

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

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FEDERAL TAX

► SUBJECT

HEALTH CARE REFORM ELIMINATES DEDUCTION FOR SUBSIDY PAYMENTS ON RETIREE PRESCRIPTION DRUG EXPENSES

► AFFECTING

Companies that receive subsidy payments for qualified retiree prescription drug plans and exclude these amounts from taxable income while also taking a business deduction for the associated costs.

► DETAILS

Companies with qualified retiree prescription drug plans are eligible to receive subsidy payments from the Secretary of Health and Human Services, if the plan meets certain requirements. Specifically, a qualified retiree prescription drug plan is employment-based retiree health coverage that has an actuarial value at least as great as the Medicare Part D standard plan and meets certain other disclosure and recordkeeping requirements.

These subsidy payments are excluded from the taxpayer's gross income. Typically, if an item is excluded from income, any expenses associated with this tax-exempt income would not be deductible. However, under prior law the exclusion of the subsidy payments from income was not to be taken into account when determining a deduction for retiree prescription drug costs. Therefore, a company could have obtained a benefit from excluding the subsidy payments from income and taking a deduction for the amounts that resulted in the subsidy benefit.

► Read more



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The Patient Protection and Affordable Care Act, signed into law by President Obama on March 23, 2010, Pub. L. No. 111-148, removes the language in the Code that permits the exclusion of the subsidy payments in determining the deduction for retiree prescription drug costs. The modification made by this Act was to become effective for taxable years beginning after December 31, 2010. However, on March 30, 2010, President Obama signed the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, which maintains the provision but defers the effective date by two years. As a result, a company will be required to take into account the subsidy payments in determining the appropriate deduction. Therefore, the deduction for retiree prescription drug costs should be reduced by the amount of the subsidy payments received.

This new provision, as amended, will thus be effective for taxable years beginning after December 31, 2012.

► IMMEDIATE ACTION NECESSARY

Affected companies must give immediate attention to this legislative change due to the potential financial statement consequences of the enactment of this legislation. Because of this change, affected taxpayers will need to adjust deferred tax assets that had been recognized in anticipation of future tax deductions. Because future tax deductions will be reduced by the amount of the subsidy payments, the corresponding deferred tax asset will need to be reduced. This adjustment will be recognized as a current tax expense in the period the law is enacted and will affect first quarter 2010 financial results for calendar-year companies.

The deferred tax asset is not adjusted for amounts that will be settled before the effective date. Therefore, if deferred tax items will reverse before the effective date of the legislation, these amounts should not be adjusted. Instead, these amounts will reverse in the ordinary course in the periods prior to the effective date.

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