



May 15, 2015

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

Re: Section 4980I – Excise Tax on High Cost Employer-Sponsored Health Coverage

Dear Sir or Madam:

This letter is submitted on behalf of ICMA Retirement Corporation (“ICMA-RC”), a non-profit corporation established in 1972 to assist state and local governments and their agencies and instrumentalities in the establishment and maintenance of retirement plans for public sector employees. ICMA-RC offers a full range of retirement and welfare plan administration services to governmental employers, including record keeping, plan sponsor and participant educational services, and access to a range of investment options from which plan sponsors can design their investment line-ups. In furtherance of our mission to lessen the burdens of government by helping public employees build retirement security, ICMA-RC offers state and local governmental employers the opportunity to adopt a VantageCare Retirement Health Savings (“RHS”) Program that is designed to help public sector employees cover the cost of rising medical care expenses in retirement. Although branded as RHS, ICMA-RC makes RHS available as a form of Health Reimbursement Arrangement (“HRA”), as recognized by IRS Notice 2002-45, 2002-28 I.R.B. 93.

ICMA-RC’s RHS clients pre-fund HRA benefits for their retirees by setting aside amounts in trust over their employees’ careers and those amounts generally only become available for medical expense reimbursements upon an employee’s retirement or separation from service. This pre-funding approach is intended to provide retirees with a health benefit that can be used over the retiree’s lifetime and is undertaken in reliance on IRS Notice 2002-45, which allows amounts to be carried over from year to year.

Overview

On February 23, 2015, the Department of Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) released Notice 2015-16 (“the Notice”) in order to initiate and inform the development of regulations necessary to implement the Excise Tax on High Cost Employer-Sponsored Health Coverage, which was added by the Affordable Care Act (“ACA”) through Section 4980I of the Internal Revenue Code (“Code”). Beginning in 2018, Code Section 4980I will impose a forty percent excise tax on the cost of applicable employer-sponsored coverage provided to employees and former employees in excess of a dollar limit set by statute. The Notice provides a general overview of Section 4980I with a particular focus on the definition of applicable coverage, the determination of cost of applicable coverage, and the applicable dollar limit. Further, the Notice invites public comment to inform future proposed regulations under Code Section 4980I. Of particular note to ICMA-RC and its clients, the Notice indicates that future



guidance is expected to clarify that HRAs are applicable coverage for the purpose of determining the excise tax and proposes potential valuation methods for determining the cost attributable to HRAs.

Retiree-only HRAs are particularly prevalent with state and local government employers, who have a long history of providing health benefits to their retirees. We hope that our comments below will help Treasury and IRS better understand the particular challenges Code Section 4980I may present for state and local governments.

ICMA-RC welcomes Treasury and IRS's request for public comment on Section 4980I before issuing proposed regulations and appreciates the opportunity to weigh in on future regulations that could significantly impact the ability of state and local governments to help their workers pay for the rising cost of health care in retirement. We recognize the difficulty in developing the regulatory framework necessary to implement Code Section 4980I and appreciate the efforts of Treasury and IRS to reduce confusion. As Treasury and IRS work to resolve issues raised by Section 4980I, ICMA-RC encourages the development of proposed regulations that: (1) clarify the entity responsible for paying the excise tax attributable to the cost of self-insured coverage; (2) exclude self-insured excepted-benefits-only plans from the definition of applicable coverage; (3) provide employers the flexibility to choose among different HRA valuation methods, including a method that would value the cost of an HRA when contributions are actually set aside for or credited to participants; and (4) adopt regulations that would exclude HRAs from the cost of applicable coverage to the extent that the HRA is used to fund an employee contribution toward other employer-sponsored health coverage.

1. Clarification of the Entity Responsible For Paying the Excise Tax on Self-Insured Coverage

As discussed in the Notice, the entity responsible for paying the excise tax generally is set by statute. Section 4980I(c)(2)(a) states that the health insurance issuer shall pay the excise tax for applicable coverage provided under an insured plan. Section 4980I(c)(2)(b) states that the employer shall pay the excise tax for applicable coverage for an arrangement under which the employer makes contributions described in subsection (b) or (d) of Section 106. For all "other coverage," Section 4980I(c)(2)(c) states that the "person that administers the plan benefits" shall pay the excise tax. RHS is neither insured coverage, nor an arrangement that accepts contributions under subsection (b) or (d) of Section 106. As the provider of an arrangement categorized as "other coverage," ICMA-RC requests clarification that the statute's reference to "the person that administers the plan benefits" refers to the party who would most closely qualify as the plan "administrator" for purposes of ERISA Section 3(16).¹

ICMA-RC believes that the ERISA administrator is the most appropriate person to pay the excise tax attributable to HRAs based on the nature of the arrangement. In contrast to the cost attributable to an insured plan, which is generally designed by a third-party insurance issuer and selected by a sponsoring employer, the third-party record keeper of an HRA like ICMA-RC is not in a position to make decisions impacting dollar amounts expended on individual health coverage. Additionally, clarification that the ERISA administrator is the "person who administers the plan benefits" would reduce confusion and

¹ ICMA-RC makes RHS available only to governmental employers who are exempt from Title I and Title IV of ERISA. Notwithstanding this fact, any guidance referencing the ERISA "administrator" would be instructive in distinguishing the third-party administrator from other parties who "administer" the plan, such as the "plan sponsor," who is responsible for paying other ACA fees like the PCORI fee.



enhance tax compliance. HRAs often involve a variety of third-party service providers that assist the sponsoring employer carry out a range of HRA functions, including claims processing and review, statement preparation, custody and trust, and investment management of funds held in connection with the plan. Amidst these different service providers, however, there will always be a single entity (typically, but not always, the employer) functioning as the plan administrator within the meaning of ERISA Section 3(16). Finally, the clarification we are seeking likely matches Congressional intent as it is likely that Congress intended the “person who administers the plan benefits” to mean the plan administrator as the term has been historically understood through ERISA. Accordingly, we are requesting confirmation that the third-party record keeper is not the responsible entity for paying the excise tax attributable to HRA coverage.

2. Exclusion of Self-Insured Excepted-Benefits-Only Plans from Applicable Coverage

Code Section 4980I(d)(1)(B)(ii) provides that excepted-benefits-only plans offered under a separate policy, certificate, or contract of insurance are not included in the definition of applicable employer-sponsored coverage, which is subject to the forty percent excise tax on excess benefits. However, the statute does not expressly exclude self-insured limited dental and vision benefits plans from the definition of applicable coverage. As suggested in the Notice, we encourage Treasury and IRS to propose regulations that would harmonize the application of the Section 4980I excise tax as it applies to insured and self-insured excepted-benefits-only dental and vision plans.

To accomplish such harmony, we propose an approach that would allow limited dental and vision benefits plans to qualify as a “separate policy” under Section 4980I(d)(1)(B)(ii). If “separate policy” is interpreted independent of the term insurance, “separate policy” could be read broadly to include self-insured plans limited to dental and vision coverage offered independent from an employer’s primary health plan, regardless of whether the arrangement provides participants the right to elect not to receive coverage. Such an approach would allow Treasury and IRS “to achieve greater consistency between insured and self-insured coverage,” as desired by the recently amended excepted-benefits-only regulations. See 79 FR 59130, 59132 (Oct. 1, 2014).

3. HRA Valuation Methods

Code Section 4980I(d)(2)(A) provides that the cost of applicable coverage shall be determined under rules similar to the rules used to determine the COBRA applicable premium. To address the difficulty that would be created by applying the general Section 4980I valuation rules to HRAs, the Notice indicates that Treasury and IRS are considering two methods that could be used to determine the cost of applicable coverage for an HRA and invites suggestions for other approaches that could be used to determine the cost of applicable coverage for an HRA. Under the Notice’s first proposed valuation method, the cost of applicable coverage would be determined based on amounts made newly available to a participant each year. Under the Notice’s second proposed valuation method, the cost of applicable coverage would be determined by adding together all claims and administrative expenses attributable to an HRA for a particular period and dividing that sum by the number of employees covered for that period.

ICMA-RC appreciates the Service’s recognition of the burden that would be created by valuing HRAs under the general valuation principles of Section 4980I and encourages the Service to develop HRA-specific valuation methods that would relieve such burdens. However, we believe the HRA



valuation methods proposed in the Notice overlook the impact such valuations methods would have on pre-funded HRAs intended to benefit participants throughout retirement and encourage Treasury and IRS to consider the impact of any proposed valuation method on employers who make available such plans. Pre-funded HRAs, like RHS, are intended to fund a retiree health benefit throughout an employee's career by setting aside amounts in trust that become available to participants for the reimbursement of medical expenses upon separation from service. By setting aside amounts in trust over an RHS participant's career, the employer and employee are provided with greater certainty that amounts necessary to reimburse medical expenses in retirement will be available when requested for reimbursement.

As discussed below, ICMA-RC is concerned that the Notice's valuation method based on amounts made newly available to a participant each year could unfairly overvalue the cost of an HRA if adopted as the exclusive HRA valuation method. Additionally, we are concerned that the valuation method based on all claims and administrative expenses incurred during a given period could lead to unpredictable valuations from year to year if adopted as the exclusive HRA valuation method. Accordingly, we encourage Treasury and IRS to develop proposed regulations that provide employers the flexibility to choose among different HRA valuation methods, including a method that would value the cost of an HRA when contributions are actually set aside for or credited to participants. Such an approach would prevent employers from suffering the negative consequences of an imprecise HRA valuation method in a way that would limit administrative complexity and prevent excessive penalties on employers who have responsibly pre-funded a health benefit for their retirees.

A. Overvaluation Concerns Regarding the Notice's First Proposed HRA Valuation Method

The Notice's first proposed valuation method would determine the cost of applicable coverage based on "amounts newly made available to a participant each year." If Treasury and IRS adopt final regulations that only value HRAs based on amounts that are newly made available to participants, the cost of applicable coverage for the typical participant in a pre-funded retiree-only HRA would seemingly only be valued in the first year of retirement, when all amounts set aside over the participant's career are newly made available on a one-time basis. Conversely, the account would not be valued when the funds are set aside or when the amounts are actually paid as reimbursements for medical expenses. Such a result would significantly impact the ability of state and local governments to pre-fund an HRA that is intended to provide participants with reimbursements for medical expenses incurred throughout retirement.

In addition to the overvaluation that could occur when participants retire, we are also concerned that an HRA valuation method based on amounts newly made available could result in another type of overvaluation when a deceased participant's unused amounts are made available to other participants in the plan. As set forth in IRS Notice 2002-45, an HRA cannot pay a death benefit without regard to medical expenses and cannot reimburse medical expenses for any individuals other than the employee, the employee's spouse, or the employee's dependents. Consequently, HRA amounts that go unused before the death of a participant and any eligible spouse or dependents are made available to other participants in the plan when a participant dies. This transfer of unused amounts from a deceased participant's account to the accounts of current RHS participants creates a possibility that the same dollar amounts could be subject to the excise tax multiple times as they are newly made available to different participants. For example, amounts set aside for Participant A could be valued when newly made available to Participant A and also, when the unused amounts of Participant A's account are made available to Participant B following Participant A's death.



B. Unpredictability Concerns Regarding the Notice's Second Proposed HRA Valuation Method

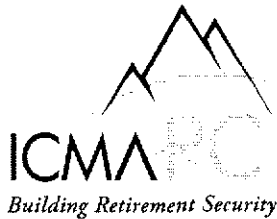
The Notice's second proposed HRA valuation method would determine the cost of applicable coverage based on expenses actually paid by an HRA during a given year. We appreciate Treasury and IRS developing an approach for HRAs that avoids the overvaluation problems discussed above but are concerned that adopting the second proposed valuation method as the exclusive HRA valuation method could lead to unpredictable HRA valuations from year to year, especially for smaller employers. As mentioned above, all amounts set aside during an RHS participant's career are generally made available for reimbursements to participants on a one-time basis upon retirement or separation from service. In any given year, the plan's total expenses could significantly increase or decrease in proportion to the number and significance of claims actually paid. Such a valuation method would make it unpredictable and difficult for employers, especially smaller employers with fewer participants, to structure health coverage in a way that would fall under the excess benefit dollar threshold from year to year. Accordingly, we encourage Treasury and IRS to propose a flexible HRA valuation approach, including a method that would value the cost of an HRA when contributions are actually set aside for or credited to participants.

C. Develop an HRA Valuation Method Based on Employer Contributions Set Aside for Participants

As discussed above, we are concerned that the Notice's proposed HRA valuation methods could unfairly penalize employers who pre-fund HRA benefits for retirees by overvaluing HRAs under the Notice's first proposed method and creating unpredictability under the Notice's second proposed method. Therefore, we encourage Treasury and IRS to adopt regulations that would allow employers to value the cost of applicable coverage attributable to pre-funded HRAs, like RHS, by valuing the employer's cost when contributions are actually set aside for or credited to the plan's participants. An HRA valuation method based on contributions set aside for participants would more closely connect valuation to the period in which HRA expenses are incurred by the employer, rather than the period in which amounts are "newly made available" to participants or when claims are paid to participants. Additionally, such a valuation method would closely parallel the statutorily defined valuation method required for employer contributions to FSAs, Archer MSAs, and HSAs by 4980I(d)(2)(B) and (C) in a way that would limit administrative complexity and prevent excessive penalties on employers who have responsibly pre-funded a health benefit for their retirees.

4. Exclude HRAs From Applicable Coverage When Used Towards Other Applicable Coverage

The Notice indicates that stakeholders have cautioned Treasury and IRS about the potential for "double counting" that may occur when HRAs, which are included in the cost of applicable coverage, are used to fund an employee's contribution toward other coverage, which is also independently included in the cost of applicable coverage. Likewise, ICMA-RC is concerned about this potential for "double counting" and urges Treasury and IRS to adopt regulations that will prevent the cost of applicable coverage from unfairly including the same employer expense more than once. Accordingly, we encourage Treasury and IRS to adopt regulations that would exclude HRAs from the cost of applicable coverage to the extent that the HRA is used to fund an employee contribution toward other employer-sponsored health coverage. At the very least, we encourage Treasury and IRS to adopt regulations that exclude HRAs from the cost of applicable coverage when the HRA exclusively limits reimbursements to fund employee contributions toward other coverage. Many of ICMA-RC's clients rely on RHS to help cover the cost of insurance premiums for retirees in between the year in which an employee separates



from service and the year in which a retiree becomes eligible for Medicare. Any regulations that make it more difficult for employers to fund health coverage during this window will adversely impact employers' ability to provide their employees with access to affordable coverage during this window. Such a result would contradict the ACA's goal to make it easier for older non-working Americans, including earlier retirees, to receive access to affordable health coverage.

Conclusion

We appreciate the fact that Treasury and IRS anticipated many of the issues created by Code Section 4980I and welcome your consideration of the issues we have raised in this letter. The implementation of Section 4980I will impact the way in which state and local governmental employers pay for the cost of rising health care costs, especially in retirement, and we ask Treasury and IRS to consider their interests as regulations are developed. We believe that these interests will be best served if Treasury and IRS adopt regulations that: (1) clarify the entity responsible for paying the excise tax attributable to the cost of self-insured coverage; (2) exclude self-insured excepted-benefits-only plans from the definition of applicable coverage; (3) provide employers the flexibility to choose among different HRA valuation methods, including a method that would value the cost of an HRA when contributions are actually set aside for or credited to participants; and (4) adopt regulations that would exclude HRAs from the cost of applicable coverage to the extent that the HRA is used to fund an employee contribution toward other employer-sponsored health coverage.

As you continue to develop regulations under Code Section 4980I, ICMA-RC welcomes the opportunity to provide additional feedback and comments.

If you have any questions or concerns, please contact me at 202-962-8096.

Sincerely,

Angela Montez

Senior Vice President & General Counsel, ICMA-RC