Drug Benefits to Retirees to be Taxed in 2011

March 26, 2010 - With last week's passage of the health care reform bill, corporate America is starting to speak up about its costs. And this week alone, some the country's largest companies have started to tell their shareholders about profit write-downs that they are going to have to take as a result of the bill. The reason? Well, under the new law companies that offer drug benefits to their retirees will have to begin paying a tax on those benefits. In the short term, these costs will have to be covered by investors. But in the long term, it is likely that companies will simply drop this type of plan and that the elderly will be left holding the bag.

It's only been a few days since health care reform was signed into law by President Obama. Many economists have been warning that the true costs of the bill would lead to stifled job growth and a reduction in benefits for current employees. There is already evidence that both predictions are about to come true.

The message boards on LinkedIn, a social networking platform for business, are already full of postings from corporate executives and small business owners who say they will not hire any new employees. Many of them are investigating the possibility of turning their existing employees into independent contractors with no benefits. Others are talking about shifting production and servicing facilities to outsourced operations which may be overseas. They are looking at ways to reduce the number of employees on their payrolls and to reduce their exposure to the new taxes associated with health care.

Now a number of companies are reporting that because the law contains new taxes on certain benefits that their shareholders will pay the price in the form of reduced profits. Today, AT&T announced that it would have to write down its profits by $1 billion due to a tax on drug benefits for retirees. Other large companies including John Deere, Caterpillar and Honeywell have all announced additional costs of $100 Million or more.

The likely outcome of this will be that eventually these companies and others like them will dump these plans and their retirees will be stuck with Medicare, which will cost them more. It will also mean that taxpayers will get stuck paying the bill because Medicare is funded by taxpayer dollars. To some degree, this scenario is already playing out in other areas.

On Monday, I participated in a conference call with two Republican congressmen; Dr. Tom Price and Dave Camp. One of the other participants on the call said that her daughter was head of Human Resources for a major hotel chain that until recently had offered a health plan that was considered to be a "Cadillac" plan. Such plans will be taxed heavily under the new health care reform law, so the company made the determination to drop their plan prior to the time the law goes into effect. While some have said that these plans will not be taxed for several years, that is not completely true. Only plans offered to union members will have the tax waived for the next few years. Similar plans offered to non-union workers will be taxed almost immediately.

None of this is good news for anyone who is currently looking for a job. The less money that companies have to spend, means the fewer employees they can hire. And if business owners are as upset as many of them seem to be, those seeking employment may be forced to shift their goals from finding a job with benefits to simply finding work that provides them with nothing more than a paycheck.

It is not much better news for those currently employed and who have benefits. If the benefits offered by your employer are "too good" according the government, then they are either going to be reduced or taxed. Neither option is very appealing.

For its part the Obama administration is questioning the timing of corporate announcements about the costs of health care reform. But it is earnings season - we are approaching the end of the first quarter of 2010 - and current law requires companies to provide the most accurate cost estimates that they can. It is quite likely that as corporate accountants have more time to study the legislation that additional costs will continue to be reported in the next few months.

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