Notice 2015-16

ALSTON&BIRD LLP

One Atlantic Center
1201 West Peachtree Street
Atlanta, GA 30309-3424

404-881-7000
Fax: 404-253-8598
www.alston.com

Mr. Ashley Gillihan | Direct Dial: 404-881-7390 | Email: ashley.gillihan@alston.com

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CC:PA:LPD:PR (Notice 2015-16)
Room 5203
Internal Revenue Service
PO Box 7604
Ben Franklin Station
Washington, DC 20044

Submitted electronically to Notice.comments@irscounsel.treas.gov

Re: Notice 2015-16

Dear Ladies and Gentlemen:

We are pleased to provide these comments, submitted at the request of several of our clients, relating to Notice 2015-16 (the "Notice"). The Notice addresses possible approaches the Treasury Department (Treasury) and the Internal Revenue Service (IRS) are considering adopting with respect to the excise tax under section 4980I of the Internal Revenue Code (the "Code"). The opportunity to provide formal comments in advance of rule-making is particularly appreciated given the potential impact the tax will have on many, if not most, employer-sponsored plans and plan participants, and the new administrative burdens the tax will impose on employers, other plan sponsors, and insurers. These burdens will ultimately be borne by employees, their spouses, and dependents.

This tax will have a far greater impact than the colloquial name "Cadillac plan tax" suggests and may severely disrupt the employment-based health market, which for decades has been the source of health coverage for a majority of non-elderly Americans. The potential impact of this tax is exacerbated by a number of factors, including the plans that are considered to be "applicable coverage" subject to the tax, the dollar thresholds, the indexing mechanism, the high rate of the tax (40%), and non-deductibility. All these factors favor repeal or, at the least, significant modification. In the meantime, in order to prevent further unintended consequences that will ultimately impact employees and retirees and their spouses and dependents, the Treasury and IRS should use their regulatory authority to provide flexibility in calculating the tax and reducing unnecessary burdens. Detailed discussion follows, including specific recommendations on selected issues

General Comments Regarding the Notice

The section 4980I excise tax was adopted as one of many revenue raisers supporting the provisions of the Affordable Care Act (ACA). In addition to meeting revenue objectives, the 4980I excise tax was designed in part to limit the tax subsidy for health coverage and to help control the control of health care costs. It proved at the time to be a more politically viable option compared to limiting the Code section 106 exclusion for employer provided health care. The tax was intended to affect what were purported to be very generous plans. During consideration of the bill that became the ACA, the excise tax was referred to as the tax on "gold plated" health plans and subsequently became commonly known as the "Cadillac" plan tax.

While the "Cadillac" plan moniker continues to be used for sake of convenience, recent analysis indicates that this tax will affect many more plans than those that could possibly be considered "gold-plated" or "Cadillac" and for reasons other than the generosity of the plan. For example, a preliminary analysis shows that 48% of employers are likely to trigger the tax in 2018, and 82% could hit the threshold by 2023.[1] The same report found that 73% of companies are very or somewhat concerned that they will be adversely affected by the tax, and 62% say it will have a moderate or greater impact on their health care strategy in 2015 and 2016. Another recent study found that the impact of the tax was likely to be based on factors other than plan richness, such as geography.[2] The economic realities of the market-place mean that the ultimate impact of the tax will fall on employees, retirees, and their spouses and dependents in the form of less health coverage, no health coverage, or increased cost share for similar coverage to offset any tax that may be directly or indirectly owed by the coverage provider. This impact is already being felt, well in advance of the 2018 effective date, as employers plan ahead.

From an administrative perspective, the excise tax is formidable, involving new information gathering requirements and detailed calculations. To some extent, section 4980I may build on existing provisions, such as W-2 reporting and COBRA cost. However, as acknowledged in the Notice, new requirements and differences from existing rules will be appropriate and required. The burden on the Treasury and IRS is also substantial, not only requiring new detailed rule-making, but also considerable enforcement activity.

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[1] "2014 Health Care Changes Ahead Survey Report", Towers Watson, September 2014. http://www.towerswatson.com/en-US/Press/2014/09/nearly-half-us-employers-to-hit-health-care-cadillac-tax-in-2018-with-82-percent-by-2023

[2] The report may be found at http://www.nea.org/assets/docs/Milliman--What_Does_the_Excise_Tax_Actually_Tax.pdf

Given this reality, we believe it is imperative that Treasury and IRS utilize their administrative authority so as to minimize disruption in the employment-based health market, avoid unintended consequences, and minimize administrative burdens. The authority granted to the Treasury and IRS in section 4980I(g) to "prescribe such regulations as may be necessary to carry out this section" should be utilized with these goals in mind.

Arrangements that Are Not Group Health Plans Are Not Subject to the Excise Tax

Code Section 4980I(a)(1) imposes an excise tax on the excess coverage benefit of only "applicable employer sponsored coverage." It does not impose an excise tax on any coverage that is not "applicable employer sponsored coverage." Section 4980I(d)(1) describes applicable employer sponsored coverage as, subject to specified exemptions, "coverage under any *group health plan* made available to the employee by an employer which is excludable from the employee's gross income under section 106, or would be so excludable if it were employer-provided coverage (within the meaning of such section 106)" (emphasis supplied). Thus, there are two elements to the applicable employer sponsored coverage definition: (i) the coverage must be provided under a *group health plan* and the (ii) coverage must be excluded from income under Code Section 106 (or would be so, if employer-provided, i.e., pre-tax). Code Section 4980I(f)(4) defines a group health plan for purposes of 4980I by reference to the definition of group health plan in Code Section 5000(b)(1). Code Section 5000(b)(1) defines a group health plan as an arrangement that provides health care that is "of or contributed to by, an employer".

Thus, it is clear that Congress did NOT intend to impose the excise tax on arrangements that are not "group health plans." Two such arrangements are addressed below: health savings accounts (HSAs) and voluntary arrangements providing supplemental excepted benefits.

1. **The guidance should clarify that employer contributions to an HSA are not included in the excise tax determination unless the HSA is a group health plan.**

The Notice indicates that an employer's contributions (including employee pre-tax salary reduction contributions) to an HSA will be categorically included in the excise tax determination. The Notice also indicates that after-tax contributions to an HSA will be excluded; we support this treatment, as there is no basis in the statute for including after-tax contributions to an HSA. Our comment relates to an employer's contributions to an HSA.

In support of including employer contributions to an HSA in the excise calculation without any apparent limitation, the Notice references Code Sections 4980I(c)(2)(B) and 4980I(d)(2)(C). Neither these sections nor the statute support including an employer's

contributions to an HSA in all instances. The literal language of the statute, including the above mentioned sections, *only* support the inclusion of contributions to HSAs in the excise tax calculation if the HSAs are group health plans. HSAs qualify as group health plans only to the extent that they fail to satisfy the safe harbor prescribed by the Department of Labor (DOL) in Field Assistance Bulletin (FAB) 2004-1 and 2006-2. Consequently, we request that the regulations clarify that employer contributions to an HSA are included in the excess benefit determination only if the HSA is a group health plan in accordance with the Department of Labor's guidance in FAB 2004-1 and 2006-2.

HSAs do not qualify as applicable employer sponsored coverage.

Although pre-tax contributions to an HSA are excludable from gross income under Code Section 106(d), HSAs are typically not considered "group health plans," even when the employer contributes to them. HSAs, which are established and maintained primarily in accordance with Code Section 223 (not Code Section 5000(b)(1)), are tax advantaged trust or custodial accounts established and maintained *by individuals* with a bank or approved non-bank trustee or custodian. The HSA belongs to the individual—not the employer—even when the employer contributes to the HSA. Contributions may be made to an individual's HSA on a pre-tax basis (including pre-tax salary reductions made through a cafeteria plan) or they may be made on a tax deductible based by the accountholder or others on behalf of the accountholder. In all cases, the contributions to an individual's HSA are non-forfeitable. If an employer makes contributions to an employee's HSA, and the employee terminates employment, the employee is able to keep those contributions for future use; the employer cannot recoup its contributions. The individual accountholder dictates the manner in which the funds in the HSA will be used-- not the employer who contributed to the HSA—and the funds in the HSA may be used for both medical and non-medical expenses. In fact, Code Section 223 permits an HSA accountholder to withdraw funds from the HSA for any purpose, subject to income tax and an additional 20-percent tax. The additional tax does not apply once the accountholder turns age 65 or becomes disabled[3]. Thus, the Code recognizes that HSAs may be used for other purposes than medical benefits, including other post-retirement needs. To date IRS and Treasury have not issued any formal guidance addressing whether an HSA is a "group health plan" under Code Section 5000; however, the "tri-agencies,"[4] including the IRS and Treasury, have clearly indicated their position that HSAs generally are not group health plans. For example, the tri-agencies included the following statement in the preamble to the regulations on prohibitions against lifetime and annual dollar limits under the Affordable Care Act (ACA):

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[3] Contrast this with the tax treatment of group health plans, which will lose the exclusion under Code Section 105, even for medical expenses, if the plan permits payments for other than medical expenses. See 26 C.F.R. 1.105-2.

[4] "Tri-agencies" refers to the Department of Treasury (including the IRS), the Department of Labor, and the Department of Health and Human Services. These agencies share jurisdiction over certain requirements relating to group health plans.

> Both MSAs and HSAs generally are not treated as group health plans because the amounts available under the plans are available for both medical and nonmedical expenses.[5]

Notwithstanding the general treatment of HSAs (and MSAs), it is possible for HSAs to qualify as "group health plans." The DOL has issued guidance in both 2004 and 2006 (FABs 2004-1 and 2006-2) describing situations in which an employer could cause the HSA to become a group plan subject to ERISA's group plan requirements. For example, an HSA would qualify as a group health plan under ERISA if an employer exerts control over the investments offered through the HSA or the employer communicates the HSA to employees as an "employee benefit plan" maintained by the employer—just to name a few. Under no circumstance, however, does an HSA qualify as a group health plan under the DOL's guidance solely because the employer made contributions to the HSA. Also, the tri-agencies, including the IRS and Treasury, have noted that the special enrollment rules, which are only applicable to "group health plans" (as defined in Code Section 5000 for IRS and Treasury purposes), do not apply to HSAs unless and to the extent the HSA is a group plan under ERISA's rules.[6] Thus, the IRS and Treasury have followed the DOL's lead when making a determination whether an HSA is a group health plan or not.[7]

Neither the language in section 4980I(c)(2)(B) nor section 4980I(d)(2)(C) extend the definition of applicable employer sponsored coverage to HSAs that are not group health plans.

Section 4980I(c)(2)(B) and Section 4980I(d)(2)(C) address, respectively, which entity has liability to pay any tax due under Section 4980I and how cost is determined for purposes of the excise tax. Section 4980I(c)(1) provides that the excise tax is paid by the "applicable coverage provider", which term is defined in Section 4980I(c)(2) based on the type of applicable employer-sponsored coverage. Section 4980I(c)(2)(B) states the following with respect to MSAs and HSAs:

> **If the applicable employer-sponsored coverage** [group health plan coverage] consists of coverage under an arrangement under which the employer makes

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[5] 75 Fed Reg 37188, at 37190 (June 28, 2010). Similar treatment has been accorded for purposes of HIPAA Administrative Simplification and COBRA.

[6] 69 Fed. Reg. 78719, 78734 (Dec. 30, 2004).

[7] Likewise, the Department of Health and Human Services has also followed the DOL's lead when applying HIPAA's privacy rules for group health plans. See ABA Joint Committee on Employee Benefits, Questions for the Department of Health and Human Services, Q/A-5
(May 17, 2005), available at
http://www.americanbar.org/content/dam/aba/migrated/jceb/2005/qa05hhs.authcheckdam.pdf (as visited Aug. 9,
2013)

> contributions described in subsection (b) [contributions to MSAs] or (d) [contributions to HSAs] of section 106, the employer. (emphasis added)

The bolded language makes it clear that this section is relevant only once it has been determined that the MSA or HSA is "applicable employer-sponsored coverage," which is only possible under Section 4980I(d)(1) if the arrangement is a group health plan. If the HSA is in fact applicable employer sponsored coverage, then Section 4980I(c)(2)(B) specifies that the employer is the "coverage provider" for purposes of any excise tax liability. The section does not in any way, however, serve to define what is considered "applicable employer-sponsored coverage" in the first place or expand it to HSAs that are NOT group health plans. Any other reading circumvents the clear statutory provisions.

Section 4980I(d)(2)(C) provides instructions on how to calculate the value of applicable employer sponsored coverage consisting of HSA contributions. More specifically, Section 4980I(d)(2)(C) states the following with respect to coverage under an HSA or MSA:

> **In the case of applicable employer-sponsored coverage** [group health plan coverage] consisting of coverage under an arrangement under which the employer makes contributions described in subsection (b) [contributions to MSAs] or (d) [contributions to HSAs] of section 106, the cost of the coverage shall be equal to the amount of the employer contributions under the arrangement. (emphasis added)

Similar to 4980I(d)(1), the bolded language above from 4980I(d)(2)(C) makes it clear—at a minimum-- that this section applies only after it has been determined that the arrangement is applicable employer-sponsored coverage, which is limited to group health plan coverage.

In terms of whether Congress could have intended a more expansive application, we believe two additional interpretations of 4980I(d)(2)(C) exist. One plausible interpretation of this rather unclear language is that it refers to coverage *under a group health plan* (e.g., a high deductible health plan or HDHP) that consists of employer HSA contributions. The only way that the contributions to the HSA could be considered *coverage under the group health plan* is if the HSA were integrated into the group health plan, which would make the HSA a group arrangement under the DOL's rules.[8] The other reasonable interpretation of this provision, which we believe is the most appropriate interpretation, is that this language is referring to the portion of an HSA that is

[8] In fact, if the HSA is not a group health plan integrated into the employer's major medical plan, making HSA contributions through that group health plan would violate ERISA's exclusive benefit rule.

"applicable employer- sponsored coverage" (i.e., a group health plan) that is attributable to an employer's contributions and not any contributions made by the accountholder-employee, such as on an after-tax basis.[9] In either case, Congress is clearly not referencing an HSA that is not a group health plan. Moreover, to conclude that Congress meant anything other than one of the two interpretations set forth above would undermine and change the meaning of Code Sections 4980I(a)(1) and (d)(1), both of which limit the tax to the excess benefit of "applicable employer sponsored coverage," which is coverage through a group health plan.

We also note that there is some ambiguity as to whether "employer contributions" in this context should include salary reduction contributions made by employees to an HSA (assuming the HSA is a group health plan). In the context of HSAs, Congress refers only to "employer" contributions in Code Section 4980I. While it is widely accepted that references to "employer" contributions in the Code also include a reference to pre-tax employee salary reductions, we do not believe that Congress intended to include them in the term "employer contributions." In Code Section 4980I(d)(2)(B), Congress made a clear distinction between "employer contributions" and employee pre-tax salary reductions, which clearly indicates that Congress intended to treat them separately. In other words, had Congress intended for the term "employer contributions" to include "employee pre-tax salary reductions," they clearly would have said so, as evidenced by their language in 4980I(d)(2)(B). Consequently, we recommend that IRS and Treasury exclude from the excise tax calculation an employee's pre-tax salary reduction contributions to an HSA that constitutes applicable employer sponsored coverage to ensure consistency with clear Congressional intent. Further, given the tax structure governing HSAs, if salary reduction HSA contributions are included in the excise tax contribution, employees may obtain a similar tax benefit by making the contributions directly the HSA on a pre-tax basis, and then deducting the contribution in accordance with Section 223. This approach would be more cumbersome for employees, and some employees might forgo the HSA contribution in this situation, leaving the employee potentially further exposed to medical expenses. We recommend that individuals should not be required to go through additional administrative hoops to obtain similar tax benefits and that salary reduction contributions to HSAs (assuming the HSA is a group health plan) should be excluded from the tax.

2. **The guidance should clarify that voluntary supplemental excepted benefit coverage is not included in the excise tax calculation (even when funded on a pre-tax basis) unless the arrangement is a group health plan.**

As discussed further above, in order for health coverage to be subject to the excise tax, the coverage must be "applicable employer-sponsored coverage" and therefore, provided under a "group health plan" as defined in Code Section 5000(b)(1). Also as discussed

[9] As noted above, we support the provision in the Notice that would exclude all pre-tax HSA contributions from the tax.

above, arrangements that are not section 5000 group health plans should not be subject to the excise tax, even if paid for on a pre-tax basis.

Further, since enactment of the ACA, the tri-agencies have issued guidance that adopts a new term "employment payment plan." See Notice 2013-54 and related guidance which defines certain types of arrangements for the purchase of individual market coverage which are considered to be group health plans subject to the ACA. Consistent with DOL regulations and the guidance relating to employer-payment plans, arrangements that facilitate the purchase of individual market supplemental policies and that meet DOL requirements regarding voluntary arrangements should not be considered group health plans subject to the tax.

Specifically, under DOL regulations (29 C.F.R. § 2510.3-1(j)), an insurance program offered to employees is not an employer provided benefit covered by ERISA if:

(i). No contributions are made by the employer;

(ii). Employee participation in the program is completely voluntary;

(iii). The employer does not endorse the arrangement, and the employer's role is limited to:

(a) allowing the insurer to publicize the program,
(b) collecting premiums through payroll deductions, and
(c) remitting contributions to the insurer; and

(iv). The employer receives no consideration in connection with the arrangement, other than reasonable compensation for its administrative expenses.

Further, to be considered an employer payment plan subject to the ACA under the employer payment plan guidance,, the arrangement must be both a group health plan under ERISA and provide major medical coverage. We note that this guidance has evolved in an environment where the Agencies have been carefully differentiating between coverage that is group health plan coverage subject to the ACA and coverage that truly should be treated as an excepted benefit (for all ACA purposes). See also 45 CFR Reg. § 148.220(b)(4), which provides post-ACA new criteria for certain supplemental coverage to be considered an excepted benefit in the individual market. We recommend that the same approach be followed for purposes of the excise tax.

Thus, consistent with DOL regulations regarding voluntary arrangements and Notice 2013-54, an arrangement would not be a group health plan subject to the excise tax if the arrangement facilitates the purchase of individual market coverage, meets the requirements in the DOL regulations cited above, and the plan does not provide major medical coverage, i.e., is an excepted benefit. This exclusion should apply regardless of whether the employee contributions are made on a pre- or post-tax basis. This approach

is entirely consistent with the post-ACA guidance relating to application of the ACA to employer payment plans.

Special Consideration Should Be Given to the Impact on Small Employers

Special consideration should be given to the impact of the 4980I excise tax on small employers, generally, employers with no more than 100 employees. While the tax will impose new burdens on all employers that offer health coverage, new legal requirements and the associated technical administrative burdens typically fall hardest on small employers. For example, the excise tax calculations require employers to determine whether there is an excess benefit and, if so, to apportion the tax among the entities responsible for payment. Thus, should an employer have coverage subject to the tax from more than one issuer, the employer will have to calculate which insurer is responsible for how much of the tax. These determinations will be burdensome for all employers, and particularly difficult for small employers.

In adopting rules under the ACA, the Treasury Department has also recognized that this group of employers faces special circumstances. For example, employees with less than 100 employees were provided an additional year of transition relief from the 4980H employer penalties in order to "assist these employers with transitioning into compliance." The current exemption from Form W-2 reporting of the value of health coverage for small employers (fewer than 250 W-2s) is another example.

The 4980I excise tax involves both planning issues (as employers try to design plans so as to avoid the tax) as well as potentially complex calculations (particularly in the event the tax is triggered). It is often difficult for small employers to take on such tasks, including planning ahead, while there is regulatory uncertainty. Often, the practical reality is that small employers find it difficult to plan for a variety of possible outcomes, and must wait until the law is more certain and third parties have developed the necessary systems to address the new legal requirements. As the 4980I tax comes into play, these employers will also be just adjusting to the employer penalty regime and the change in small group size from 50 to 100 employees. Both of these provisions will result in significant changes in benefit offerings for some employers.

Indeed, it is anticipated that insurers will merely charge back the cost of any 4980I excise tax as a premium surcharge for small employers. For many small employers (with between 50 and 100 employees) whose experience has been better than normal and has not previously been pooled because of their prior "large group" status, application of small group rate rules in 2016 (unless further delayed) may result in significant unexpected cost increase and a migration away from offering health coverage to employees. The imposition of an additional punitive excise tax at the same time that rates are rising (due to redefining small group status) will force many small employers to reconsider offering coverage at all. Allowing such employers transition relief until the full impact of the 4980I excise tax on the small group market can be assessed should help

enable such entities to better plan for its impact and prepare employees (where necessary) for the additional potential out of pocket exposure. In many cases plan adjustments (e.g., offering dental or vision coverage as a stand-alone benefit or moving to a high deductible plan but adjusting pre-tax HSA contributions) will enable these employers to budget for and continue to offer quality benefits without excise tax exposure.

Another consideration is trying to provide incentives for smaller employers to continue to maintain coverage. Small employers (less than 50 full-time equivalent employees) are not subject to the so-called pay-or-play penalties under section 4980H. Thus, to the extent that penalties provide a dis-incentive to dropping employer sponsored coverage, that is not a factor for non-applicable large employers (Non-ALEs). Having to deal with 4980I excise tax issues is likely to be one more factor that motivates smaller employers to drop coverage completely.

As the Treasury and IRS develop rules under Section 4980I, special consideration should be given to the burdens on small employers, the extent to which the rules give sufficient time for such employers to transition to compliance, and whether additional transition rules are needed for such employers. We believe that, consistent with prior agency guidance, transition relief should be extended to employers with 100 or fewer employees until the full impact on small employers can be carefully examined. An exception for employers that are not subject to the section 4980H penalties should also be considered in order to minimize disincentives for such employers to offer health coverage. Given the number of employers of this size who currently offer coverage, any possible revenue associated with such an exception is likely to be small.

Health FSAs Funded Solely with Pre-Tax Salary Reduction Contributions Should Not Be Considered in the Excise Tax Determination

As noted earlier in our letter, Congress had several goals in mind with respect to the 4980I excise tax, including but not limited to slowing the growth of health care costs. To accomplish this, the excise tax operates to lower the value of employer provided, tax-free health coverage, which appears to be intended to result in lesser but wiser consumption of health care. As we also discussed in our general comments above, the excise tax is poorly designed to suit these purposes and will have many unintended and unnecessary consequences. Treating health flexible spending accounts as applicable employer sponsored coverage will result in unintended and unnecessary consequences.

Treating coverage under Health FSAs, especially those funded solely with pre-tax salary reductions as applicable employer-sponsored coverage, will not help achieve the goals underlying section 4980I. As a result of the ACA, pre-tax salary reductions for Health FSAs are limited by statute to $2,500 each year (adjusted for inflation). As a result, Health FSAs funded solely with pre-tax salary reductions are too limited in scope to contribute in any significant way towards the growth of health care costs and/or the financing of nationwide health care.

In addition, we have heard from employers that Health FSAs are low hanging fruit that will be at risk of elimination to the extent that employers who maintain Health FSAs will otherwise be subject to the excise tax. If Health FSAs are eliminated by employers, many employees who rely on these arrangements to assist with unreimbursed medical expenses —and many do despite how limited they may be—will now be required to pay for these expenses with out of pocket funds. It is clear then that treating Health FSAs funded solely with pre-tax salary reductions as applicable employer sponsored coverage will exact a *greater* harm on individuals who rely on these arrangements, even though limited in nature, to assist with unreimbursed medical expenses than it will play a role in achieving the goals of 4980I. Consequently, we request the IRS to exercise its regulatory authority to exclude Health FSAs that are funded solely with pre-tax salary reduction contributions.

Again, we appreciate the opportunity to submit comments on these complex issues in Code Section 4980I. If you have any questions or wish to discuss further, please feel free to contact me at 404-881-7390 or ashley.gillihan@alston.com.

Sincerely

Ashley Gillihan, Esq.