



## AMERICAN BENEFITS COUNCIL

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### RETIREE PRESCRIPTION DRUG SUBSIDY: BACKGROUND ON SUBSIDY AMOUNT AND TAXATION

#### **Summary**

The decision to provide a 28% tax free subsidy was a deliberate political decision made by Congress when enacting the Medicare Modernization Act of 2003 (“MMA”). This memo demonstrates that this 28% subsidy does not represent a tax “double dip” as some have suggested.

The proposal to tax this subsidy as a part of the America’s Affordable Health Choices Act (H.R. 3962) would cause the same serious negative consequences that Congress sought to avoid in 2003.

#### **Background**

During deliberation of MMA, Congress was concerned that significant numbers of employers might drop their prescription drug plans for retirees. A proposal was made to provide a \$600 per participant subsidy to employers who retained this coverage. In its original proposal, this subsidy would have been treated as taxable income in a manner similar to the current proposal in the current health reform legislation.

CMS and CBO actuaries and economists performed exhaustive analyses of this proposal and determined that a \$600 taxable subsidy would result in more than 1/3 of employers dropping their retiree prescription drug coverage. Those analyses also determined that by raising the taxable subsidy to \$800, the number of employers that were expected to drop retiree prescription drug plans would drop to about 12%.

During development of MMA, Congress was running up against spending limits. While they wanted to increase the subsidy to \$800 to preserve employer coverage, the outlays would push the total cost of the bill over the imposed spending limits. At that time, revenue impacts were not scored against the spending limits. Accordingly, a decision was made to provide employers with the after-tax equivalent of \$800 subsidy. Assuming a 25% corporate income tax rate, a taxable \$800 subsidy would provide the same after-tax subsidy as a \$600 tax-free subsidy.

At the time, it was determined that a 28% tax free subsidy would approximate the desired \$600 after-tax subsidy. Congress deliberately adopted the 28% tax-free subsidy for MMA.

The current proposal to make this subsidy taxable is privately estimated to cause more than 1/3 of current plan sponsors to move their retirees into the Medicare Part D plan. This estimate is consistent with the analyses of CMS and CBO in 2003. The current proposal would overturn the specific tax policy adopted by Congress after substantial analyses and deliberation in 2003.