

Healthcare Reform: Elimination of Retiree Drug Subsidy Deduction

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Under the amended *Patient Protection and Affordable Care Act* (PPACA), employers that currently receive a federal subsidy for providing retiree prescription drug coverage (Retiree Drug Subsidy) will no longer be able to deduct those retiree drug expenses as of 2013.

The PPACA retains the Retiree Drug Subsidy but eliminates an employer's ability to deduct the amount of the subsidy. This change increases an employer's income tax liability—in effect, increasing the employer's cost of providing prescription drug coverage to retirees. How much depends on the total amount of the subsidy and the employer's applicable corporate tax rate, which currently ranges from 15% for income below \$50,000 to 35% for income over \$10 million.

Although employers will not face the higher tax liability until 2013, under financial accounting rules, employers must now include the present value of the future

taxes as a current liability charged against earnings.

Employer Response

In response to the increased cost of providing retiree prescription drug coverage, some employers are considering eliminating their retiree prescription drug benefits. In this case, retirees who were previously covered by the employer's prescription drug plan would be eligible to enrol for prescription drug coverage under Medicare Part D.

Although Medicare Part D has historically had a gap in coverage that made the program a much more expensive option for retirees compared to coverage under an employer's prescription drug plan, the PPACA established a system to eliminate this gap.

Before the PPACA, the program provided expansive benefits for the initial \$2,830 in prescription drug costs and for prescription drug costs above \$6,440, but required members to bear the full cost of prescription drugs between \$2,830 and \$6,440. Now the PPACA provides for enhanced Medicare Part D coverage, which progressively narrows this gap

between 2011 and 2020, making Medicare Part D a more financially viable alternative to employer-provided prescription drug coverage. This enhanced Medicare Part D coverage provides many employers with an additional reason to consider eliminating retiree drug benefits.

By terminating its retiree drug benefits, an employer would avoid the increased tax liability and current accounting hit to earnings. Before doing this, there are practical and legal concerns that an employer should consider.

Legal Concerns

Employers need to consider the probability of litigation when terminating a retiree drug plan. Under the *Employee Retirement Income and Security Act* (ERISA), lawsuits can be filed by disgruntled plan participants or groups of retirees. The likelihood of success for these lawsuits depends on what types of promises have been made and the wording of its plan documents. Lawsuits challenging retiree benefits changes are generally not successful where the company has been careful to

reserve the right to amend or terminate health benefits, and retirees have not been led to believe through written plan communications and documents that their retiree medical benefits are vested.

Lawsuits about termination of retiree prescription drug benefits can be more complicated where there are union contracts—particularly contracts that are unclear about the scope of retiree coverage—or where the company has represented that retiree medical benefits are guaranteed for the life of the retiree.

To evaluate litigation risks, employers considering eliminating retiree prescription drug coverage should carefully review the wording of their benefits plan materials, union contracts, employee/retiree communications and other applicable documents.

Next Steps for Employers

In addition to legal concerns, employers considering eliminating retiree coverage should consider the likelihood of negative reactions from retirees. Termination of retiree prescription drug coverage may also result in negative press for the company. In anticipation of these unfavour-

able responses, employers should be creating written materials—participant mailings, call-centre scripts, press kits—that clearly describe the mechanics of, and reasons for, the change. They should also be prepared to provide retirees with assistance in electing drug coverage under Medicare Part D in a timely matter.

Employers that provide retiree prescription drug coverage should analyze the increased future tax liability and the current accounting charges necessary to retain this coverage, and evaluate the practical and legal risks of eliminating this benefit.

Employers that decide to retain retiree prescription drug benefits should ensure that they incorporate the future tax liability of these benefits into their current and projected earnings. For those that decide to eliminate retiree drug benefits, they should anticipate negative responses and possible litigation associated with that decision. **B**

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