



# AMERICAN BENEFITS COUNCIL

December 10, 2009

## TAX PROPOSAL RELATED TO RETIREE PRESCRIPTION DRUG SUBSIDY: ILLUSTRATIVE FINANCIAL IMPACTS ON PLAN SPONSORS

The proposal to tax the subsidy employers receive for sponsoring drug coverage for retirees will have unintended financial consequence on those plan sponsors that continue to provide Part D-equivalent benefits. From the Congressional “scoring” perspective, this proposal only considers the related revenue and outlays over the next ten years. However, financial accounting requirements mandate that, regardless of the effective date of the tax, plan sponsors must immediately record the present value of decades of higher taxes. The applicable present values must be reflected in both the plan sponsors’ balance sheets and the plan sponsors’ net income statements as a single sum on the date of enactment.

The following table illustrates the disparate impacts of this proposal on four otherwise identical companies. The only distinctions among these companies are (a) whether they voluntarily provide Part D-equivalent prescription drug coverage to their retirees, and (b) if they do provide such coverage, the relative sizes of their retiree populations in comparison with the current workforce. The following chart clearly shows the dramatic, unintended financial impact on companies that provide these voluntary benefits to their retirees. The impact is compounded for companies that continue to support large legacy retiree populations.

*(Millions of Dollars)*

Otherwise Identical Companies =>	A	B	C	D
Provides Part D-Like Coverage =>	No	Yes	Yes	Yes
Relative Size of Retiree Population =>	n/a	Small	Average	Legacy <sup>(a)</sup>
<b>Current Company Net Earnings:</b>				
Before Retiree Benefit Expense	\$ 168	\$ 168	\$ 168	\$ 168
Net Retiree Benefit Expense		\$ 45	\$ 68	\$ 98
<b>Current Company Net Earnings</b>	<b>\$ 168</b>	<b>\$ 123</b>	<b>\$ 100</b>	<b>\$ 70</b>
<b>Companies sponsoring retiree health plans already pay a heavy price compared with other companies.</b>				
<b>Retiree Drug Subsidy Tax Impact:</b>				
One-Time Effect of Proposed Tax <sup>(b)</sup>	n/a	\$ 18	\$ 35	\$ 58
<b>Revised Company Net Earnings</b>	<b>\$ 168</b>	<b>\$ 105</b>	<b>\$ 65</b>	<b>\$ 12</b>
<b>Percentage Change in Net Earnings</b>	n/a	(14%)	(35%)	(83%)
<b>The proposal to change the tax treatment of retiree drug subsidy puts sponsoring companies at a serious competitive disadvantage.</b>				

**NOTES:** (a) Includes many retirees from discontinued or divested businesses.  
 (b) This amount also increases the company’s balance sheet liability, and represents the present value of new taxes that would be imposed over the lifetimes of current participants, to the extent retiree drug benefits are accrued as of the date of enactment.