

BRIEF ANALYSIS

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Prescription Drugs for Seniors: The Roth IRA Solution

By John C. Goodman

Almost everyone agrees that the elderly need insurance coverage for prescription drugs. However, a growing number of health policy analysts believe that solving the problem of prescription drugs requires wholesale reform of Medicare. And fundamental Medicare reform may take a year or more to complete.

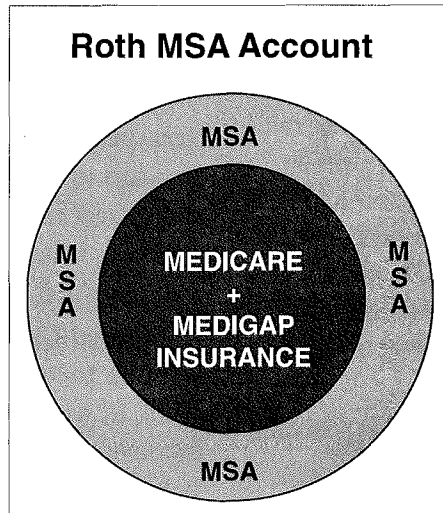
In the meantime, Congress can make it much easier for the elderly to self-insure for drug costs and other medical expenses not paid by Medicare or private insurance. How? By allowing senior citizens to turn their Roth IRAs into "Roth MSAs."

The Problem. Despite its political popularity, Medicare violates almost all principles of sound insurance. It pays too many small bills the elderly could easily afford on their own, while leaving them exposed to thousands of dollars of potential out-of-pocket expenses, including the cost of their drugs. Each year about 360,000 Medicare beneficiaries spend more than \$5,000 out of pocket.

To prevent financial devastation from medical expenses, about two-thirds of Medicare beneficiaries have supplemental insurance, either provided by a former employer or purchased individually. Although some "Medigap" policies cover prescriptions, most do not. Among those that do, coverage is often incomplete. Ironically, the poorest seniors often have the best drug coverage because they qualify for Medicaid, the federal-state health program for the poor.

The Need for a Long-Term Solution. The elderly could have better health care coverage — including a

prescription drug benefit — if they were allowed to combine their Medicare funds with the money they currently spend on private insurance and pay one premium for a comprehensive private plan. The combined sum should be enough to buy the same kinds of health insurance coverage the nonelderly now have, including prescription drug coverage, according to a study prepared for the National Center for Policy Analysis by Milliman & Robertson, Inc., the nation's leading actuarial firm on health benefits. This solution, although desperately needed, requires a fundamental restructuring of Medicare.



Using Roth IRAs as a Partial Solution. While there is no substitute for fundamental reform of Medicare, much can be done to relieve the financial burdens of the elderly by making small changes in the law governing one of the nation's most popular savings vehicles, Roth IRAs.

Roth IRAs differ from ordinary IRAs in that deposits are made with after-tax instead of before-tax dollars, usually by means of a tax deduction. Both accounts grow tax-free. But since taxes on Roth IRAs are paid before the initial deposit, withdrawals

are tax-free after age 59½. By contrast, since deposits to an ordinary IRA have not been taxed, withdrawals are subject to income taxes.

Roth IRAs also have other advantages in the current context. Seniors with ordinary IRAs must stop making deposits when they reach the age of 70½ and begin making minimum withdrawals. By contrast, seniors can contribute up to \$2,000 a year to Roth IRAs at any age, and they are not required to withdraw funds at any time.

Roth IRAs also can help to resolve one of the most enduring problems of health insurance. Under almost all private and public health insurance schemes, people can

BRIEF ANALYSIS

No. 315

Page 2

realize benefits only by spending on health care. Roth IRAs can offer an alternative. Any funds not spent on health care could be withdrawn without penalty and spent on other goods and services or left to grow with interest, then later spent on health care or other goods and services. Thus the playing field between current and future spending, and between health care and other spending, would be leveled. No other financial asset allows these unbiased choices.

Roth IRAs, therefore, represent an attractive way for seniors to build up a store of savings for medical contingencies. For that reason an ideal use for a Roth IRA is to turn it into a Roth MSA.

Turning Roth IRAs into Roth MSAs. Seniors already can withdraw funds from their Roth IRAs to pay medical bills. But to qualify for the special tax rules described below, they would have to deposit up to \$2,000 per year in a Roth MSA. Such deposits could consist of transfers from a Roth IRA. Seniors could also convert funds from an ordinary IRA to a Roth MSA by paying income taxes (but not Social Security benefit taxes) on the amount converted. Moreover, the senior would have to agree to:

- Make an initial lump-sum deposit or make regular deposits over a 12-month period.
- Make withdrawals only to pay medical expenses during the 12-month period.

Advantages of Roth MSAs. As the figure shows, the Roth MSA is designed as a wraparound account. It provides funds with which to pay medical bills not paid by third-party insurance. For seniors who have only Medicare coverage, the Roth MSA could be used to pay expenses not paid by Medicare. For those who have both Medicare and Medigap insurance, the Roth MSA could be used to pay expenses not paid by either. Roth MSAs could wrap around virtually any form of insurance, including a Medicare HMO.

Roth MSAs also could be integrated into employer Medigap plans, affording employers and retirees a new

option. Currently, firms with more than 50 employees are not allowed to have tax-free Medical Savings Accounts. But firms could be allowed to make tax deductible deposits to their retirees' Roth MSA accounts.

Needed Change: Lift the Five-Year Moratorium on Withdrawals. Current law imposes a five-year moratorium on Roth IRA withdrawals. While that restriction may make sense if the goal is to encourage retirement savings, it interferes with planning for health expenses, where decisions ordinarily are made each year. If the moratorium were lifted specifically for health care purchases, senior citizens would be able to integrate their Roth IRA with Medicare and Medigap coverage.

Needed Change: Allow Roth MSA Contributions Irrespective of Wage Income. Under current law, deposits to a Roth IRA cannot exceed wage income in any given year. Yet the need for savings for health expenses is not limited to those who remain in the labor market. After all, most seniors are retired.

Needed Change: Allow Roth MSA Contributions without Income Limits. Under current law, deposits to Roth IRAs are limited to individual taxpayers with incomes below \$110,000 and couples with incomes below \$160,000. Yet the burdens of health care expenses do not end when income exceeds these limits. Accordingly, an expanded Roth IRA for health care should be available to all seniors regardless of income. Even if the annual contribution limits for Roth IRAs are maintained under current law, deposits to Roth MSAs should be available to all.

Conclusion. Congress can allow Roth IRAs to be used as Roth MSAs on relatively short notice without extended hearings. This would significantly help senior citizens who face potential out-of-pocket expenses for prescription drugs.

John C. Goodman is president of the National Center for Policy Analysis.