

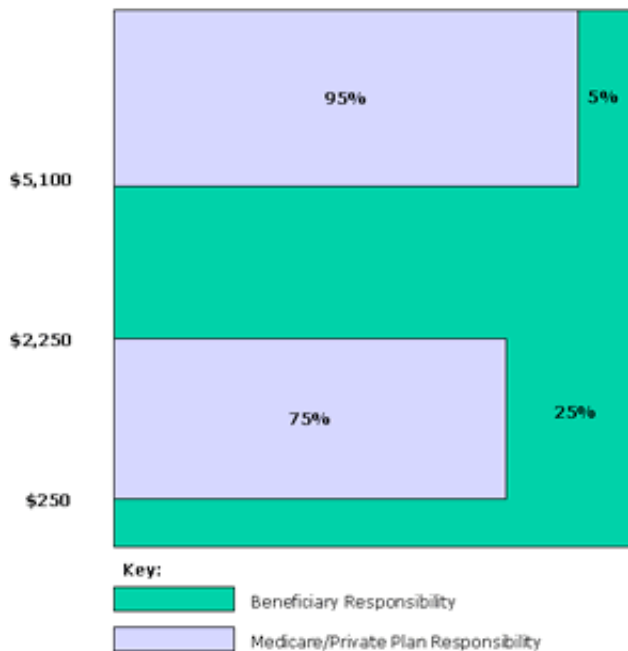


Medicare Prescription Drug Improvement and Modernization Act of 2003

On December 8, 2003, President Bush signed the Medicare Prescription Drug Improvement and Modernization Act of 2003 into law. The most significant aspect of the Act is the prescription drug component that will be added to Medicare coverage effective 2006. This and other highlights are detailed below.

Prescription drug benefit

As of January 1, 2006, Medicare beneficiaries will have the option of enrolling in a voluntary prescription drug program for \$35 per month. As a part of the prescription drug benefit, Medicare will allow private health plans to provide coverage for prescription drugs and will guarantee the presence of at least two private health plans from which Medicare beneficiaries can choose, except in geographic areas where private plans are not available. Once the member's prescription drug costs surpass the annual deductible of \$250, the Medicare drug plan will pay 75% of the next \$2,000 in drug costs while the member pays the remaining 25%. Once the member's total drugs costs exceed \$2,250 (\$250 deductible plus \$2,000 in "covered" drug costs), the member then pays 100% of the costs between \$2,500 and \$5,100. Medicare has a catastrophic policy that kicks in once the member's drug costs exceed \$5,100. The member shares in only 5% of the cost above \$5,100. The remaining 95% is borne by Medicare and the private plans. See chart below.



After 2006, the monthly premium of \$35, the deductible of \$250, the \$2,250 out-of-pocket maximum and the \$5,100 catastrophic threshold will increase at the same rate as the cost of prescription drugs. Milliman USA has estimated this rate to be about 15% per

year, which would make the annual deductible \$500 by 2011. Their calculations also project that the Medicare drug benefit will have an average cost between \$1,320 and \$1,500 per beneficiary in 2006. It is estimated that beneficiaries who have annual drug expenses of \$810 are at a "break-even" point. The 30% or so of beneficiaries who spend less than \$810 in annual drug costs would actually incur additional costs to participate in the Medicare Drug Plan. Those who spend more than \$810 per year (approximately 70%) would benefit financially from the new plan. The Kaiser Family Foundation has a calculator on their website which can help seniors determine their prescription drug costs under the Medicare Rx Plan. <http://www.kaisernetwork.org/static/kncalc.cfm>

Until the Medicare drug benefit is available, beneficiaries will be able to purchase a drug discount card that is estimated to save them between 15% and 25%.

Employer Subsidies

Effective January 1, 2006, the Act provides tax-free subsidies to be paid to employers who sponsor retiree health plans that cover individuals who are entitled to the new Medicare-based prescription drug benefit, but who elect not to enroll. The amount of a plan's subsidy will equal 28% of the prescription drug costs paid to or on behalf of these individuals under the plan (the subsidy will not apply unless costs for an individual are at least \$250; the maximum amount considered is \$5,000; these limits will be adjusted annually).

Health Savings Accounts

The Medicare Drug Act also provides the opportunity for taxpayers age 65 and under who are enrolled in a high deductible medical plan to contribute tax-free money to a Health Savings Account (HSA). A high deductible plan is defined as having at least a \$1,000 single or \$2,000 family deductible. These HSAs will be available effective January 1, 2004 and will allow employees to contribute 100% of their deductible amount or up to \$2,600 for single and \$5,150 for family coverage (whichever is less). The unspent amounts in the HSA would accumulate year-to-year and could be invested as the account holder sees fit. Additionally, these HSAs could be funded in part by the taxpayer's employer through a cafeteria plan and would be portable when the taxpayer leaves that employer.

1099 Reporting Requirements

When the IRS authorized the use of debit/credit cards for health FSAs and HRAs earlier this year, they indicated that payments made to medical service providers in excess of \$600 through the use of such cards were reportable by the employer on Form 1099-MISC. The Medicare Act of 2003 repealed this reporting requirement. Form 1099 reporting isn't an issue under traditional health FSAs or HRAs where the employer reimburses participants after the medical services are provided, rather than making payments to providers. This change is retroactive to payments made after December 31, 2002 and is likely to make FSA/HRA debit card arrangements more attractive to employers.

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