December 8, 2009

The Honorable Harry Reid
Senate Majority Leader
S-221 United States Capitol
Washington, D.C. 20510

The Honorable Mitch McConnell
Senate Minority Leader
S-230 United States Capitol
Washington, D.C. 20510

RE: Proposed Change to the Tax Treatment of Medicare Part D Subsidy

Dear Congressional Leader:

I am writing to provide my views, shared by a number of FEI members, on the proposed legislative change to the tax treatment of the Medicare Part D Subsidy. I am the President and CEO of Financial Executives International (“FEI”), which is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. This document represents my views, and not necessarily the views of FEI as a whole or its members individually.

It has come to my attention from members representing three of FEI’s technical committees (the Committee on Taxation, Committee on Corporate Benefits Finance and the Committee on Corporate Reporting) that there is great concern about a particular provision in the proposed legislation — Patient Protection and Affordable Care Act — which pertains to the tax treatment of company sponsored prescription drug benefits. The proposed change would have a significant and immediate financial statement impact that is disproportionate to the actual out-of-pocket costs to the companies that continue to offer them. The companies that are affected by this provision are those that chose to continue to offer prescription drug benefits to their retirees after the passage of the Medicare Modernization Act (MMA) rather than transferring those obligations to the government under legislation enacted in 2003. In the interest of fairness to these companies, we ask you to consider whether it is good policy to change the existing rules in light of the impact that it will have on companies that chose to continue to cover their retirees as opposed to shifting the responsibility to the Federal government.

As background, to encourage employers to retain prescription drug benefits for retirees, the MMA created a subsidy to offset a small portion (~28%) of the cost of the benefit. To keep the subsidy low, Congress made the subsidy tax free and allowed the employer a full deduction for benefits paid (Section 139A of the Internal Revenue Code). The current legislation passed by the Senate Finance Committee would change section 139A of the IRC and limit an employer’s deduction to the extent of the subsidy received. Because the change would impact the deferred tax recorded by companies for benefits,
companies applying Statement of Financial Accounting Standards No. 109 (now Accounting Standards Topic 740) would have to adjust deferred taxes and reduce net income in the year of enactment for the impact of the change for all future years. This charge to earnings is required despite the fact that the tax effect related to the recognition of the original benefit was recorded through equity. While this accounting consequence is counterintuitive, the authoritative guidance related to this matter is very clear and is unlikely to change. One estimate is that some employers might be subject to a net income charge of 25 times the additional annual taxes that they will pay in the year the provision becomes effective.

We believe that Congress should consider the substantial impact this change would have on the reported earnings of companies, which have continued to provide a benefit to retirees in accordance with the intent of the MMA.

We appreciate the Senate’s consideration of these matters and would welcome the opportunity to discuss any and all related matters. If you or your staff have any questions please contact Lorraine Malonza at 973-765-1047 or lmalonza@financialexecutives.org.

Very truly yours,

Marie N. Hollein
President and CEO
Financial Executives International

cc: The Honorable Nancy Pelosi
    The Honorable John Boehner
    The Honorable Charlie Rangel
    The Honorable Dave Camp
    The Honorable Max Baucus
    The Honorable Charles Grassley