal revenues in the range of \$4 to \$30 billion. Given  
31 the current economic environment, including a return to federal deficit spending, the Council  
32 believes that pursuing a reduction or elimination of the 7.5% threshold has little political viability  
33 at this time. The Council believes that seeking health insurance coverage for the estimated 40  
34 million Americans without any coverage is a higher legislative priority than seeking a more  
35 favorable medical expense deduction. CMS Report 10, which is before the House at this meeting,  
36 outlines additional advocacy efforts to promote the AMA proposal to expand health insurance  
37 coverage and choice.

38

### 39 RECOMMENDATION

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41 The Council on Medical Service recommends that the following be adopted in lieu of Resolution  
42 122 (A-01), and that the remainder of the report be filed:

43

- 44 1. That the AMA reaffirm Policy H-165.874(1), which calls for immediate tax equity for  
45 health insurance costs of self-employed and unemployed persons. (Reaffirm HOD Policy)

## TECHNICAL APPENDIX

### EFFECTS OF THE MEDICAL DEDUCTION AT THE HOUSEHOLD LEVEL

#### How Medical Deductibility Varies With Medical Expenses, Income, and Itemization

Tables 1 and 2 illustrate how medical deductibility and corresponding tax breaks (i.e., reductions in taxes owed) vary by household medical expense and income. The left half of each table depicts the medical deduction with the 7.5% threshold, whereas the right half depicts the deduction without the threshold. The last column shows the impact on households of removing the threshold. Table 1 shows households with AGI of \$60,000 and medical expenses ranging from \$1,000 upward. Under current tax law, households must itemize deductions in order to take advantage of the medical expense tax deduction. Although a household may have deductible medical expenses in excess of the 7.5% threshold, it only pays to itemize if combined medical and non-medical deductions are greater than the standard deduction (\$7,200 for married households filing jointly in 2001). For purposes of illustration, Table 1 assumes that households have only medical deductions.

Table 1 also illustrates the fact that the higher the out-of-pocket medical expense, the larger the potential tax break from the medical deduction—up to a point. Households with extremely high medical expenses relative to income (i.e., over 107.5% of AGI) would not derive greater tax breaks by incurring higher medical expenses because their deductions already cancel out all tax liability. For example, for the households in Table 1 with medical expenses of \$64,500 or greater, there is no additional tax benefit associated with higher medical expenses, regardless of the threshold. Because the uninsured face greater out-of-pocket medical expenses than those with insurance coverage, an uninsured individual stands to benefit more from the medical deduction than an otherwise identical individual with insurance. Table 2 depicts households with medical expenses of \$10,000 at various income levels (AGI). With the 7.5% threshold, the higher the income, the higher the dollar threshold that must be met before medical expenses become deductible, and the smaller the remaining amount that may be deducted. On the other hand, for every dollar deducted, higher-income households stand to derive larger tax breaks because they are in higher tax brackets.

#### Effect of the Medical Deduction on Effective Prices and Utilization

Whenever the medical deduction is in force, the tax break effectively lowers prices the household pays for medical care, thereby increasing health care utilization compared to what it would have been otherwise. For example, in Table 2, once the household with AGI of \$30,000 exceeds the threshold (if any), the deduction lowers the household's effective out-of-pocket expenses by 15%, the household's tax rate. Among those who take medical deductions, effective prices are lowered more for those in higher tax brackets.

#### How Allowing a More Favorable Deduction Would Affect Medical Deductibility

Reducing or eliminating the 7.5% threshold would magnify all of the effects of the medical deduction, as illustrated in Tables 1 and 2. Households that continue to claim the standard deduction would be unaffected but, by making more medical expenses deductible, more households would find it advantageous to itemize instead. If the 7.5% threshold were eliminated, higher-income households would no longer have to overcome higher dollar hurdles to qualify for

the medical deduction. Reducing rather than eliminating the 7.5% threshold would flatten rather than eliminate the differential in dollar hurdles.

As shown in Table 1, the additional tax benefit of a more favorable deduction would be greater the greater the medical expenses (except for those with expenses above 107.5% of AGI). Similarly, Table 2 shows that the additional benefit from reducing or eliminating the threshold would be greater the higher the income. Further, the additional tax benefit would be greater for households that already itemized deductions. Effective prices for medical care would be lowered (and utilization would rise) only for households who initially took the standard deduction but are now induced to itemize medical expenses. Among households induced to itemize, the reduction in effective prices is greater the higher the tax bracket. Households that would have itemized medical deductions even with the 7.5% threshold would not experience a further reduction in the effective prices they pay for medical care. Rather, they would experience a tax gain by being able to deduct the portion of medical expenses that was previously below the threshold. The higher the medical expenses and the higher the tax bracket, the greater the gain (and associated revenue loss to the federal government).

By lowering households' effective prices for medical care further and for more households, a more favorable deduction would result in increased utilization of health care services. In a small number of cases, the effect of lowering effective prices for medical care could even induce individuals to forgo health insurance. Some individuals could decide to pay out-of-pocket for any medical care they might receive rather than pay insurance premiums, particularly if they are relatively healthy and are willing to assume some degree of risk. Take for example, an individual in the 36% tax bracket who itemizes deductions and who would save \$2,000 in premiums by forgoing health insurance. In the absence of the medical deductibility threshold, all of his medical expenses would be deductible and, thus, effectively lowered by 36%. By forgoing insurance, the individual could save \$2,000 in premiums, face medical expenses up to some amount over \$2,000, and still come out ahead financially. In fact, he could pay out-of-pocket as much as \$3,125 and break even, since \$3,125 reduced by 36% equals \$2,000. In practice, however, the impact of a more favorable deduction on the rate of uninsured is likely to be marginal, given the small number of currently insured individuals who would stand to benefit from premium savings, be aware of the potential savings, and choose to take their chances without insurance coverage.

#### PREVALENCE AND DISTRIBUTIVE EFFECTS OF THE MEDICAL DEDUCTION

Information on the number of tax returns, number itemizing deductions, number itemizing medical expense deductions, and associated dollar amounts is provided by the Internal Revenue Service annual *Statistics of Income Bulletin*. The data are broken down by income (AGI) but are not available by tax bracket, health status, or insurance status. Because the medical expense deduction data is reported in terms of AGI, not tax brackets, all estimates of the dollar amounts of tax breaks conferred by the deduction are rough estimates. Figures 1-3 illustrate the tax breaks associated with the medical deduction for 1999, the most recent data available.

#### Prevalence of the Medical Deduction

The medical expense deduction is not widely taken. Few households have unreimbursed medical expenses in excess of 7.5% of their AGI. Further, for most households, the standard deduction is greater than combined medical and non-medical itemized deductions. In 1999, about one third of

households itemized deductions, and fewer than 5% took a deduction for medical expenses. Although this is a relatively small percentage, it represents nearly 5.9 million tax returns claiming medical deductions. In dollar terms, medical deductions accounted for 5% of all itemized deductions, or \$35 billion. According to the Joint Committee on Taxation, this amount translated into tax breaks for households – and loss of federal tax revenue – of \$4.2 billion.

#### Likelihood of Taking the Medical Deduction by Income

Higher-income households are more likely to itemize deductions, making them more likely to take advantage of medical deductions when medical expenses alone do not justify itemization. In contrast, the likelihood of taking the medical deduction is “bell-shaped,” with fewer than 1% of households at either end of the income scale itemizing medical expenses and a peak of 7.1% of households at AGI of \$30,000-40,000. Very low-income households are unlikely to incur high enough out-of-pocket medical expenses to make itemization advantageous, and very high-income households must overcome high absolute spending thresholds to qualify for the medical deduction.

#### Average Tax Break Due to the Medical Deduction by Income

In dollar terms, among those taking a medical deduction in 1999, the average was \$6,000. The average did not vary much by income up to AGI of \$200,000, at which point it ballooned, reaching more than \$70,000 among all households with AGI over \$500,000. The fact that tax rates rise with income amplifies the balloon effect for the tax benefit conferred by the medical deduction. As shown in Figure 1, the 1999 tax break among households claiming medical deductions averaged roughly \$1,000 among households with AGI under \$100,000 versus nearly \$30,000 among households with AGI over \$500,000. This ballooning at higher incomes is due to the fact that higher-income households must, by definition, spend more in order to be included in the group taking medical deductions. Another factor is the well-established empirical observation that, as income rises, health care spending increases *and* takes up a greater proportion of income. A final factor is lower effective out-of-pocket per-unit costs faced by those in higher tax brackets.

Although medical deduction tax breaks increase markedly with income, high-income households make up a small portion of all households. Figure 2 adjusts for the skewed distribution of households by income, showing average medical deduction tax breaks by income among *all* households, whether claiming medical deductions or not. The differential tax benefit by income is much less dramatic when taken over the entire population.

#### How Allowing a More Favorable Deduction Would Affect Medical Deductibility

Figures 1-3 crudely simulate the effect of removing the 7.5% threshold on average medical deduction tax breaks and shares of the total tax break by income. The total subsidy afforded by the medical deduction would not only increase, but its distribution would shift further toward higher income groups. As can be seen by Figures 1 and 2, the additional benefit from eliminating the threshold is greater in absolute and percentage terms the higher the income. Figure 3 shows the shift in distribution of the total tax benefit toward upper income households. These simulations do not account for the fact that many more households, particularly at upper incomes, would now be able to deduct medical expenses. They also do not account for the fact that removing the threshold would lower effective per-unit medical expenses, or the associated increases in utilization and out-of-pocket medical expenditures.



**Table 1. Tax Break From the Medical Expense Deduction as a Function of Medical Expenses**

For households with Adjusted Gross Income (AGI) of \$60,000, married filing jointly in 1999 (medical deductibility threshold of \$4,500; tax bracket 28%; standard deduction of \$7,200; the potential tax break if takes standard deduction is \$2,016 [28% x \$7,200]); assumes no non-medical deductions.

Qualifying Medical Expenses	With 7.5% AGI Threshold				Without Threshold				Benefit from Removing Threshold
	Deductible Medical Expenses	Potential Tax Break from Medical Deduction if Itemizes	Which Deduction?	Actual Tax Break	Deductible Medical Expenses	Potential Tax Break From Medical Deduction if Itemizes	Which Deduction?	Actual Tax Break	
\$1,000	0	0	Standard	2,016	1,000	280	Standard	2,016	0 <sup>1</sup>
\$5,000	500	140	Standard	2,016	5,000	1,400	Standard	2,016	0 <sup>2</sup>
\$7,200	2,700	756	Standard	2,016	7,200	2,016	EQUAL	2,016	0 <sup>2</sup>
\$10,000	5,500	1,540	Standard	2,016	10,000	2,800	Medical	2,800	784 <sup>2</sup>
\$11,700	7,200	2,016	EQUAL	2,016	11,700	3,276	Medical	3,276	1,260
\$20,000	15,500	4,340	Medical	4,340	20,000	5,600	Medical	5,600	1,260
\$50,000	45,500	12,740	Medical	12,740	50,000	14,000	Medical	14,000	1,260
\$64,500	60,000	16,800	Medical	16,800	64,500	16,800	Medical	16,800	0

<sup>1</sup> Assuming instead that the household has enough combined medical and non-medical deductible expenses to itemize deductions with (and without) the threshold, the benefit from removing the threshold becomes \$280 (\$280 minus \$0).

<sup>2</sup> Again, assuming itemization both with and without the threshold, the benefit of removing the threshold becomes \$1,260 (\$1400 minus \$140; \$2,016 minus \$756; and \$2,800 minus \$1,540).

**Table 2. Tax Break From the Medical Expense Deduction as a Function of Income (AGI)**

For households with \$10,000 of qualifying medical expenses, married filing jointly in 1999 (standard deduction = \$7,200)

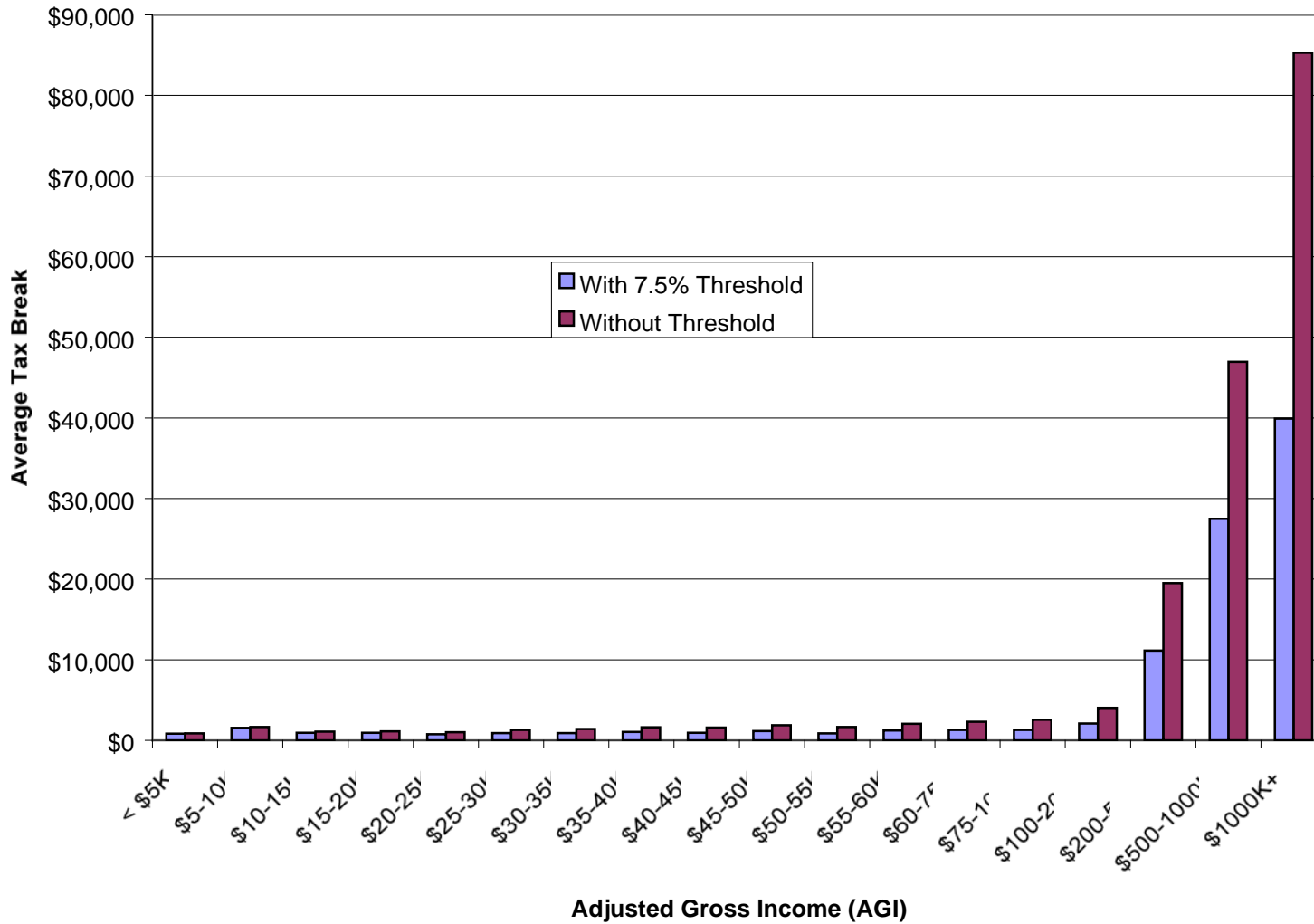
AGI	Tax Rate	Potential Tax Break from Standard Deduction	With 7.5% AGI Threshold			Without Threshold			Benefit from Removing Threshold <sup>2,3</sup>
			Threshold (\$)	Amount Deductible	Potential Tax Break from Medical Deduction if Itemizes <sup>1</sup>	Threshold (\$)	Amount Deductible	Potential Tax Break from Medical Deduction if Itemizes <sup>1</sup>	
\$10,000	15%	1,080	750	9,250	1,388	0	10,000	1,500	112
\$30,000	15%	1,080	2,250	7,750	1,163	0	10,000	1,500	337
\$60,000	28%	2,016	4,500	5,500	1,540	0	10,000	2,800	784 - 1,260
\$100,000	28%	2,016	7,500	2,500	700	0	10,000	2,800	784 - 2,100
\$150,000	31%	2,232	11,250	0	0	0	10,000	3,100	868 - 3,100
\$200,000	36%	2,592	15,000	0	0	0	10,000	3,600	1,008 - 3,600
\$500,000	39.6%	2,851	37,500	0	0	0	10,000	3,960	1,109 - 3,960

<sup>1</sup> Shaded amounts indicate that the medical deduction is greater than the standard deduction, and that the household automatically itemizes deductions even in absence of non-medical deductible expenses. Had qualifying medical expenses been \$7,200 or less, rather than \$10,000, removal of the threshold would not have resulted in automatic itemization.

<sup>2</sup> The lower amount assumes that with (and without) the 7.5% threshold, the household does not have enough combined medical and non-medical deductible expenses to itemize and, thus, takes the standard deduction of \$7,200. The higher amount assumes that the household has enough combined medical and non-medical deductible expenses to itemize, even with the 7.5% threshold. The percentage of households itemizing deductions rises with AGI, making it more likely that the higher amount is in effect the higher the AGI. In 1999, the percentage of households itemizing deductions for the AGIs shown was approximately 5% (\$10,000), 25% (\$30,000), 65% (\$60,000), at least 90% (\$100,000 and above).

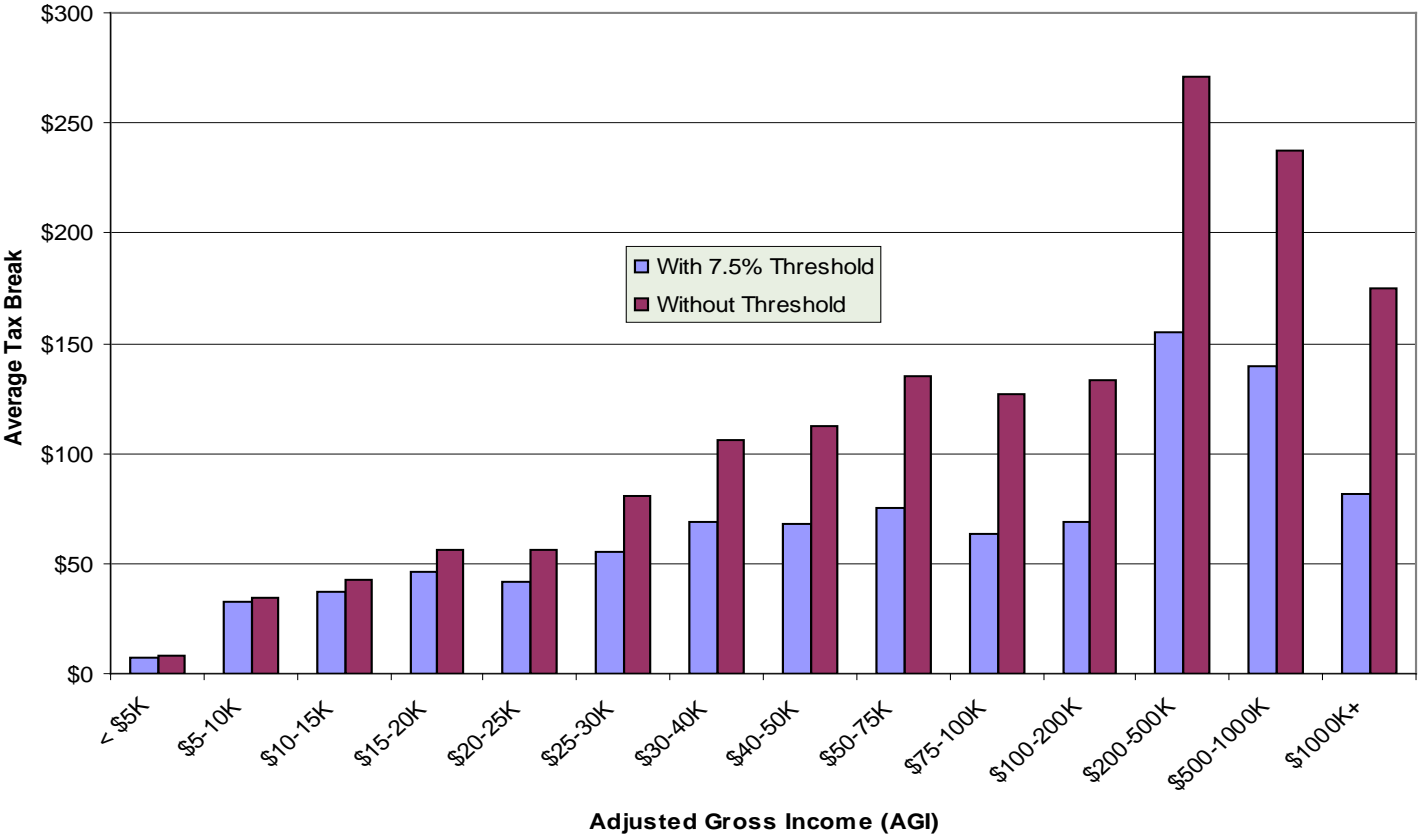
<sup>3</sup> This table understates the differential benefit from removing the threshold by income because of higher average medical expenditures at higher incomes, as well as lower likelihood of itemizing deductions or owing taxes at lower incomes.

**Figure 1. Average Medical Deduction Tax Break per Household Among Those Claiming Medical Deductions, 1999**



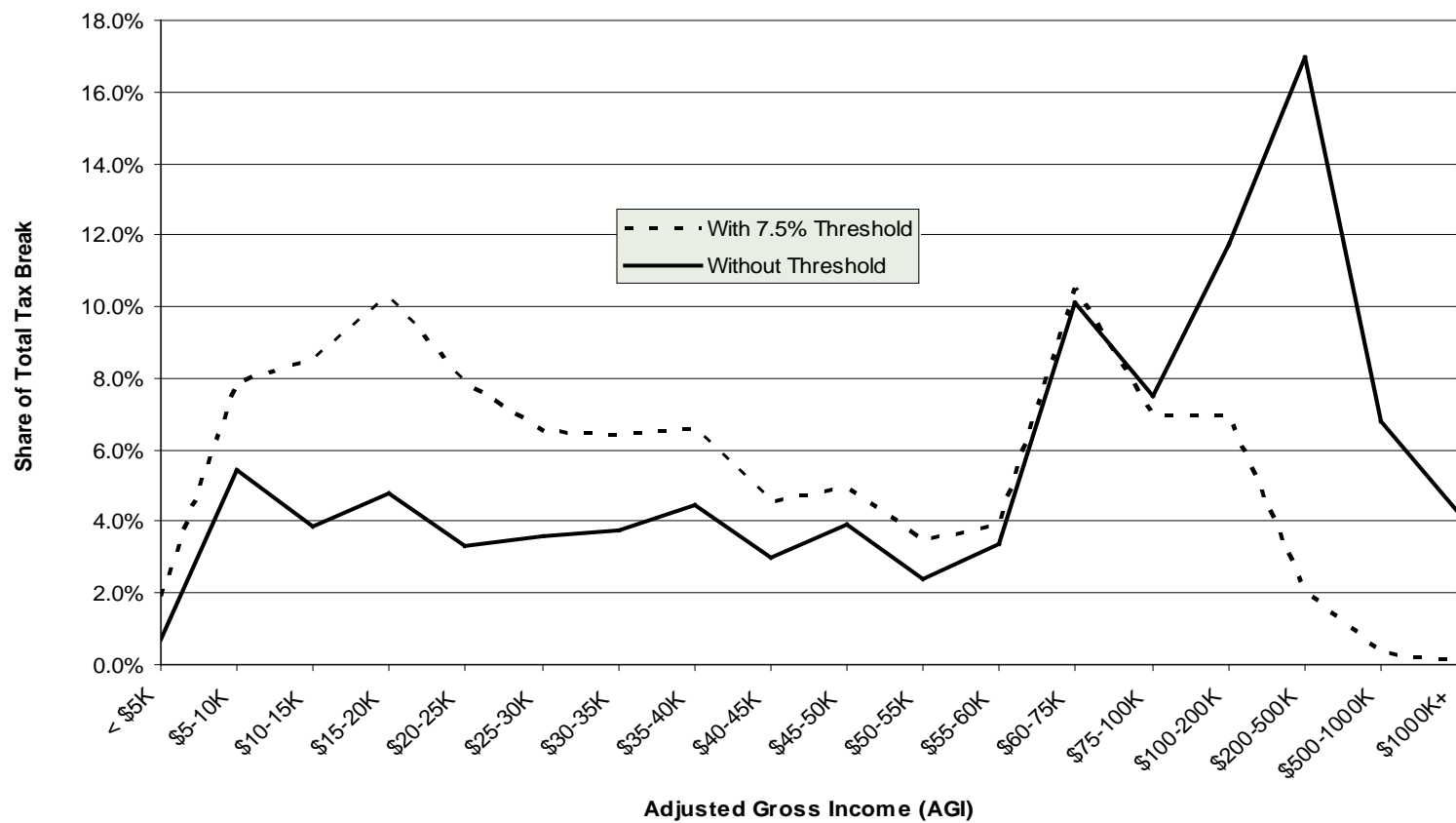
Note: Does not account for expected increase in number of households eligible for medical deduction or expected increase in utilization of services.

**Figure 2. Average Medical Deduction Tax Break per Household  
Among All Tax-Filing Households, 1999**



Note: Does not account for expected increase in number of households eligible for medical deduction or expected increase in utilization of services.

**Figure 3. Shift in Distribution of Total Tax Break From Medical Expense Deduction by Income (AGI) as a Result of Eliminating the 7.5% AGI Threshold for Deductibility, 1999**



Note: Does not account for expected increase in number of households eligible for medical deduction or expected increase in utilization of services.