JOINT ECONOMIC COMMITTEE DEMOCRATS

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POLICY BRIEF OCTOBER 2003

MISDIRECTED TAX OPTIONS IN THE MEDICARE CONFERENCE

Members of the House and Senate are appropriately concerned about the significant number of retirees who would lose employer-sponsored drug coverage if Congress enacts either the House or Senate Medicare prescription drug bill.

About 30 percent of the Medicare population currently has employer-sponsored prescription drug coverage. Unfortunately, both the House and Senate bills will exacerbate the problem of employers dropping retiree health benefits. In fact, the Congressional Budget Office (CBO) estimates that 32 percent of Medicare beneficiaries with employer-sponsored drug coverage would lose coverage under the House bill, while 37 percent of such beneficiaries would lose coverage under the Senate bill.

CBO estimates that the drop in employer-sponsored prescription drug plans would increase federal revenues by about $25 billion over the 2004-2013 period by changing the composition of compensation packages for tax purposes. Clearly the best use of those cost-saving dollars would be to add them into the employer subsidies for those employers who maintain retiree prescription drug coverage. Instead, the conferees are considering an array of tax schemes, many of which have no incentives for retaining retiree health benefits, some of which are prohibitively expensive, and some of which further exacerbate employers dropping retiree coverage **(Table 1)**.

Table 1

Misdirected Tax Options in the Medicare Conference

Proposal	Purpose	Will it Protect Employer-Sponsored Prescription Drug Coverage for Current Retirees?	Cost
Enhance Flexible Spending Accounts (FSAs)	Allow employees to carry forward $500 in unused FSA benefits to the following year.	**No.** A benefit for working people, not retirees. Provides no incentive for employers to maintain retiree prescription drug coverage.	$9 billion*
Health Savings Accounts (HSAs)	Tax free savings accounts for medical expenses that would replace and expand Medical Savings Accounts.	**No.** Subsidizes individual saving for medical expenses. Does nothing to expand employer-sponsored retiree prescription drug coverage. Shifts health costs to employees and may encourage employers to drop coverage for workers and retirees. Tax benefits primarily go to high-earners, with little or no saving incentive for low- and moderate-income families.	$6 billion*
Employer Tax Credit	A tax credit to employers who provide retiree prescription drug coverage.	**No.** A tax credit based on average cost rather than employer-specific costs is not likely to be an effective incentive for employers to retain retiree plans.	official estimate not available
Employer pre-funding of retiree medical costs	Allow employers to pre-fund retiree prescription drug benefits with deductible contributions and tax-free investment earnings.	**No.** Does not help current retirees or provide an incentive to employers to maintain prescription drug coverage. Unlikely that many employers would take advantage of this option. Similar option already exists for employers with 401(h) or VEBA health benefit plans. Does not allow for employee contributions.	official estimate not available
Retiree Medical Benefit Accounts (RMBAs)	Create retirement accounts similar to IRAs or 401(k)s to accumulate savings for post-retiree medical expenses.	**No.** Does not help current retirees. Shifts costs from employers to employees. Could lead to less coverage for future retirees if employers choose to contribute to RMBAs rather than provide retirement coverage. Tax benefits will primarily go to high-income workers. Very few workers currently contribute the full amount to existing tax-favored savings plans. Would be very costly without income limits on eligibility.	official estimate not available

*Source: Joint Committee on Taxation

Among the tax options under consideration are:

Enhanced Flexible Spending Accounts (FSAs): Under the House bill, flexible spending account holders could rollover up to $500 of unused contributions into the next year.

- Enhanced FSAs would do nothing to encourage employers to continue retiree prescription drug coverage, or provide retirees with resources to cover additional expenses.
- FSAs aren't applicable to most retirees – they are a benefit for working people.
- Most of the tax saving would go to higher-earners because they are more likely to contribute to an FSA and because the tax benefits from FSA contributions are skewed to upper-income taxpayers. Allowing limited rollovers from one year to the next will encourage larger contributions to FSAs.

Health Savings Accounts (HSAs): The House bill creates HSAs—new tax-advantaged saving accounts for health care spending—that are essentially expanded Medical Savings Accounts.

- HSAs would provide tax incentives to certain individuals who save for medical expenses. They are unrelated to Medicare coverage or retiree benefits. Even worse, the incentives to shift health care costs to individuals may encourage employers to drop retiree coverage altogether.
- Tax-free withdrawals from HSAs can be used to pay unreimbursed medical expenses at any time. There is no requirement that account holders save sufficient resources to meet drug and medical expenses after retirement.
- HSAs provide little or no tax savings for low-income families. A married couple with two young children contributing to an HSA next year, for example, would not receive any tax benefit unless their income was at least $26,425. Families with incomes moderately above that level would see minimal tax savings. Most of the tax benefits from HSAs go to higher-income families.

Employer tax credit: A new refundable tax credit for employers who continue to provide supplemental prescription drug coverage for retirees.

- A credit large enough to have a positive influence on retiree coverage would be quite costly.
- To be effective, the tax credit must be based on an individual employer's actual costs of providing retiree drug benefits. A credit that is too small or based on the average costs of all employers (which might be far too

small for employers with higher retiree costs) would fail to keep employers from dropping coverage for a significant number of retirees.

Employer pre-funding of retiree medical costs: Employers could pre-fund retiree prescription drug benefits with deductible contributions to a drug benefit fund and earn tax-free investment income on assets in the fund.

- It is not clear than many employers would choose to continue to provide retiree drug benefits even if this option were available. Similar tax-advantages already exist for 401(h) plans that are part of private pension plans, or voluntary employee benefit association (VEBA) trusts for non-profit organizations, but these plans are not widely utilized.

Retiree Medical Benefit Accounts (RMBAs): Allow workers to make tax-free contributions to either individual accounts, similar to IRAs, or separate accounts within 401(k) plans for the purpose of accumulating savings that can be withdrawn tax-free for medical expenses after retirement.

- RMBAs would not help current retirees who lose employer-sponsored prescription drug coverage. Even worse, they could lead to less coverage for future retirees if employers choose to contribute to RMBAs rather than provide retirement coverage, much in the same way that employees have opted for 401(k) type retirement arrangements in lieu of traditional pensions. This would shift all the risk of future prescription drug cost increases onto retirees.

- RMBAs would be yet another tax shelter for saving. Few families would benefit from these accounts, as most of the tax benefits would go to upper-income families who could make tax-free withdrawals for future medical expenses.

- Unless there were income limits on eligibility for the accounts, the revenue loss would be substantial and far surpass the $25 billion apparently at play in the Medicare conference. The estimated revenue loss could exceed $100 billion over the next 10 years and substantially more in the following decades.

Conclusion

The House and Senate Medicare prescription drug bills are fundamentally flawed as drafted, because millions of retirees with employer-provided health benefits will lose those benefits as result of the legislation. The American public is expecting that a Medicare prescription drug bill will help them, not hurt them. None of the above outlined tax proposals limit the loss of coverage, and some of them make the problem worse.

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