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Neha Nanda
San Jose State University

Karla Rees
San Jose State University

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Tax Policy Analysis

S. 844 (117th Congress) - Personal Health Investment Today (PHIT) Act of 2021

By: Neha Nanda CPA and Karla Rees CFP® EA, MST Students

Introduction

On March 18, 2021, Senator John Thune (R-SD) introduced the Personal Health Investment Today Act of 2021 (S.844, 117th Congress). This bipartisan bill was co-sponsored by eleven Senate members, and there is a related bill, H.R. 3109, co-sponsored by 30 bipartisan members of the House of Representatives. The purpose of this proposal is to “encourage more physical activity in the United States and incentivize healthier living by allowing Americans to use a portion of the money saved in their pre-tax health savings account (HSA) and/or flexible spending fees.”¹

In general, S.844 modifies IRC Section 213 to allow a medical care tax deduction for “qualified sports and fitness expenses.” S.844 defines “qualified sports and fitness expenses” as an amount paid for “participating in physical activity” and includes the following: (i) “membership at a fitness facility”; (ii) “participation or instruction in physical exercise or physical activity” or (iii) “equipment used in program of physical exercise or physical activity.” The annual limitation on the fitness expense is \$2,000 for joint or head of household filers and \$1,000 for all other filers. This proposal defines a fitness facility as one “which provides instruction in a program of physical exercise, offers facilities for the preservation, maintenance, encouragement, or development of physical fitness, or serves as the site of such a program of a State or local government.”

Expenses that qualify under this proposal include exercise videos, books, and similar material if “such materials constitute instruction in a program of physical exercise or physical activity.” Expenses related to sports equipment other than exercise equipment will also qualify if they are used “exclusively for participation in fitness, exercise, sport or other physical activity” and the amount paid for any single item does not exceed \$250. In addition, apparel and footwear expenses will qualify if they are not used for any other purpose other than the “specific physical activity.” Expenses that do not qualify under this proposal include “a private club owned and operated by its members” and clubs that offer “golf, hunting, sailing, or riding facilities.” The amendments made by this proposal will apply to taxable years that begin after the date this proposal is enacted.

¹ Thune, Murphy Reintroduced Bill to Encourage Healthy Living, (March 18, 2021); available at <https://www.thune.senate.gov/public/index.cfm/press-releases?ID=18436FDD-2082-4D5D-8D0D-0149AA09DE8E>.

According to IRC Section 213, a medical care deduction is allowed for unreimbursed expenses that “exceed 7.5 percent of adjusted gross income”.

Some individuals have a medical benefit plan through their employer, known as a Health Savings Account (HSA) or Flexible Spending Account (FSA). In each of these benefit plans an employee can set aside pre-tax funds, up to a specified annual limit, that can be used to pay for certain qualifying out of pocket medical expenses, including copays, coinsurance, deductibles, and prescriptions for either medical, vision, or dental care, based on the definitions of IRC Section 213. If S.844 was enacted, the qualifying sports and fitness expenses would also be allowed for reimbursement through an individual’s HSA or FSA benefit plans. Taxpayers would be able to receive a deduction on their paycheck through their employer and request reimbursement of the qualifying expense that is processed through these accounts, thereby avoiding federal income, Medicare tax and Social Security tax.

Application of Principles of Good Tax Policy

This section analyzes S.844 using the twelve principles set out in the AICPA’s *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*.²

Criteria	Does the proposal satisfy the criteria?	Rating +/-
<p><i>Equity and Fairness</i> – Are similarly situated taxpayers taxed similarly? Also, consider any different effects based on an individual’s income level and where they live.</p>	<p>Horizontal equity will not be met because similarly situated taxpayers will not be taxed similarly. Tax deductions for U.S. taxpayers with similar income will differentiate based on whether they have medical expenses that exceed the 7.5 percent AGI floor for medical expenses or have access to an HSA or FSA.</p> <p>Some taxpayers will be able to use their Flexible Spending Accounts (FSA) and Health Savings Account (HSA) to pay for medical expenses on a pre-tax basis. However, not all employers provide this benefit. Larger businesses typically provide these, but a vast majority of taxpayers do not use these accounts.</p> <p>For instance, in 2017, Forms W-2 showed that less than 9.7 million taxpayers reported an amount in Box W, which identifies a taxpayer’s HSA deduction through the</p>	<p>-</p>

² American Institute of Certified Public Accountants (AICPA) Tax Division. (January 2017). Tax Policy Concept Statement No. 1—Guiding Principles of Good Tax Policy: A Framework for Evaluation of Tax Proposals; available at <https://www.aicpa.org/ADVOCACY/TAX/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf>.

	<p>employer.³ In addition, another 1.2 million taxpayers claimed an HSA deduction outside the employer plan, possibly through individual coverage or self-employed plans that are HSA eligible.⁴ The total of these two sources is over 10.9 million returns with HSAs but only represent 7.1 percent of the 153 million returns filed.⁵</p> <p>Similarly, taxpayers in different locations are likely not a factor under this proposal. For instance, swimmers that exercise in colder regions would have access to indoor facilities versus states like California, where some swim clubs workout year-round outside. In both scenarios, taxpayers using their FSA or HSA would qualify for reimbursement of these expenses.</p> <p>Vertical equity partially limits the impact of taxpayers with higher income that will pay more in taxes than taxpayers with lower income due to the qualified expense limitation and the overall 7.5 percent AGI floor. However, many higher-income taxpayers can enroll in an FSA plan or have an HSA and benefit if they do not already exceed the spending account limits. According to the Bureau of Labor Statistics, 44 percent of workers have access to flexible spending accounts, but 70 percent of the workers with access have the highest 10 percent of average wages.⁶</p> <p>Based on this analysis, the equity and fairness principle has not been met.</p>	
<p><i>Certainty</i> – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?</p>	<p>This proposal does not meet the principle of certainty because individuals will not be able to easily calculate their medical care tax deduction related to “qualified fitness expenses” on their annual filing of tax return due to several reasons including, difficulty calculating the tax base and clarity over definitions related to proposal.</p>	

³ IRS SOI Tax Stats – Individual Information Return Form W-2, Table 5.A.; available at <https://www.irs.gov/pub/irs-soi/17inallw2.xls>; accessed 7/16/2021.

⁴ IRS SOI Tax - Returns with Itemized Deductions: Sources of Income, Adjustments, Deductions, Credits, and Tax Items, Table 2.2; available at <https://www.irs.gov/pub/irs-soi/17in22ms.xls>; accessed 7/17/2021.

⁵ IRS SOI Tax - Individual Statistical Tables by Size of Adjusted Gross Income, Table 1.6; <https://www.irs.gov/pub/irs-soi/17in16ag.xls> ; accessed 7/17/2021.

⁶ Bureau of Labor Statistics; available at <https://www.bls.gov/ncs/ebs/factsheet/flexible-benefits-in-the-workplace.htm#ref2> ; accessed 7/17/2021; <https://www.bls.gov/ncs/ebs/benefits/2019/employee-benefits-in-the-united-states-dataset.xlsx> ; rows 124793 and 125047.

	<p>The proposal discusses limitations, such as a \$250 limitation for an item of sports equipment, and exceptions, such as clubs that offer golf, hunting, sailing, or riding facilities are not qualified “fitness facility” for this deduction.</p> <p>Furthermore, the proposal has a specific definition for what is defined as “qualified sports and fitness expense” and “fitness facility”; however, it does not define terms such as “specific physical activity” concerning apparel and footwear bought for the activity. There is also not enough detail provided for programs that have multiple components. Recordkeeping information is also not listed in the proposal explaining the documents needed from taxpayers to substantiate their “qualified expense” and how they can validate the expense was related to a qualifying item for a “specific physical activity.”</p> <p>Furthermore, taxpayers may not know until year-end if they have sufficient medical expenses to itemize.</p>	-
<p><i>Convenience of payment</i> – is the tax due at a time that is convenient for the payor?</p>	<p>Taxpayers take a deduction on Schedule A of all of their medical expenses and retain the expenses with their payment receipts for proper record keeping. The deduction will reduce taxable income if taxpayer’s total medical expenses exceed the AGI floor limit of 7.5 percent and they are itemizing deductions instead of taking the standard deduction. Therefore, no special tax payment is needed under this bill.</p> <p>Furthermore, for taxpayers that use FSA or HSA plans, their paychecks are automatically adjusted, and the proper withholding is calculated on their paychecks.</p>	N/A
<p><i>Effective Tax Administration</i> – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also, consider the time needed to implement this tax or change.</p>	<p>The cost to collect the tax at the minimum level for both the government and taxpayers will increase. This bill contains limitations and special definitions on the type of qualified expenses such as “fitness facility,” “qualified sports and fitness expenses,” etc. The IRS may need to pay more attention to the deductions taken by taxpayers and check related documents to ensure correct deduction is taken and substantiated. For instance, it is unclear from the bill how the IRS will ensure that the “apparel and footwear” are “necessary” and taxpayers are using them for only the “specific physical activity.”</p>	-

	<p>Moreover, there are terms in the bill that are left undefined such as programs that include “components,” “specific physical activity,” a facility that provides “encouragement of physical fitness”, hence, the taxpayer may need to consult a tax adviser to understand the terms and what recordkeeping is needed to substantiate these expenses.</p> <p>Therefore, this bill does not meet this principle.</p>	
<p><i>Information Security</i> – Will taxpayer information be protected from both unintended and improper disclosure?</p>	<p>No additional information changes will need to be made for this proposal because third-party administrators are already equipped with the proper security for those enrolled in an FSA or HSA.</p> <p>This change would require an itemizing taxpayer to keep additional documentation, but protection of these documents would be similar to other medical expense deductions.</p> <p>The principle of information security is met for this bill.</p>	<p style="text-align: center;">+</p>
<p><i>Simplicity</i> - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?</p>	<p>S. 844 does not meet the principle of simplicity as it contains limitations, specific definitions, as well as exceptions. These proposed new rules and definitions may lead to “unintentional errors” in calculating the tax deduction or HSA/FSA usage. The taxpayer also might not be aware that certain activities such as sailing, golf facilities are excluded from the tax deduction. Also, some expenditures may cover both included and excluded activities and need to be separated. Taxpayers may need a tax advisor to review their expenses to ensure correct deduction is taken on their tax returns.</p> <p>Furthermore, IRC Section 213 deduction is only available to individuals who itemize their deductions – which is more complex than individuals who take the standard deduction. Taxpayers not expensing items through an FSA/HSA will also need to ensure they meet the 7.5 percent AGI floor to take this deduction under IRC Section 213.</p>	<p style="text-align: center;">-</p>

<p><i>Neutrality</i> - The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</p>	<p>This bill does not meet the principle of neutrality primarily because this proposal is intended to encourage individuals to spend more money on physical fitness activities and related items.</p> <p>Even though taxpayers could decide to participate in an additional or different qualified activity instead of exempted activities such as golf and sailing, taxpayers with flexible spending plans could choose to participate in an activity where they would otherwise not choose to do so without this bill.</p> <p>S. 844 would encourage taxpayers to participate in qualified activities for a potential tax benefit. However, the tax savings for those without an HSA or FSA are minimal or non-existent (since they might not itemize or have enough medical expense to claim that deduction).</p>	<p>-</p>
<p><i>Economic growth and efficiency</i> – will the tax unduly impede or reduce the productive capacity of the economy?</p>	<p>This bill does not meet the economic growth and efficiency criteria because it impacts specific fitness facilities and companies that manufacture exercise equipment, fitness apparel, fitness videos more than any other type of organization. This bill could promote health and fitness activities, but not all health and fitness activities are included in this bill. This may adversely impact businesses or clubs that offer activities such as golf, or sailing. Furthermore, providing this deduction to taxpayers may decrease the government's revenue and compensate for the lost revenue by increasing taxes elsewhere.</p> <p>Other consequences of positive health benefits could reduce an individual's need for prescriptions to lower blood pressure or cholesterol levels. This could also deter individuals from eating unhealthy foods and reduce their spending at restaurants, although perhaps increasing their spending on natural foods.</p>	<p>-</p>
<p><i>Transparency and Visibility</i> – Will taxpayers know that the tax exists and how and when it is</p>	<p>Taxpayers may read articles or IRS publications on the addition of allowable medical expenses. However, it is likely that fitness gyms and fitness equipment companies would advertise the new law if passed to solicit additional revenue. This type of advertising could lack details of the tax law and cause misunderstanding.</p>	<p>-</p>

<p>imposed upon them and others?</p>	<p>The overall deduction is based on an individual’s AGI, their qualified fitness expense and can be easily calculated. However, the taxpayer will have to keep track of their AGI, other above-the-line deductions, qualified fitness expenses to ensure they have expenses of more than 7.5 percent to get the tax deduction on their tax return. In addition, there is likely to be confusion on the actual tax saving which are small given that a deduction is only allowed if all unreimbursed medical expenses for the year exceed 7.5 percent of AGI and the savings depends on the taxpayer’s tax rate. A single person in a 20 percent bracket will save just \$200.</p> <p>Additionally, the businesses that provide employees with HSA and FSA benefits should be informed of the included additional qualified medical expenses. Hence, this bill is neutral on the principle of transparency and visibility.</p>	<p>+/-</p>
<p><i>Minimum tax gap</i> – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule?</p>	<p>S. 844 does not meet the minimum tax gap principle. There is a higher likelihood of intentional and unintentional non-compliance. For instance, individuals may purchase clothing and footwear for purposes other than the “specific physical activity”. There are many terms in the bill that are left undefined; hence, increasing the chance of unintentional compliance with taxpayers.</p>	<p>-</p>
<p><i>Accountability to taxpayers</i> – Do taxpayers have access to information on tax laws and their development, modification, and purpose; is the information visible?</p>	<p>Taxpayers may read articles or IRS publications on the addition of allowable medical expenses. Information will also be available upon enrolling in FSA or HSA plans of allowable expenses.</p> <p>Taxpayers will be held accountable to third-party administrators of FSA and HSA plans, as the taxpayer will need to provide documents to substantiate the reimbursement.</p> <p>However, the proposed bill does not clarify how spending more on paid fitness activities, and related items will help their health goals. For example, a taxpayer may get the</p>	<p>+</p>

	<p>same health benefit by participating in free fitness activities – such as hikes and eating healthy. Also, joining a gym does not necessarily mean the person will use the equipment that improves health as many gyms also sell high-calorie food or offer massages and other items not always associated with improved physical health. Thus, taxpayers may be confused about the purpose of the bill.</p>	
<p><i>Appropriate government revenues</i>– will the government be able to determine how much tax revenue will likely be collected and when?</p>	<p>S. 844 does not meet the appropriate government revenues criteria. Depending on their economic situation, their AGI amount, and their medical and dental expenses, they might take this deduction or opt to take the standard deduction. Moreover, participating in qualified fitness programs is at the discretion of the taxpayer. Hence, the government will likely struggle to get a good estimate of the cost of this bill and how many taxpayers will take this deduction or increase contributions to their flexible spending plans or health savings accounts.</p>	<p>-</p>

Conclusion

S.844 modifies the IRC Section 213, Medical, Dental, etc., expenses by adding “qualified sports and fitness expenses.” Although this proposal has appears to have the best intentions of promoting healthier lifestyles and providing incentives for individuals, based on the above analysis, it is not a good idea as presented due to the following reasons.

Higher-income taxpayers are more likely to afford to enroll in qualified fitness expenses and purchase fitness gear and equipment; however, they may already have good health insurance so are unlikely to claim a medical expense deduction. By including qualified fitness expenses in IRC Section 213, taxpayers can use their flexible spending plans, health savings accounts or add to their itemized deductions these new medical expenses. Again, this won’t benefit most taxpayers as they don’t have these plans.

Some terms are left undefined for taxpayers increasing the complexity of the bill. For instance, S.884 defines a fitness facility as a facility that provides physical exercise, “offers facilities for preservation, maintenance, encouragement, or development of physical fitness or serves as a site of such program of a State or local government.” However, terms such as “encouragement” “preservation” are not defined. Similarity, in sections where limitations are discussed for apparel and footwear, terms “necessary” and “specific physical activity” are not defined. The term “components” is also not clarified in the section of the bill that discusses “programs which include components other than physical exercise and physical activity.”

Even though S. 844 aims to encourage physical activity and provide incentives to taxpayers, this bill fails to explain why certain clubs and activities are excluded from generating the tax break. The bill defines qualified fitness expenses to include fitness facility membership costs, participation or instruction in physical activity, or equipment costs used in a physical exercise/activity program. However, it excludes certain physical activities and clubs. For instance, the proposal specifically excludes private clubs owned and operated by its members or clubs that offer golf, hunting, sailing, or riding facilities. It also does not discuss how it may impact free activities individuals participate in, such as walks around the neighborhood, hiking, etc., which are equally good at promoting health. The proposal should equally value all physical activities.

Under this proposal, the cost for exercise videos, books, and similar material will also qualify. However, it is unclear if taxpayers will use them long-term to keep up their health and physical activity. It is also unclear how the IRS will ask taxpayers to substantiate if they use the apparel and footwear only for the “specific physical activity.”

S.844 should be modified to include more definitions of the terms, discuss why certain activities were excluded, describe how it will work with the IRC Section 213 medical and dental expenses and other code sections, and how the taxpayers should substantiate their expenses. In addition, there are better and less expensive alternatives to promote a healthy lifestyle, such as public service campaigns on the benefits of walking and healthy eating or creation of government funded parks and fitness facilities that can benefit those unable to afford gym memberships.