TAX-FREE SUBSIDIES FOR EMPLOYER-SPONSORED RETIREE PRESCRIPTION DRUG PLANS (NEW MEDICARE PART D § 1860D-22)

The "Medicare Prescription Drug, Improvement and Modernization Act of 2003," Pub. L. 108-173 (December 8, 2003), ("Act"), which has been widely publicized for adding a prescription drug benefit to Medicare (Medicare Part D), also creates a tax-free subsidy for employers (or multiemployer plans) who provide certain retiree prescription drug benefits. Below, we briefly describe key features of the Medicare Part D prescription drug benefit, provide details concerning the tax-free subsidy, and identify plan design alternatives available to employers who wish to provide retiree prescription drug coverage.

A. Key Features: Medicare Part D Prescription Drug Benefit

- The Medicare Part D prescription drug benefit begins in 2006.
- Prescription drug benefits will be available to Medicare-eligible individuals for an average monthly premium of $35 and an annual deductible of $250 for 2006.
- There are special rules for low-income individuals.
- After the deductible is met, the Medicare drug benefit will cover 75% of drug costs up to $2,250 for 2006.
- Eligible individuals must cover all additional drug costs, unless their out-of-pocket expenses reach an "annual out-of-pocket threshold" of $3,600 for 2006. Medicare will pay any expenses above that threshold, subject to copays equal to the greater of: (i) $2 for a generic drug and $5 for any other drug or (ii) 5 percent of the cost.

B. Description of Tax-Free Subsidy

If a Medicare-eligible individual does not elect Medicare Part D prescription drug coverage described in A above, the Department of Health and Human Services (HHS) will pay –

1. a "tax-free subsidy"
2. to "sponsors"
3. of "qualified retiree prescription drug plans"
4. for each "qualified covered retiree"
5. if certain conditions are satisfied.

1. Amount of Tax-Free Subsidy

- For *each* qualified covered retiree, the amount of the subsidy is 28% of the "allowable retiree costs" that are between $250 and $5000 (for plan years ending in 2006, and then indexed).
- "Allowable retiree costs" means the prescription drug costs that are actually paid by the sponsor or by or on behalf of qualified covered retirees (net of discounts, chargebacks, and average percentage rebates).

- Maximum subsidy for 2006 would be $1,330 per retiree, e.g., 28% of a maximum of $4,750 ($5000 less $250) in allowable retiree costs. (Actual subsidy amount for an employer will depend on the amount of actual expenditures incurred by qualified covered retirees).
- New Code § 139A excludes the subsidy from gross income.
- The exclusion applies for purposes of both the regular tax and the alternative minimum tax (including the adjustment for adjusted current earnings).
- The subsidy does not affect the ability of the employer to take a deduction.

2. Plan Sponsor

- The subsidy is paid to the "plan sponsor."
- The Act uses the ERISA § 3(16)(B) definition of "plan sponsor," with an exception for plans jointly maintained by an employer and union. Under the exception, the employer is the plan sponsor only if it provides the primary source of financing for the plan.
- Generally, the sponsor is –
  - ~ the "employer" of a single-employer plan, or
  - ~ the "board of trustees" of a multiemployer plan.

3. Qualified Retiree Prescription Drug Plan

- An employment-based "group health plan" (as defined in section 607(1) of ERISA) that provides prescription drug benefits that are actuarially equivalent to or better than the Medicare drug benefit.
- Plans may be –
  - ~ welfare plans under ERISA,
  - ~ federal and state government plans,
  - ~ collectively bargained plans, or
  - ~ church plans.

4. Qualified Covered Retiree

- An individual covered under a qualified retiree prescription drug plan,
- who is entitled to benefits under Medicare Part A or enrolled under Part B, *and*
- who has *not* enrolled in: (i) a Medicare Part D "prescription drug plan" as defined by HHS in future guidance or (ii) a Medicare Advantage prescription drug plan.

5. Conditions

Plan sponsor must:

- Provide HHS at least annually (or more often if required) with an attestation that the actuarial value of prescription drug coverage under the plan is at least equal to the actuarial value of standard Medicare Part D prescription drug coverage based on guidance to be developed by HHS.
- Maintain records for purposes of audits and oversight.

- Provide disclosure information to HHS and qualified covered retirees in accordance with the HIPAA (Health Insurance Portability and Accountability Act) rules on disclosure of creditable coverage.

C. Plan Design Alternatives: Employer-Sponsored Retiree Prescription Drug Coverage

Design alternatives include the following:

- An employment-based plan can provide retiree prescription drug coverage that is actuarially equivalent to or better than the Medicare drug benefit so that the plan sponsor may qualify for the subsidy with respect to any individuals who waive coverage under Medicare Part D.
- An employment-based plan can pay all or a portion of the premiums to enroll retirees in Medicare prescription drug plans. Under this design, retirees would be participating in Medicare Part D. Accordingly, the plan sponsor would not be eligible for the subsidy.
- An employment-based plan can choose to continue prescription drug coverage by supplementing the new Medicare prescription drug benefits (*e.g.*, by providing benefits that coordinate against, or "wrap around," the Medicare benefits). If the retiree did enroll in Medicare Part D, the plan sponsor would not be eligible for the subsidy.