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H.R. 1231, MAKING HEALTH CARE MORE AFFORDABLE: EXTENDING PREMIUM CONVERSION TO FEDERAL RETIREES

HEARING

BEFORE THE

SUBCOMMITTEE ON CIVIL SERVICE
AND AGENCY ORGANIZATION

OF THE

COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 1231

TO AMEND THE INTERNAL REVENUE CODE OF 1986 TO ALLOW FEDERAL CIVILIAN AND MILITARY RETIREES TO PAY HEALTH INSURANCE PREMIUMS ON A PRETAX BASIS AND TO ALLOW A DEDUCTION FOR TRICARE SUPPLEMENTAL PREMIUMS

JULY 9, 2003

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H.R. 1231, MAKING HEALTH CARE MORE AFFORDABLE: EXTENDING PREMIUM CONVERSION TO FEDERAL RETIREES

WEDNESDAY, JULY 9, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CIVIL SERVICE AND AGENCY ORGANIZATION,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2247, Rayburn House Office Building, Hon. Jo Ann Davis of Virginia (chairwoman of the subcommittee) presiding.

Present: Representatives Jo Ann Davis of Virginia, Blackburn, and Van Hollen.

Staff present: Ronald Martinson, staff director; B. Chad Bungard, deputy staff director and senior counsel; John Landers, detailee; Vaughn Murphy, legislative counsel; Robert White, director of communications; Christopher Barkley, clerk; Tania Shand, minority professional staff member; and Teresa Coufal, minority assistant clerk.

Mrs. DAVIS OF VIRGINIA. The Subcommittee on Civil Service and Agency Organization will come to order.

This hearing represents an important step in our efforts to extend premium conversion, or the ability to pay for health care premiums with pre-tax money, to Federal retirees, military retirees, and active duty military personnel. This is a benefit that is widely available in the private sector, and has been available to executive branch Federal employees since October 2000.

This is a matter of equity. The Federal Government has a long history of treating our active employees and retirees the same. They have access to the same health care, why shouldn't they have the same ability to pay their premiums with before tax dollars? And why shouldn't our military personnel be able to do the same for their TRICARE programs?

This is also a matter of fairness. Health care premiums are skyrocketing for everyone, but no one feels this pressure more than people on a fixed income. The average Federal pension check is less than $1,900 per month. Last year's Federal cost-of-living increase was just 1.4 percent. Over the last 6 years, premiums in the Federal Employees Health Benefits Plans have jumped at least 8 percent a year, almost completely off-setting the small COLA increases.

I am honored to be an original cosponsor of H.R. 1231, the legislation that would extend premium conversion to the entire Federal family. In past years, this proposal has died an anonymous death because it was not referred here but to the Ways and Means Committee, which never gave it serious consideration. This year Chairman Tom Davis, the House bill's sponsor, who is with us here today as our first witness, and Senator John Warner, the chief sponsor on the other side of the Capitol, crafted the legislation in such a way as to ensure a joint referral to the Government Reform Committee. This enables us to hold this hearing today, and to shed some light on this critical subject.

Congress recognizes the burden Americans face due to the rising cost of health care. Already this year we have taken a bold step in adding a prescription drug benefit to Medicare. And just yesterday, many of us went to the floor to ensure passage of legislation that holds Federal retirees harmless when this new drug benefit goes into effect. It is only appropriate that we now turn our attention to the issue of premium conversion for the entire Federal family as the next step in our efforts.

[The prepared statement of Hon. Jo Ann Davis and the text of H.R. 1231 follows:]

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ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

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Chairwoman Jo Ann Davis
Subcommittee on Civil Service and Agency Organization
"Making Health Care More Affordable:
Extending Premium Conversion to Federal Retirees"
Opening Statement
July 9, 2003

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This is a matter of equity. The federal government has a long history of treating our active employees and retirees the same – they have access to the same health care, why shouldn't they have the same ability to pay their premiums with before tax dollars? And why shouldn't our military personnel be able to do the same for their Tricare programs?

This is also a matter of fairness. Health care premiums are skyrocketing for everyone, of course, but no one feels this pressure more than people on a fixed income. The average federal pension check is less than $1,900 per month. Last year's federal cost-of-living increase was just 1.4 percent. Over the last six years, premiums in the Federal Employees Health Benefits Plans have jumped at least 8 percent a year, almost completely off-setting the small COLA increases.

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I

108TH CONGRESS
1ST SESSION

H. R. 1231

To amend the Internal Revenue Code of 1986 to allow Federal civilian and military retirees to pay health insurance premiums on a pretax basis and to allow a deduction for TRICARE supplemental premiums.

IN THE HOUSE OF REPRESENTATIVES

MARCH 12, 2003

Mr. TOM DAVIS of Virginia (for himself, Mrs. JO ANN DAVIS of Virginia, Mr. WAXMAN, Mr. DAVIS of Illinois, Mr. MORAN of Virginia, Mr. WOLF, Mr. HOYER, Ms. NORTON, Mr. WYNN, and Mr. VAN HOLLEN) introduced the following bill; which was referred to the Committee on Ways and Means, and in addition to the Committees on Government Reform and Armed Services, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

---

A BILL

To amend the Internal Revenue Code of 1986 to allow Federal civilian and military retirees to pay health insurance premiums on a pretax basis and to allow a deduction for TRICARE supplemental premiums.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

SECTION 1. PRETAX PAYMENT OF HEALTH INSURANCE PREMIUMS BY FEDERAL CIVILIAN AND MILITARY RETIREES.

(a) IN GENERAL.—Subsection (g) of section 125 of the Internal Revenue Code of 1986 (relating to cafeteria plans) is amended by adding at the end the following new paragraph:

"(5) HEALTH INSURANCE PREMIUMS OF FEDERAL CIVILIAN AND MILITARY RETIREES.—

"(A) FEHBP PREMIUMS.—Nothing in this section shall prevent the benefits of this section from being allowed to an annuitant, as defined in paragraph (3) of section 8901, title 5, United States Code, with respect to a choice between the annuity or compensation referred to in such paragraph and benefits under the health benefits program established by chapter 89 of such title 5.

"(B) TRICARE PREMIUMS.—Nothing in this section shall prevent the benefits of this section from being allowed to an individual receiving retired or retainer pay by reason of being a member or former member of the uniformed services of the United States with respect to a choice between such pay and benefits

under the health benefits programs established by chapter 55 of title 10, United States Code."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 2. DEDUCTION FOR TRICARE SUPPLEMENTAL PREMIUMS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 of the Internal Revenue Code of 1986 (relating to additional itemized deductions for individuals) is amended by redesignating section 223 as section 224 and by inserting after section 222 the following new section:

"SEC. 223. TRICARE SUPPLEMENTAL PREMIUMS OR ENROLLMENT FEES.

"(a) ALLOWANCE OF DEDUCTION.—In the case of an individual, there shall be allowed as a deduction the amounts paid during the taxable year by the taxpayer for insurance purchased as supplemental coverage to the health benefits programs established by chapter 55 of title 10, United States Code, for the taxpayer and the taxpayer's spouse and dependents.

"(b) COORDINATION WITH MEDICAL DEDUCTION.—Any amount allowed as a deduction under subsection (a) shall not be taken into account in computing the amount

1 allowable to the taxpayer as a deduction under section
2 213(a)."

3 (b) DEDUCTION ALLOWED WHETHER OR NOT INDI-
4 VIDUAL ITEMIZES OTHER DEDUCTIONS.—Subsection (a)
5 of section 62 of such Code is amended by inserting after
6 paragraph (18) the following new paragraph:

7 "(19) TRICARE SUPPLEMENTAL PREMIUMS OR
8 ENROLLMENT FEES.—The deduction allowed by sec-
9 tion 223."

10 (c) CLERICAL AMENDMENT.—The table of sections
11 for part VII of subchapter B of chapter 1 of such Code
12 is amended by striking the last item and inserting the fol-
13 lowing new items:

"Sec. 223. TRICARE supplemental premiums or enrollment fees.
"Sec. 224. Cross reference."

14 (d) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to taxable years beginning after
16 the date of the enactment of this Act.

17 **SEC. 3. IMPLEMENTATION.**

18 (a) FEHBP PREMIUM CONVERSION OPTION FOR
19 FEDERAL CIVILIAN RETIREES.—The Director of the Of-
20 fice of Personnel Management shall take such actions as
21 the Director considers necessary so that the option made
22 possible by section 125(g)(5)(A) of the Internal Revenue
23 Code of 1986 shall be offered beginning with the first open
24 enrollment period, afforded under section 8905(g)(1) of

1 title 5, United States Code, which begins not less than
2 90 days after the date of the enactment of this Act.
3 (b) TRICARE PREMIUM CONVERSION OPTION FOR
4 MILITARY RETIREES.—The Secretary of Defense, after
5 consulting with the other administering Secretaries (as
6 specified in section 1073 of title 10, United States Code),
7 shall take such actions as the Secretary considers nec-
8 essary so that the option made possible by section
9 125(g)(5)(B) of the Internal Revenue Code of 1986 shall
10 be offered beginning with the first open enrollment period
11 afforded under health benefits programs established under
12 chapter 55 of such title, which begins not less than 90
13 days after the date of the enactment of this Act.

○

Mrs. DAVIS OF VIRGINIA. I thank you, and I would like to now recognize the chairman of our Government Reform Committee.

Mr. TOM DAVIS OF VIRGINIA. Tom Davis. [Laughter.]

Mrs. DAVIS OF VIRGINIA. I was just asking if I needed to swear you in to make you honest. [Laughter.]

Mr. TOM DAVIS OF VIRGINIA. Oath of office swears us in. We're done.

Mrs. DAVIS OF VIRGINIA. You're done.

Mr. TOM DAVIS OF VIRGINIA. The oath of office swears Members in.

Mrs. DAVIS OF VIRGINIA. Why don't we start with you then, Mr. Davis, Mr. Chairman. Thank you.

Mr. TOM DAVIS OF VIRGINIA. Thank you. If you forget who anybody is today, it is Davis. It is Davis, Davis——

Mrs. DAVIS OF VIRGINIA. I know who you are.

Mr. TOM DAVIS OF VIRGINIA. I know. I know that. And I am happy you are where you are, Jo Ann.

STATEMENT OF HON. TOM DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. TOM DAVIS OF VIRGINIA. Madam Chairman and members of the subcommittee, I really appreciate the opportunity to come before you today to discuss this issue for our Nation's military and civil servants.

I know I am preaching to the choir this afternoon, but I am pleased to see all but two members of this subcommittee as cosponsors of the legislation this year. Although we all know full well the deliberative nature of Congress, it has been 1,152 days since I first introduced premium conversion legislation, and I am pleased to finally have the ability to testify on this issue. And for that, we thank you, Madam Chairwoman.

As you know, we have introduced legislation in the 108th Congress to allow Federal civilian and military annuitants to pay their Federal Employees Health Benefits Program premiums on a pretax basis, and allow active duty military personnel to apply a below the line deduction for TRICARE supplemental premiums paid annually. Although not an answer to rising health care costs, H.R. 1231 will take the next step in helping to improve the quality of life for those retirees and active duty personnel living on a fixed income.

I first introduced this legislation in the 106th Congress, and was pleased to receive the support of 111 of our colleagues at that time. In the 107th Congress, H.R. 2125 received even broader bipartisan support, yet despite 282 cosponsors, was never acted upon. I am pleased to say that we have moved quickly in the 108th Congress, and in the first 6 months have surpassed our total from the last Congress, with 283 cosponsors to date.

The FEHBP covers 8.6 million individuals, including 2.2 million Federal and postal employees, 1.9 million Federal annuitants, and 4.5 million dependents. All of us here today recognize the importance of the FEHBP as we seek to retain and recruit the best and the brightest to serve our Nation as members of the Civil Service. Deputy Director Blair pledged late last year to work closely with the members of the Government Reform Committee, as well as pro-

viders and plan participants, to keep the FEHBP a model for employer-provided health care coverage. OPM has continued this commitment, and I firmly believe that our legislation will be integral to this effort.

Under current law, amounts distributed from a section 401(a) qualified plan and used to pay for benefits in a former employer's section 125 cafeteria must be included in the participant-retiree's income. Section 402(a) stipulates that distributions from a qualified plan are taxable to the distributee in the taxable in which distributed, except for two instances stated in the statute. Current exemptions include distributions made to a spouse or former spouse under court order, and eligible rollover distributions transferred within 60 days.

In 1959, Congress created the Federal Employees Health Benefits Plan [FEHBP] as a recruitment and retention tool for the Federal Government to compete in the job market. There is no disputing that Federal employees, retirees, and their survivors enjoy the widest selection of health plans in the country, enabling users to compare the costs, benefits, and features of different plans. Market-orientation and consumer choice have been hallmarks of the program's success. And although OPM has been more successful than private sector plans at constraining costs, the numbers tell us that our annuitants are losing more and more of their monthly paychecks to health care premiums.

According to GAO, FEHBP premiums have increased by an average of nearly 10 percent a year since 1998, a trend which promises to continue in the near future given the increased costs for prescription drugs and outpatient care. Conversely, COLAs have only increased by 2.38 percent for CSRS and 1.96 percent for FERS over the last 5 years. It is critical for annuitants to receive relief since they have been forced in recent years to shoulder increasingly high health insurance and prescription drug costs on their average monthly annuity of $1,869 and average annual annuity of $22,428. It has been estimated this legislation would result in a savings of approximately $434 a year. For some, this could mean an annual utility bill or car insurance payment, for others it could mean airfare to see their family. Regardless of the choice, a modest amount of money to those on a fixed income will have a substantial impact.

In addition, this legislation is important to establish parity between employees and retirees. OPM made administrative changes and began offering premium conversion plans to executive branch employees in October 2000 and Congress extended the tax benefit to legislative branch workers in January 2001. This option must be made available to those whose income is fixed and whose medical costs are on average much higher than current employees. In fact, yesterday the House reaffirmed parity between retirees and current employees with the passage of H.R. 2631, Madam Chairwoman, legislation which we sponsored together. This legislation represents the Federal Government's commitment that our annuitants will remain on equal footing with current employees with regard to prescription drug benefits. This commitment must also be made in terms of providing the premium conversion benefit to our annuitants.

In conclusion, now more than ever is the time to show our appreciation to those men and women who have and continue to dedicate their lives to our Nation and our ideals. Our Nation's tax code, although arcane and complex, has many built-in incentives that assist individual taxpayers in areas our Nation holds most dear, such as education, philanthropy, and health care. I can think of few priorities as dear as providing appropriate health care for our retirees and our active duty military. It is my hope that this legislation will be enacted in the 108th Congress. I will continue to work to ensure its passage.

I appreciate the subcommittee taking a look at this issue today and look forward to working with all of you as we remain vigilant in our efforts to provide the best for our Federal civilian and military employees and annuitants. Thank you very much.

[The prepared statement of Hon. Tom Davis follows:]

Testimony of the Honorable Tom Davis
Government Reform Subcommittee on the Civil Service
Hearing on Premium Conversion Legislation
Wednesday, July 9, 2003

Madame Chairman and Members of the Subcommittee, I appreciate the opportunity to come before you today to discuss this important issue for our nation's military and civil servants.

I can't help but feel like I am preaching to the choir this afternoon, as I am pleased to see all but two of the members of the Subcommittee as cosponsors of my legislation on this issue. Although we all know full-well the deliberative nature of Congress, it has been 1,152 days since I first introduced premium conversion legislation, and I am pleased to finally have the ability to testify on this issue.

As you know, I have again introduced legislation in the 108th Congress to allow federal civilian and military annuitants to pay their Federal Employees Health Benefits Program (FEHBP) premiums on a pretax basis, and allow active duty military personnel to apply a below the line deduction for TRICARE supplemental premiums paid annually. Although not an answer to rising healthcare costs, H.R. 1231 will take the next step in

helping to improve the quality of life for those retirees and active duty personnel living on a fixed income.

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increased by an average of nearly 10 percent a year since 1998, a trend which promises to continue into the near future given the increased costs for prescription drugs and outpatient care. Conversely, COLAs have only increased by 2.38 percent for CSRS and 1.96 percent for FERS over the last 5 years. It is critical for annuitants to receive relief since they have been forced in recent years to shoulder increasingly high health insurance and prescription drug costs on their average monthly annuity of $1869 and average annual annuity of $22,428. It has been estimated that my legislation would result in a savings of approximately $434 a year. For some, this could mean an annual utility bill or car insurance payment, for others it could mean airfare to see their family. Regardless of the choice, a modest amount of money to those on a fixed income will have a substantial impact.

In addition, this legislation is important to establish parity between employees and retirees. OPM made administrative changes and began offering premium conversion plans to executive branch employees in October of 2000 and Congress extended the tax benefit to legislative branch workers in January 2001. This option must be made available to those whose income is fixed and whose medical costs are on average much higher

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Mrs. DAVIS OF VIRGINIA. Mr. Chairman, we are delighted to have had you here to testify today. And by tradition, we do not question Members of Congress who testify before the committee. So I thank you again, Chairman Davis, for taking the time.

Mr. TOM DAVIS OF VIRGINIA. Jo Ann, you always have ample opportunity to ask me questions off-stage.

Mrs. DAVIS OF VIRGINIA. I know where I can get you.

Mr. TOM DAVIS OF VIRGINIA. So I will be happy to help as we work through this. I just appreciate your willingness to hold this hearing and try to move this at least on a fast-track through this committee where we will face additional obstacles, but we will try to work through them. Thank you very much.

Mrs. DAVIS OF VIRGINIA. Thank you, Mr. Chairman.

We are going to go ahead and proceed. We should have a Member or two show up here shortly.

I ask unanimous consent that all Members have 5 legislative days to submit written statements and questions for the hearing record, and that any answers to written questions provided by the witnesses also be included in the record. Without objection, it is so ordered.

I also ask unanimous consent that all exhibits, documents, and other materials referred to by Members and the witnesses may be included in the hearing record, and that all Members be permitted to revise and extend their remarks. Without objection, it is so ordered.

Before we begin, I do want to enter into the record a statement from Walter Olihovik, the national president of the National Association of Postmasters of the United States. Without objection, it is so ordered.

[The prepared statement of Mr. Olihovik follows:]

Statement of
The National Association of Postmasters of the United States
Walter Olihovik, National President

Before

The House Government Reform Subcommittee on Civil Service and Agency Reorganization

On

"Health Care Affordability for Federal Retirees"

Wednesday, July 9, 2003

Madame Chair Jo Ann Davis, Congressman Danny Davis, and Members of the Subcommittee I am Wally Olihovik, President of the 42,000 member National Association of Postmasters of the United States (NAPUS). NAPUS represents the approximately 27,000 postmasters in this nation, as well as retired postmasters.

It is a privilege to share with you my thoughts about how the escalating cost of health care adversely affects retired postmasters. Pending legislation introduced by Chairman Tom Davis and Senator John Warner take a small step to alleviate the increasing financial burden that increasing Federal Employees Health Benefits Program (FEHBP) premium places on a large number of my members and your constituents. As you are aware, the average FEHBP premium increased by slightly over 11% for the 2003 contract year. At the same time, the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS) cost-of-living-adjustment rose by only 1.4%. That cavernous disparity between the FEHBP premium increase and the retirement COLA is not an aberration. In fact, over the past five years, FEHBP premiums have increased by 53.2%, while federal retiree COLAs increased by only 11.2% for CSRS and by just 9.2% for FERS. With each passing year, FEHBP premium increases erode a greater and greater portion of postal and federal retirees' fixed incomes.

For many NAPUS members, this phenomenon is chronic and financially devastating. This fact is particularly acute for those who have been unable to supplement their federal pension. For new retirees and postmasters contemplating retirement, the financial impact can be shocking. Active postal employees contribute their portion of the FEHBP premium with "pre-tax" dollars. This means that an employee is not assessed federal income taxes or social security taxes on their premium contributions. However, upon retirement, these very same individuals must pay their FEHBP contribution with funds withheld from their annuities, <u>after</u> income tax reductions. This unfair retiree tax can cost annuitants hundreds of dollars each year. Not too long ago, the Postal Service and the Office of Personnel Management extended postal and federal employees "premium conversion" to relieve some of the financial burden, without increasing the employer contribution to FEHBP.

Currently, the Internal Revenue Code stipulates that pre-tax contributions towards health insurance are part of a "salary reduction agreement" and therefore limited to "earned income." Since retirement annuities are not considered "earned income," current law precludes federal retirees from enjoying the same tax preferred rights as active employees. NAPUS believes that this rule is discriminatory and serves no valid public policy goal. Moreover, extending "premium conversion" to postal and federal retirees would help to mitigate the ever-escalating costs associated with health insurance that is borne by CSRS and FERS retirees.

Consequently, NAPUS strongly supports enactment of H.R. 1231, introduced by Chairman Tom Davis, and S.623, introduced by Chairman John Warner. The legislation enjoys broad bipartisan support meriting 277 House cosponsors and 41 Senate cosponsors. Premium conversion represents a responsible and tested approach to address the high cost of health insurance and demonstrates our nation's commitment to affordable health coverage.

Madame Chair, thank you for conducting this hearing and providing NAPUS with opportunity to share our views. We encourage you to report favorably H.R. 1231 to correct the unfair financial plight suffered by so many who are committed to postal and federal service.

Mrs. DAVIS OF VIRGINIA. If our second panel of witnesses, Charles L. Fallis, president of the National Association of Retired Federal Employees; Sue Schwartz, deputy director of government relations for the Military Officers Association of America; and William H. Young, president of the National Association of Letter Carriers, if you all would come forward and remain standing, I will administer the oath. It is the subcommittee's standard of practice to ask witnesses to testify under oath. If you will raise your right hands.

[Witnesses sworn.]

Mrs. DAVIS OF VIRGINIA. Let the record reflect that the witnesses have answered in the affirmative. You may be seated.

The panel will now be recognized for an opening statement. We will ask you to summarize your testimony in 5 minutes. Any more complete statements you may wish to make will be included in the record.

I would like to welcome Charles Fallis, president of NARFE. I thank you for being with us today. And I am going to recognize you first, Mr. Fallis, for 5 minutes.

STATEMENT OF CHARLES L. FALLIS, PRESIDENT, NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES; SUE SCHWARTZ, DEPUTY DIRECTOR OF GOVERNMENT RELATIONS, MILITARY OFFICERS ASSOCIATION OF AMERICA; AND WILLIAM H. YOUNG, PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS

Mr. FALLIS. Thank you. On behalf of the Nation's 2.3 million Federal annuitants, I am happy to testify today in support of H.R. 1231 and S. 623, bills that were introduced by Representative Tom Davis and Senator John Warner. I also want to commend you, Chairwoman Davis, for holding, for the first time ever, hearings on this premium conversion issue that is so important to us. I want to thank you for the lengths that you have gone out of way to ensure the health and economic well-being of Federal retirees.

I think the reasons are clear why these bills should become law. Premiums for plans available for the Federal Employees Health Benefits Program have skyrocketed ever since 1998. It was these double digit premiums, these hikes that helped persuade OPM to revisit and reconsider earlier interpretations that Section 125 of the Internal Revenue Code did not apply to the Federal Government as an employer. And as a result of those reconsiderations, the premium conversion benefit was granted first to executive branch employees in October 2000 and then, thereafter, to legislative branch employees in January 2001.

We are glad, of course, that our colleague who are still working receive this relief, but, of course, we were understandably disappointed that annuitants were left out. We believe very strongly that, as a matter of fairness and equity, Federal annuitants should be included and should have equal relief. Annuitants live on fixed incomes, and much of the meager cost-of-living increases that were received during the last 6 years were eroded substantially by the premium increases. The reality is that most of the 2003 average COLA of $26 was immediately consumed by these premium increases.

But it is not just retirees who should care about this legislation. Indeed, imagine the shock of a newly retired homeland security worker when he or she retires and receives a first annuity check and learns that the Federal Government does not permit Federal retirees pre-tax earnings to pay for their share of health premiums. The result of that is that about a $434 savings which was there during the work years is lost immediately upon retirement, at a time when it is needed the most.

It will be a rude awakening for today's active Federal and postal worker to learn that this inequity will continue unless the Davis and Warner bills are passed. For that reason, I am grateful to the Federal, postal, and military organizations, including those who are testifying here with me today, for the strong support they have given to H.R. 1231 and S. 623.

On the downside, some lawmakers have expressed concerns that the proposed legislation, premium conversion, would be extended only to Federal retirees and not to all other retirees. Well, NARFE suggests that, because of their service to their country, providing premium conversion rights to Federal and military retirees is a reasonable first step toward providing it to all retirees.

The Congressional Joint Committee on Taxation says that premium conversion legislation, when fully implemented, would cost $7.1 billion over 10 years. NARFE certainly is sensitive to the cost of legislation, particularly in light of the Federal budget deficit. Nonetheless, we also recognize that several proposals to use the tax code to help other Americans absorb skyrocketing health care costs are currently receiving favorable consideration, and we do not believe that H.R. 1231 and S. 623 are out of line in that connection. Higher health insurance premiums have hit everyone in the Federal community, employees and retirees alike. That is why everyone who serves our country, including Federal and military retirees, should receive equal tax relief to make health insurance more affordable for all.

We commend Congressman Tom Davis, Senator John Warner, and you, Chairwoman Davis, along with actually about 282 Members of the House, for recognizing that retirees, too, are struggling with rising health costs just as our other citizens.

So, thank you again, Chairwoman Davis, for holding this hearing. I can assure you of NARFE's full support and cooperation in moving H.R. 1231 to the floor of the House as soon as possible. Thank you very much.

[The prepared statement of Mr. Fallis follows:]

STATEMENT BY
CHARLES L. FALLIS
PRESIDENT
NATIONAL ASSOCIATION OF RETIRED
FEDERAL EMPLOYEES

TO THE SUBCOMMITTEE ON CIVIL SERVICE AND
AGENCY REORGANIZATION
COMMITTEE ON
GOVERNMENT REFORM AND OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES

HEARING ON
H.R. 1231
THE FEDERAL CIVILIAN/UNIFORMED SERVICES
PREMIUM CONVERSION BILL

JULY 9, 2003

National Association of Retired Federal Employees

Charles L. Fallis, NATIONAL PRESIDENT
Dan C. Galvan, NATIONAL VICE PRESIDENT
David F. Sullivan, NATIONAL SECRETARY
Michael B. Hoyman, NATIONAL TREASURER

On behalf of our nation's 2.3 million federal annuitants, I am happy to testify in support of H.R. 1231 and S. 623, bills introduced by Representative Tom Davis and Senator John Warner, that would allow federal annuitants and military retirees and active duty personnel to use pre-tax earnings to pay their share of health insurance premiums. I also want to commend you, Chairwoman Davis, for holding the first ever congressional hearing on the federal/military premium conversion bills and for going to great lengths to protect the earned economic and health security of federal workers and annuitants.

Under this legislation, the amount retirees would pay for their share of health insurance premiums would be subtracted from the amount of their income reported to the IRS. For example, if a federal retiree's annual share of a FEHBP premium is $1,700, then her adjusted gross income would be lowered by that amount for purposes of filing personal income taxes. The income tax paid by retirees would be lower because their taxable income would be lower (see Table 1). Federal and military retirees and active duty personnel would not be required to take any further action under this legislation since their reported income would automatically result in lower income tax. That means they would not have to itemize deductions, fill out special tax forms or depend on their accountant or family members to seek this relief. As a result, there is no guesswork here. The automatic nature of this tax relief would be especially important to older retirees who have difficulty – or need help – handling their own income tax filings.

The reasons Congressman Davis' and Senator Warner's bills should become law are clear. Premiums for plans available through the Federal Employees Health Benefits Program – along

with other employer-sponsored plans – have skyrocketed every year since 1998. While the authority to create a premium conversion plan had existed in the tax code since 1978, the repeated double-digit premium hikes helped persuade OPM to reconsider earlier interpretations that Section 125 of the Internal Revenue Code did not apply to the federal government as an employer. As a result, the premium conversion benefit was first granted to executive branch employees in October 2000 and then to legislative branch workers in January 2001.

We are glad that our colleagues who are still working receive this relief, but we were disappointed that annuitants were left out since the tax code is unclear on whether we may participate. As a matter of equity, federal annuitants must receive this same relief. Annuitants live on fixed incomes, and much of the 1.3 to 3.5 percent COLAs received by federal annuitants and military retirees during the last six years have been eroded by the double-digit increases in health insurance premiums (see Table 2).

At an average monthly gross annuity of $1,869 -- most federal retirees and survivors -- while not poverty stricken – are not living in the lap of luxury either. The reality is that most of the average monthly cost-of-living adjustment of $26.00 in 2003 was immediately consumed by this year's FEHBP enrollee share increases, like the $22.52 jump in the Blue Cross/Blue Shield standard option family plan (see Table 3). There was little left over to absorb other rising expenses.

But more than just retirees should care about this legislation. Indeed, imagine the shock of a newly retired homeland security worker when he receives his first annuity check and learns that

the federal government no long uses pre-tax earnings to pay his share of health insurance premiums. Under present law, that means the average annual tax savings of $434 he received when working ends when he retires --- just when it is needed the most.

This rude awakening for today's active federal and postal workers will continue unless the Davis and Warner bills are enacted. For that reason, I am grateful to the federal, postal and military organizations – including those testifying with me today – who have given their strong support to H.R. 1231 and S. 623.

Some lawmakers have expressed concerns that premium conversion would only be extended to federal and military retirees – and not other retirees – under the proposed legislation. NARFE suggests that, because of their service to our country, providing premium conversion rights to federal and military retirees is a reasonable first step toward providing it to all retirees.

Towards that end, we believe that the Internal Revenue Service (IRS) should revisit their interpretation of whether the current tax code does allow retirees to participate in Section 125 premium conversion plans. In fact, Section 125 includes "former employees" within the definition of "employees" eligible to participate in the tax-favored plans. Consequently, we contend retirees, as former employees who receive deferred compensation from their employer, already should be considered eligible for premium conversion and related Section 125 tax plans.

In a February 1, 2000 "Coordinated Issue Paper" (UIL #125.05-00), the IRS said that retirees that receive income from Section 401(a) "qualified [retirement] plans" cannot shelter such funds

spent on the enrollee share of employer-sponsored health insurance from taxable income. The IRS argues that retired workers should not participate in Section 125 plans since Section 402 of the tax code does not explicitly allow such "former employees" to exclude qualified plan annuities spent on employer sponsored health insurance from their reported income. The paper asserts that there are only two narrow exceptions of when annuities can be excluded from reported income: (a) in distributions made to a former spouse under a court order [402(e)(1)(A)]; or, (b) rollovers from exempt funds that are transferred to an eligible retirement plan [402(c)]. We strongly believe that the third exception for all retirees should be Section 125 plans since annuities or pensions are deferred compensation for services rendered in the past and are no different from immediate compensation – wages – withheld for health insurance premiums that can be excluded from reported income under current interpretation of the tax code.

What distinguishes private-sector retirement plans from the federal government's civilian retirement system – and what is not addressed in the IRS issue paper – is that for some purposes the government system is considered a Section 401(a) qualified retirement plan and for other purposes it is not. For instance, when a 40-year-old worker leaves his private-sector employer after 15 years of service, he receives both the employer and employee retirement contributions and earnings from a defined benefit plan. But unlike private sector workers, a Civil Service Retirement System employee would not be entitled to the government-employer retirement contributions – but only his own -- if he decided to pull out of CSRS upon separating from federal service before having enough years of employment to retire with an immediate annuity.

Given this example, federal civilian retirement is not conclusively a qualified plan as defined by Section 401(a). As a result, the IRS should rule that retired federal employees be allowed to participate in premium conversion plans since receiving distributions from qualified plans is the only tax code impediment to their participation in Section 125 plans.

While Congress would not directly consider the cost of an administrative resolution to the premium conversion issue, budgetary effects would be contemplated if legislation were necessary to extend this tax relief to retirees and the active duty uniformed services. If fully implemented, the Congressional Joint Committee on Taxation says that premium conversion legislation introduced by Chairman Davis and Senator Warner in the 107th Congress would cost $7.1 billion over ten years. NARFE is certainly sensitive to the cost of any legislation, particularly in light of the federal budget deficit. Nonetheless, we also recognize that several proposals to use the tax code to help other Americans absorb skyrocketing health care costs are currently receiving favorable consideration. Indeed, the cost of H.R. 1231 and S. 623 is not out of line with other plans. Moreover, retirees and military personnel are likely to spend whatever tax savings they receive and thereby help the economy.

Some health care economists have argued that the tax relief provided by premium conversion is a disincentive for employees to select the most efficient and cost conscious health plans. They reason that enrollees would be less likely to search for an option with lower premiums and better coverage if rate hikes are cushioned by $300 to $500 in annual tax savings.

While health insurance is made more affordable by premium conversion, double-digit premium increases will continue to compel enrollees to shop around for better plans despite the addition of tax relief. NARFE takes this a step further by reminding our members during open season that they have a role in making FEHBP premiums, coverage and plans more competitive by encouraging them to switch to options of better value, if they are available.

Higher health insurance premiums have hit everyone in the federal family. That is why everyone who serves our country, including federal and military retirees, should receive the same tax relief to make health insurance more affordable. We commend Congressman Davis, Senator Warner and you for recognizing that retirees are struggling with rising health care costs.
Apparently, many of your colleagues agree with the legitimacy and value of this extension of premium conversion. Sixty-three percent of the House and 39 percent of the Senate have already indicated their support as cosponsors.

Thank you again, Chairwoman Davis, for holding this hearing. I can assure you of NARFE's full backing and cooperation in moving H.R. 1231 to the floor of the House as soon as possible.

Table 1: Comparing Taxpayers With and Without Premium Conversion.

Paying for Health Insurance With Pre-Tax Salary		Paying for Health Insurance With After-Tax Salary	
Annual Salary:	$28,000	Annual Salary:	$28,000
Insurance Premium Paid:	$1,700	Insurance Premium Paid:	$1,700
Income Reported to IRS:	$26,300	Income Reported to IRS:	$28,000
Federal Tax Rate:	x 28.0%	Federal Tax Rate:	x 28.0%
State Tax Rate:	x 6.0%	State Tax Rate:	x 6.0%
Federal & State Income Taxes Paid:	$8,925	Federal & State Income Taxes Paid:	$9,480

Premium Conversion Savings	
Taxes Paid Without Premium Conversion:	$9,480
Taxes Paid With Premium Conversion:	$8,925
Total Savings:	$555

Table 2: Federal Employees Health Benefits Program (FEHBP) Premium Increases versus Federal Annuity Cost-Of-Living Adjustments (COLAs).

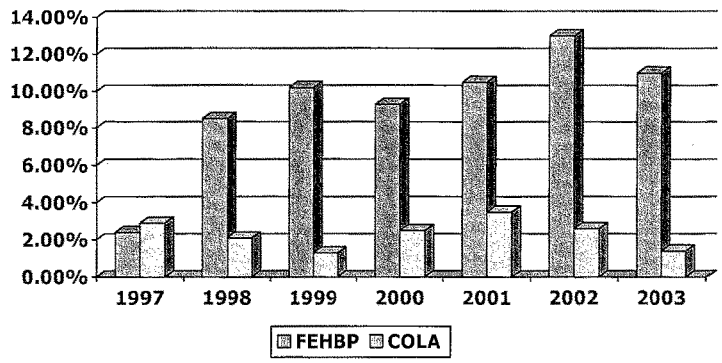
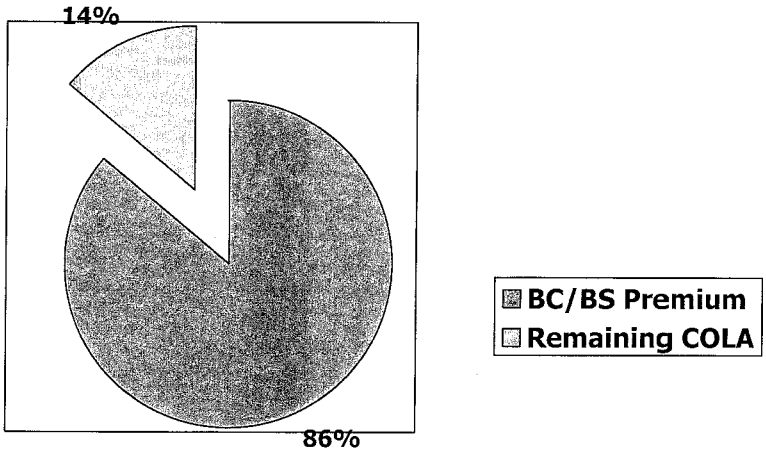


Table 3: Percentage of Average 2003 Federal Annuity COLA Consumed by FEHBP Blue Cross/Blue Shield Standard Option Family Plan:



Mrs. DAVIS OF VIRGINIA.. Thank you, Mr. Fallis.

We have been joined by my colleague, Ms. Blackburn from Tennessee. Ms. Blackburn, did you have an opening statement?

Ms. BLACKBURN. No, ma'am, I do not. I appreciate the opportunity to step in for just a few moments and be with you all. I think we are all interested in this, interested in seeing it move forward, but we have been in the middle of a day-long markup in Judiciary. Thank you, Madam Chairman.

Mrs. DAVIS OF VIRGINIA. Thank you, Ms. Blackburn. Unfortunately, that is the problem with several of our colleagues today, there are meetings on top of meetings, as it so often happens here on the hill.

I would now like to recognize Sue Schwartz of the Military Officers Association of America. I want to thank you, Ms. Schwartz, for being here today. You have 5 minutes.

Ms. SCHWARTZ. Good afternoon, Madam Chairwoman and distinguished members of the subcommittee. The Military Officers Association of America [MOAA] is grateful for the invitation to present our views on H.R. 1231 and S. 623, to allow active duty servicemembers and Federal civilian and military retirees and survivors to pay health insurance premiums on a pre-tax basis and to allow a deduction for TRICARE supplemental premiums.

Madam Chairman, we are also most appreciative of your leadership as an original cosponsor of H.R. 1231, as well as for your continued support for equity in the treatment of uniformed services and Federal employees. H.R. 1231 would allow 8.6 million current and retired military servicemembers, their families, and survivors the same privilege already enjoyed by millions of other Americans.

Many uniformed services beneficiaries, active duty, including Ready Reservists and National Guardsmen, and retirees, pay premiums for a variety of health programs. For the vast majority of military beneficiaries, these are not tax deductible because their health care expenses do not exceed 7.5 percent of their adjusted gross income. This creates significant inequity with many private sector and Federal workers, many of whom already enjoy tax exemptions for health and dental premiums through employer-sponsored health benefit cafeteria plans. Since 2000, OPM has offered current Federal employees pre-tax benefits under the Federal Flexible Benefits Plan, called FedFlex.

This year the gap between military and Federal employee benefits will widen even further. OPM will soon expand FedFlex by offering the option to enroll in flexible spending accounts [FSAs]. Federal employees will soon enjoy even greater benefits covering additional out of pocket costs.

MOAA firmly believes that military beneficiaries are Federal employees too and should be able to enjoy the same equal tax relief regarding their health care expenses.

A survey of private sector employees conducted last year by the Society for Human Resource Management shows that 69 percent of the private sector organizations surveyed offer flexible medical spending account benefits. Even my employer, MOAA, a private, non-profit organization with less than 100 employees, offers the premium conversion benefit. If MOAA can provide this benefit to 95 employees to maximize employee benefits, why cannot the Fed-

eral Government provide the same benefit for those who currently serve or those who have served their Nation in uniform?

As DOD competes with the private sector in the "war for talent," premium conversion can offer a valuable recruitment and retention tool. DOD is challenged to search for new ways to attract qualified candidates away from the private sector to choose military service, as well as to enhance retention.

Compensation issues continue to be of concern to our military families. Pay and benefit improvements are integral to retaining a top quality all-volunteer force to wage the war against terrorism at home and abroad. The stresses of military life along with the recent increase in operations tempo associated with fighting two wars since September 11 are taking their toll on military families. Sacrifices are taken for granted as a part of the military life. However, in response to the hardships we impose upon our military families, it is important that every attempt is made to provide them with a quality of life that is competitive with the private sector.

MOAA firmly believes that sailors, soldiers, airmen, and marines who sacrifice so much in service to their country are also Federal employees in every way and deserve to be afforded the same tax relief for their health care premiums as current Federal workers.

It is most unfortunate that Federal annuitants are prohibited from participating in FedFlex. Both military retirees and Federal annuitants also bear the burden of increasingly high premiums. One example of where military retirees would greatly benefit concerns the TRICARE Retiree Dental Program.

One of the greatest complaints we hear from our retiree members is the high cost of the retiree dental program. Unlike the active duty dental program, the Government does not subsidize retiree premiums, a significant dissatisfier for retired beneficiaries. While the program is clearly successful, participation could be greatly enhanced by offering premium conversion to offset the high costs of the program.

MOAA strongly supports enactment of this legislation to correct this significant inequity in the tax code affecting the military. Rising health care costs affect all Federal employees, civilian or uniformed, active or retired, and this proposal is essential to ensure all are provided similar relief.

Our hope is that the precedent set in 2000 for currently serving Federal civilian employees will pave the way to ensure equal treatment for all military and Federal personnel.

Madam Chairman, I look forward to answering your questions. And thank you again for this opportunity.

[The prepared statement of Ms. Schwartz follows:]

STATEMENT OF

THE MILITARY OFFICERS ASSOCIATION OF AMERICA

(MOAA)

Subcommittee on Civil Service and Agency Orgainzation

House Government Reform Committee

July 9, 2003

Presented by

Sue Schwartz, DBA, RN

Deputy Director, Government Relations

Military Officers Association of America

Madam Chairman and distinguished members of the Subcommittee, the Military Officers Association of America (MOAA) is grateful for the invitation to present our views on HR 1231, which would allow active duty servicemembers and Federal civilian and military retirees and survivors to pay health insurance premiums on a pretax basis and to allow a deduction for TRICARE supplemental premiums.

MOAA is the largest military officers association in the country and the fourth largest military veterans organization with approximately 389,000 members. Our membership consists of current, former, or retired officers of the seven uniformed services and their surviving spouses. Included in our membership are active duty, National Guard and Reserve, retired and former officers who were honorably discharged. MOAA was founded in 1929 and is dedicated to "serving those who serve America".

MOAA strongly supports this legislation to help ensure equal treatment for all military and federal beneficiaries

Madam Chairman, we are also most appreciative of your leadership on this issue as an original cosponsor of HR 1231 -- as well as for your continued support for equity in the treatment of uniformed service and federal employees. If enacted, this legislation would allow 8.6 million current and retired service members, families, and survivors the same privilege already enjoyed by millions of other Americans

HR 1231

HR 1231 would amend Section 125 of the Internal Revenue Code to allow active duty and retired military members and federal civilian annuitants to pay their health insurance premiums on a pre-tax basis. Under this premium conversion concept, Federal tax rules allow employees to deduct their share of health insurance premiums from their taxable income, thereby reducing their income tax liability. HR 1231 would provide tax incentives to offset the cost of these important services and promote enrollment.

To meet their health care requirements, many uniformed services beneficiaries – active duty, (including Ready Reservists and National Guardsmen) and retirees --- pay premiums for a variety of health insurance programs, such as TRICARE Prime enrollment fees, TRICARE Standard supplemental policies, the TRICARE Dental Plan (TDP), and the TRICARE Retiree Dental Plan (TRDP). For the vast majority of military beneficiaries, these premiums and enrollment fees are not tax-deductible because their health care expenses do not exceed 7.5 percent of their adjusted gross taxable income, as required by IRS rules.

This creates a significant inequity with many private sector and federal workers, many of whom already enjoy tax exemptions for health and dental premiums through employer-sponsored health benefits "cafeteria" plans. Since October of 2000, the Office of Personnel Management (OPM) has provided current federal employees these pre-tax benefits under the Federal Flexible Benefits Plan ("FedFlex"). FedFlex makes it possible for eligible Federal employees to pay for certain benefits with pre-tax dollars.

This year the gap between military and federal employee benefits will widen even further. OPM will expand FedFlex this summer by offering the option to enroll in Flexible Spending Accounts (FSAs). Federal employees will enjoy even greater benefits with FSAs covering additional out-of-pocket costs, including co-payments and deductibles and for health care expenses not covered by insurance, such as dental services and eye care.

Kay Cole James, Director, US Office of Personnel Management has stated, "Used wisely, flexible spending accounts are effective financial management tools that can stretch the disposable incomes of account holders and ensure that funds are available, when needed, to pay for out-of-pocket medical expenses. I am confident that federal employees will benefit from participation in the FSA program…."

MOAA firmly believes that military beneficiaries are federal employees too and should be able to enjoy equal tax relief regarding their health care expenses.

The Society for Human Resource Management's 2002 Benefits Survey shows that 69 percent of the 551 private sector organizations surveyed offer medical flexible spending account benefits to their employees. Even MOAA, a private, non-profit organization with less than 100 employees, offers the premium conversion benefit option. IRS Code Section 125 allows eligible MOAA employees to pay for certain employer-sponsored fringe benefits with pre-tax dollars. A designated amount of money is set aside from each paycheck and deducted from gross pay before federal, FICA, Social Security, Medicare (and in some cases, state) taxes are calculated.

Our Premium Conversion program automatically increases take home pay since these deductions are not subject to federal or FICA taxes. If MOAA can provide this benefit to its 95 employees to maximize employee benefits, why can't the government provide the same benefit to those who currently serve or those who have served their nation in uniform?

As the Department of Defense competes with the private sector in the "war for talent", Premium Conversion can offer a valuable recruitment and retention tool. DoD is constantly challenged to search for new ways to attract qualified candidates away from the private sector to choose military service, as well as to enhance retention. Employers who offer these benefits are more likely to be viewed as employers of choice - who understand and relate to the needs of employees and their families.

Compensation issues continue to be of concern among our military families. Pay and benefit improvements are integral to retaining a top-quality all-volunteer force to wage the war against terrorism at home and abroad. The stresses of military life along with the recent increase in operations tempo – associated with fighting two wars since 9/11 are taking their toll on military families. Sacrifices are taken for granted as a part of the

military life. However, in response to the hardships we impose upon our military families, it is important that every attempt is made to provide them with a Quality of Life that is competitive with the private sector.

HR 1231 contains the following provisions for military beneficiaries:

- Enrollment fees for **TRICARE Prime** and the **TRICARE Retiree Dental Plan (TRDP)** paid by military retirees and **TRICARE Dental Program (TDP)** fees paid by active duty military members would be treated in the same way as pretax options available to private sector workers. Premiums would be deducted by the government from the person's gross pay or retired pay. These enrollment fees/premiums would not be reported as taxable income.

- **TRICARE Standard supplemental** premiums paid by active and retired servicemembers would be treated differently, since these are not government programs. Beneficiaries would be allowed to deduct these premiums on their federal income tax forms. The deduction would be allowable whether or not the taxpayer itemized his/her deductions.

MOAA firmly believes that sailors, soldiers, airmen, and Marines who sacrifice so much in service to their country are also federal employees in every way and deserve to be afforded the same tax relief for their health care premiums as current federal workers.

It is unfortunate that federal annuitants cannot participate in FedFlex because the tax code is unclear on their eligibility to participate. Both military retirees and federal annuitants also bear the burden of increasingly high health premiums. One example of where military retirees would greatly benefit concerns the TRICARE Retiree Dental Program (TRDP).

One of the greatest complaints we hear from our members is that high cost of the retiree TRDP. Unlike the active duty TRICARE Dental Program (TDP), there is no government

subsidy for retiree premiums. This is a significant dissatisfier for retired beneficiaries. Dental care is integral to a beneficiary's overall health status. Dental disease left untreated can lead to more serious health consequences and should not be excluded from a comprehensive medical care program. While the program is clearly successful, participation could be greatly enhanced by offering the Premium Conversion benefit to offset the high costs of this program.

MOAA strongly supports enactment of this legislation to correct this significant inequity in the tax code affecting the military. Rising health care costs affect all federal employees, civilian or uniformed, active or retired, and this proposal is essential to ensure all are provided similar relief.

Our hope is that the precedent set in 2000 for currently serving federal civilian employees will pave the way for similar treatment for all military and federal personnel.

Mrs. DAVIS OF VIRGINIA. Thank you, Ms. Schwartz.

And finally, last, but not least, I would like to welcome William Young, president of the National Association of Letter Carriers. I want to thank you for being with us today. And you are on.

Mr. YOUNG. Thank you very much, Chairwoman Davis, for this opportunity to testify before the Civil Service and Agency Organization Subcommittee. I would like to mention that appearing with me today is our director of retirees, Don Southern. I have two of my national trustees here, Randy Keller and Danny Rupp. And last, but not least, I have the president emeritus of the National Association of Letter Carriers, Vincent R. Sombrotto, who is here because he has a personal stake as a retiree. This legislation would affect him personally, and he is over here to make sure that I do not say anything to mess it up for him. [Laughter.]

I am here representing the nearly 305,000 members of the National Association of Letter Carriers. One of the great strengths of our organization is that a large number of our retirees, some 86,000, are also members of our union. At the outset, I would like to thank you, Madam Chair, for your leadership on another issue, protecting the prescription drug benefits of retirees enrolled in the Federal Employees Health Benefits Program. As you are quoted as saying in this morning's Washington Post, "This is an issue of the Federal Government leading by example." I could not agree with you more. And that is why I am here with you today to support premium conversion for retirees, because this, too, is an issue where the Federal Government can lead by example.

Most of our retired members, some 63,000, in fact, are also enrolled in the NALC's Health Benefit Plan, which provides a comprehensive package of health benefit insurance. As you know, NALC HBP is part of the Federal Employees Health Benefits Program.

In October 2000, premium conversion for Federal employees went into effect, enabling them to take advantage of a benefit that was already available to active letter carriers. The NALC takes great pride in having been a leader in establishing premium conversion within the Federal community. Thanks to the collective bargaining process in place for postal employees, we were able to establish premium conversion for our active members nearly a decade before it became available to the rest of the Federal work force.

Over that time, this bargained for contractual provision has saved active letter carriers throughout the country millions of dollars. I would like to commend you, Madam Chair, as well as Chairman Tom Davis and Senator John Warner for leading the effort to expand this benefit to include retirees. H.R. 1231, which has more than 280 cosponsors, will allow Federal civilian, military, and postal retirees to pay health insurance premiums on a pre-tax basis. This will provide significant out of pocket savings to these individuals.

As a general rule, letter carriers are a healthy group. The physical demands of delivering the Nation's mail inherently supports a healthy lifestyle. At the same time, a full career of walking the streets and battling the elements every day also presents our retirees with some unique and very physical challenges. Thank goodness our members can rely on a comprehensive and affordable

health plan to take care of their needs during their hard-earned retirement.

Like many of the Nation's retirees, our members often confront some difficult financial decisions. In addition, as Federal retirees, many of our members are faced with obstacles unique to the Federal and postal community such as the Windfall Elimination Provision and the Government Offset Provision which deprive Civil Service retirees of earned benefits. That makes it even more difficult for them when it comes time to pay for health insurance premiums.

To give you an idea of how helpful H.R. 1231 would be to our retired members, consider the case of a new annuitant with 30 years of service under CSRS. That annuitant will qualify for an annual annuity of approximately $24,000 a year, which is worth $20,400 after Federal taxes at the 15 percent tax bracket. If the annuitant is a union member and is enrolled in the NALC health plan, he or she must pay premiums worth more than 10 percent of their after-tax annuity income, some $2,300 a year, for family coverage. This proposal would save that retired letter carrier $345 each and every year. Now that may not sound like a lot, but to people who must live on a modest fixed income in the face of escalating health care costs and rising premiums, such savings are not insignificant.

Premium conversion has been a win-win for active letter carriers, both in demonstrating the value of collective bargaining which established it and for the resulting savings which have enabled letter carriers to pump millions of dollars back into the economy. We are grateful that you, Chairwoman Davis, recognize the importance of expanding premium conversion to include all Federal retirees. We look forward to working with you, Ranking Member Davis, and the members of this subcommittee to see that it becomes law. Thank you very much.

[The prepared statement of Mr. Young follows:]

Testimony of William H. Young
President of the National Association of Letter Carriers
Before the Subcommittee on Civil Service and Agency Reorganization
July 9, 2003

Thank you Chairwoman Davis for this opportunity to testify before the Civil Service and Agency Organization Subcommittee. I am here representing the nearly 305,000 members of the National Association of Letter Carriers.

One of the great strengths of our organization is that a large number of our retirees, some 86,000, are also members of our union. Most of our retired members – some 63,000 in fact – are also enrolled in the NALC's Health Benefit Plan, which provides a comprehensive package of health insurance benefits. As you know the NALC HBP is offered as part of the Federal Employees Health Benefit Program.

In October of 2000, premium conversion for federal employees went into effect, enabling them to take advantage of a benefit that was already available to active letter carriers. The NALC takes great pride in having been a leader in establishing

premium conversion within the federal community. Thanks to the collective bargaining process in place for postal employees, we were able to establish premium conversion for our active members nearly a decade before it became available to the rest of the federal workforce.

Over that time, this bargained for contractual provision, has saved active letter carriers throughout the country millions of dollars. I would like to commend you madam chair, as well as Chairman Tom Davis and Senator John Warner for leading the effort to expand this benefit to include retirees. H.R. 1231, which has more than 250 cosponsors will allow federal civilian, military and postal retirees to pay health insurance premiums on a pretax basis will provide significant out of pocket savings to these individuals.

As a general rule, letter carriers are a healthy group. The physical demands of

delivering the nation's mail inherently supports a healthy life-style. At the same time, a full career of walking the streets and battling the elements every day also presents our retirees with some unique, and very real physical challenges. Thank goodness our members can rely on a comprehensive and affordable health plan to take care of their needs during a hard-earned retirement.

Like many of our nations' retirees, our members often confront some difficult financial decisions. In addition, as federal retirees, many of our members are also faced with obstacles unique to the federal and postal community such as the Windfall Elimination Provision and the Government Pension Offset which deprive civil service retirees of earned benefits. That makes it even more difficult for them when it comes time to pay for their health insurance premiums.

To give you an idea of how helpful your proposal will be to our retired members,

consider the case of a new annuitant with 30 years of service under CSRS. That annuitant will qualify for an annual annuity of approximately $24,000 annually, which is worth about $20,400 after federal taxes at the 15 percent income tax bracket. If the annuitant is a union member and is enrolled in the NALC's health plan, he or she must pay premiums worth more than 10 percent of their after-tax annuity income (some $2,300) for family coverage. Your proposal would save that retired carrier $345 each and every year. That may not sound like a lot, but to people who must live on a modest fixed income in the face of escalating health care costs and rising premiums, such savings are not insignificant.

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recognize the importance of expanding premium conversion to include all federal retirees. We look forward to working with you, Ranking Member Davis and the members of this subcommittee to see that it becomes law.

Mrs. DAVIS OF VIRGINIA. Thank you, Mr. Young. And thank you to all of our panelists.

I would like to recognize my colleague from Maryland who has joined us, Mr. Van Hollen, to see if you have an opening statement you would like to make.

Mr. VAN HOLLEN. Just a very short remark, thank you, Madam Chairwoman. Let me thank the witnesses for their testimony. I want to thank you, Madam Chairwoman, for your leadership on this important issue which, as we heard from the testimony of Mr. Young, is very important to retired Federal employees. I represent an area, the Eighth Congressional District in Maryland, that has lots of current Federal employees and lots of retired Federal employees, and I can tell you this is something I hear about whenever I talk to them. You are right, it may not be a huge amount, but for people who are retired on fixed incomes it can mean quite a lot. So I want to thank you, Madam Chairwoman, and I also want to thank the chairman of the full committee, Congressman Tom Davis, for his leadership on this issue. I am proud to be a cosponsor of this legislation and I look forward to its hopefully speedy passage.

I would also like to say I want to thank you and the chairwoman of the committee for your quick leadership: I was pleased to join with you in this effort to make sure that the bill we just passed with respect to prescription drug coverage for people on Medicare did not inadvertently hurt our Federal retirees. We may have big differences on whether or not we thought the bill was otherwise a good idea, but, clearly, we all agreed on the fact that whatever the merits of the underlying bill, we did not want it to harm Federal employees. And so I appreciate the bipartisan consensus on that. Thank you, Madam Chairwoman.

Mrs. DAVIS OF VIRGINIA. Thank you, Mr. Van Hollen. And I want to thank you for joining in and supporting our Federal retirees and our active military and military retirees.

I am going to start with a few questions, if you will put me on a timer for 5 minutes, then I will go to you, Mr. Van Hollen.

I do not think we are going to be able to change the IRS' mind about premium conversion for retirees unless we enact this legislation. I have to say that the current tax policy is just too hit and miss to make sense to me. I do not understand it, but I am not an accountant either. The law says that if an employer sets up a cafeteria plan, then health insurance premiums can be pre-tax. But if the same employer does not want to go to the administrative expense of setting up the cafeteria plan, then the same health insurance premiums are not pre-tax. And then when a person retires, as you pointed out in your testimony, those same health insurance premiums are never pre-tax. And if a person is not employed and has to pay for health insurance out of his or her own pocket, that is not pre-tax either. The situation cannot possibly make sense to taxpayers and, as I said, it does not make sense to me. I think it is time for a change in this system and I do not see any reason why we should not start with our Federal civilian and military retirees.

With the rapidly growing cost of health care premiums, would you not say that Federal civilian and military retirees as a group are facing an uphill battle in being able to afford their health care

needs? Anybody want to comment on that? I think you all probably did in your testimony. It seemed to me, and correct me if I am wrong, but that your increase in your COLA was less than the cost of the increase in the health care; was that about right?

Mr. FALLIS. Just about the same. If you take the average COLA for last year, it is $26 a month. And plans like the Blue Cross/Blue Shield's standard option was I believe $22.52 a month.

Mrs. DAVIS OF VIRGINIA. So you netted about $3.50 a month increase?

Mr. FALLIS. That is right.

Mrs. DAVIS OF VIRGINIA. Do you have any examples of anything that you brought with you that your members would like to share from each of your organizations, anything to put in the record to help here?

Mr. FALLIS. I think our membership in NARFE, of course, is speaking with one voice on this. No member of NARFE has premium conversion. We think it is terribly unfair. Quite frankly, I believe with a little compassion and understanding, the IRS could have come up with a different solution here. I do not really truly see our retirement plan is what they call a "qualified plan." They indicate "qualified plans" are not included in this. But if you take a situation where in a qualified plan a 40 year-old worker leaves employment in the private sector where there is a retirement fund, that employee is allowed to take not only his or her contributions, but those that are made by the firm or the company or whatever. That is quite different in the Federal Government. When one leaves Government service he or she is not allowed to take anything other than his or her own contributions. And so I think that alone makes it different from what we would call a "qualified plan." So, yes, I believe that it could be done; probably will not be. But I think the IRS could have given us a better decision and have avoided all of this.

Mrs. DAVIS OF VIRGINIA. I think that would have been the easier way to go. But, quite frankly, I do not think it is going to be the way. Unless we do the legislation, I do not think it is going to happen.

Ms. SCHWARTZ. Madam Chair, may I add one other.

Mrs. DAVIS OF VIRGINIA. Certainly.

Ms. SCHWARTZ. There is also a very deserving group of beneficiaries within DOD, and those are our Guardsmen and Reservists who do so much for our Nation. And within the TRICARE program, their dental premiums are not subsidized by the Federal Government, just as the retiree premiums are not. And there has been a real problem with dental readiness for the Guardsmen and Reservists because it is very expensive for them to buy into this program. If we were able to get the premium conversion benefit for our Guardsmen and Reservists, it would give a significant tax break for them and maybe make them better able to afford the program. Many Guardsmen and Reservists could not deploy because their dental readiness was not adequate. So I think that is a group that really would benefit from this, and we appreciate the subcommittee helping them out as well.

Mrs. DAVIS OF VIRGINIA. Certainly, our Guardsmen and Reservists have been very active in the last year. They are doing yeoman's work and we could not be doing it without them.

Ms. SCHWARTZ. Yes. Right. Thank you.

Mrs. DAVIS OF VIRGINIA. Mr. Young.

Mr. YOUNG. Madam Chairwoman, I bring a rather unique view to this because, as I said in my testimony, all of the active members that I represent, which is the majority of the 305,000 number, already have pre-tax because the employer that we work for, the U.S. Postal Service, was able to administer a cafeteria plan. To us, to the letter carriers, it is a basic issue of fairness. It is just not fair the way it is set up right now. What it boils down to to me is that one group of employees I represent, the actives, they have a voice. At the bargaining table, I am able, or whoever the president is at the time, is able to speak on their behalf. What has happened to our retirees is, to be honest with you, they have no voice. And you have moved way up in their charts, I can tell you that, and the other people that support this, and I mean that sincerely, because for all practical purposes you are their voice, their only voice.

And so I hope that the issue of fairness surfaces here and that people understand. Like I said, for most of the people I represent, we have it. But it is not fair, it really is not. And it is even more unfair when you add into the equation that the people who can afford to take the hit the least are the very ones that are being asked to absorb it. And so I would ask the committee to keep their mind on the issue of fairness as they deal with this, because the way it is set up it is just not right, it is not fair.

Mrs. DAVIS OF VIRGINIA. Thank you, Mr. Young.

I am going to yield to my colleague from Maryland, Mr. Van Hollen, for questions.

Mr. VAN HOLLEN. Thank you, Madam Chairwoman. I do not have a lot to add. I think that is a very important point you raised, Mr. Young, with respect to fairness. I am ready to vote on this. My only question is when. I do not know when we are scheduled to vote on this as a subcommittee or a full committee. But, really, I do not have any questions. As I said, I am a cosponsor of this bill. It is an issue I have talked about on many occasions within my congressional district. So I appreciate your all being here today. And, again, thank you for your leadership.

Mrs. DAVIS OF VIRGINIA. Mr. Van Hollen, you are going to get your chance to vote on it next Wednesday, I believe. It is the 16th, whatever day that falls on.

Mr. VAN HOLLEN. Terrific. That is great.

Mrs. DAVIS OF VIRGINIA. We will be having a mark-up. We are having a hearing that day and I believe the markup is going to be right after the hearing. So I would certainly appreciate it if you were there and can vote.

Mr. VAN HOLLEN. All right. Thank you.

Mrs. DAVIS OF VIRGINIA. But we do plan on bringing it up for a markup next Wednesday. And then I would assume our chairman of the full committee, Mr. Davis, would bring it to the full committee very quickly. And then, of course, as you know, it would prob-

ably have to go over to Ways and Means after that. And that is where you are going to have to work. [Laughter.]

Where we are going to have to work. But we certainly have the cosponsors, the people who are behind you on it. I mean, 283 cosponsors is more than what we need to pass it on the House floor. So we just have to get it out of the committee and get it out there to the floor.

I do not have any further questions. But I do appreciate your taking the time to come and get all this on the record so that we can take the bill forward and try and do what I believe is fair and equitable to all people. I think the biggest argument for it, Mr. Fallis, and I think you are the one who said it, is think of the poor man or woman who is sitting here an active employee right now, they retire and they get a big hit in their paycheck. It is like they get a demotion.

Mr. FALLIS. Retirees are fast becoming known as the stepchildren of the Federal community.

Mrs. DAVIS OF VIRGINIA. Well, we appreciate all the service that our retirees have given us. And I appreciate all the service that our active men and women in the military are giving us right now. My heart is with them. Thank you, Mr. Young. My sister-in-law was a postmaster for many years. I know that is not a letter carrier, but——

Mr. YOUNG. Close enough.

Mrs. DAVIS OF VIRGINIA. Close enough, yes. Thank you all for coming.

And with that, the hearing is adjourned.

[Whereupon, at 3 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

[The prepared statement of Hon. Danny K. Davis follows:]

**STATEMENT OF THE HONORABLE DANNY K. DAVIS
AT THE SUBCOMMITTEE ON CIVIL SERVICE
AND AGENCY ORGANIZATION
HEARING ON**

H.R. 1231, To amend the IRS Code of 1986 to allow Federal civilian and military retirees to pay health insurance premiums on a pretax basis and to allow a deduction for TRICARE supplemental premiums.

Wednesday, July 9, 2003

In October 2001, President Clinton directed the Office of Personnel Management (OPM) to implement a health insurance premium conversion plan for executive branch employees participating in the Federal employee Health Benefits Program (FEHBP).

Under the plan, employees' FEHB premium withholdings are treated as a pre-tax salary deduction. Because premium conversion lowers employees' taxable income, it reduces their tax burden. The reduction in taxable income reduces the base for federal income tax, Social Security and Medicare taxes, and, in most states and localities, state and local tax based on income.

In January 2001, the premium conversion benefit was extended to legislative branch employees. H.R. 1231 would extend the benefit to federal civilian annuitants and the Tricare premiums paid by members of former members of the Uniformed Services.

As a cosponsor of the legislation, I am pleased to see that the Subcommittee intends to markup the legislation next week.

I look forward to hearing the testimony of today's witnesses.

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