AMERICANS FOR TaxFairness

ILL-DEFINED BENEFIT: CORPORATIONS PUTTING TAX-CUT SAVINGS INTO THEIR PENSION PLANS ARE MOSTLY HELPING THEMSELVES, NOT THEIR WORKERS

Some corporations are using part of their corporate-tax-cut savings to beef up their pension plans. While this may seem like an example of companies sharing their tax-cut bounty with employees, increasing pension-plan funding most immediately benefits employers. Contributions made last year and for most of 2018 will save corporations taxes, provide a good guaranteed return on investment, and even facilitate shutting down their pensions altogether.

More fundamentally, remedying underfunded pension plans is simply what the law requires, and it is effectively paying back to the plans what workers had earned, as pensions are essentially deferred wages.

PENSIONS: DEFINING A DEFINED BENEFIT PLAN
Pensions are "defined benefit" retirement plans, meaning they pay retirees a fixed amount each month for as long as they live. This contrasts with "defined contribution" plans like 401(k)s, in which employers establish and often contribute to a self-directed retirement scheme but offer no guaranteed payments. This shifts the risk for retirement security from the company to the worker, who now is responsible for making investment decisions that they may be ill-equipped to make and whose investments will face much higher fees.

Defined benefit pensions are increasingly rare. Only one-fifth of Fortune 500 companies offered pensions to new employees in 2015, down from nearly 60% in 1998. Only 18% of private-sector workers had access to a defined-benefit plan in March 2017, versus 62% that could enroll in a defined-contribution plan.

PLOUGHING TAX SAVINGS INTO MORE TAX SAVINGS
Employers' contributions to their pension plans are tax deductible. The value of a deduction depends on the tax rate: the higher the rate, the more valuable the deduction. The new tax law cut the corporate tax rate from 35% to 21%, effective in 2018. So, pension contributions made under the old 2017 rate are worth more than those made under the new one. But corporations looking for the higher deduction aren't bound by the calendar: IRS rules allow them to make contributions in 2018 (generally up until mid-September) and still claim a 35% deduction. All the companies that announced pension contributions after passage of the tax law had a strong incentive to lock in that higher deduction.

The $1 billion pension contribution Raytheon made late in 2017, for instance, will save it $350 million in taxes at the old 35% rate, rather than $210 million at the new 21% rate later this year. Assuming Pfizer makes its announced half billion dollar pension contribution before September 15, it will pocket $175 million in tax savings, rather than $105 million.

GUARANTEED RETURN: AVOIDING PENSION INSURANCE FEES

Corporate pensions are insured by a federal agency, the Pension Benefit Guarantee Corporation (PBGC), which steps in and pays benefits if a company's plan fails. The PBGC is funded through fees it charges pension plans. One of those fees penalizes firms for not "fully funding" their pension plan, which is defined as having enough money in the plan to cover all promised payments to current and future retirees. The more underfunded a company's plan, the more it's charged in fees. In 2018, companies are hit with a penalty of $38 for each $1,000 of underfunding, although the penalty is capped at $523 multiplied by the number of plan participants.

Just like paying off a high-interest credit-card debt is often the best investment a consumer can make with any spare cash, bringing a pension closer to full funding and thereby avoiding the PBGC penalty can be a savvy investment for corporations with underfunded pensions. They can earn a risk-free return this year of 3.8% ($38/$1000), a pretty good rate these days. That rate will go up to 4% by 2020, when the PBGC penalty hits $40 per $1,000 of underfunding.

Some of the companies announcing tax-cut-funded pension contributions have recently been most guilty of shortchanging their pension plans. For example, UPS, announced it will contribute $5 billion to its $10.2 billion underfunded pension plans. Lockheed Martin, whose plans are underfunded by $15 billion, will also contribute $5 billion. FedEx is pumping in $1.5 billion to a plan that is underfunded by $3.6 billion. All these contributions should save these companies substantial sums in PBGC penalty fees assessed against underfunded pension plans.

RETIRING FROM THE PENSION BUSINESS ALTOGETHER

The rapidly dwindling number of defined benefit pensions shows how eager companies are to shed their retirement responsibilities to workers. They can terminate pension plans by essentially transferring the plan to an insurance company, or in some cases offering workers a lump-sum payment. But they are only allowed to terminate pensions that are fully funded.

This funding requirement provides perhaps the biggest incentive for companies to use their tax-cut dollars to shore up their pension plans.

But what's good for corporations hoping to shed their pensions is bad for workers. Insurance company annuities, unlike the pensions they replace, are not guaranteed by the PBGC and are thus less secure. As for lump-sum payments, both outside observers and pension advocates agree that in most cases, it's a bad deal for retirees, since they often wind up using the money for daily needs and end up with no retirement savings at all.