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Notice 2015-16
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May 15, 2015

VIA E-MAIL (Notice.comments@irs.counsel.treas.gov)

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

Re: Comments on IRS Notice 2015-16

Dear Sir or Madam:

This firm represents clients that sponsor health reimbursement arrangements (“HRAs”) that are integrated with their group health plans. On behalf of these clients, we would like to comment on Notice 2015-16 (the “Notice”) regarding the forthcoming regulatory guidance on the excise tax that will apply to high cost employer-sponsored health coverage under Section 4980I of the Internal Revenue Code of 1986, as amended (the “Code”), commonly known as the “Cadillac Tax.” Specifically, we would like to address (1) the definition of applicable employer-sponsored coverage (hereinafter, “applicable coverage”); (2) the determination of the cost of applicable coverage; and (3) the manner in which “person that administers the plan benefits” should be interpreted.

I. Executive Summary

As discussed in Section II.D below, HRAs are clearly different from health FSAs and HSAs. Neither health FSAs nor HSAs accomplish some of the most important goals of the Affordable Care Act (the “ACA”)—decreasing moral hazard and incentivizing employees to utilize funds wisely and participate in wellness programs—all of which help contain rising health care costs and promote healthier and longer lives.

Unlike HRAs, health FSAs actually encourage employees to spend health care dollars in a potentially unwise manner since the funds must generally be utilized by the end of the plan year. In addition, the different rules that apply to HSAs allow them to be utilized as tax-free investment vehicles for retirement rather than the reimbursement of eligible medical care expenses. For these reasons, we urge Treasury and the IRS to exempt all HRA contributions from the Cadillac Tax



calculation because HRAs actually help minimize rising health care costs and promote employee enrollment in wellness programs. The inclusion of HRA contributions in the Cadillac Tax calculation will force our clients, and other employers, to either eliminate their HRAs entirely or severely restrict them to a point that their benefits become nominal and the cost of administration outweighs the intended benefit.

If all HRA contributions are not exempted from the calculation of the Cadillac Tax, we urge Treasury and the IRS to consider exempting HRAs sponsored by not-for-profit entities since those employers do not receive any tax incentive to contribute to HRAs and there is no loss of revenue to Treasury.

If HRA contributions are not exempted, we strongly urge Treasury and the IRS to offer multiple methods of determining the cost of applicable coverage. This will allow employers to utilize the method that most fairly represents their workforce demographics. Regardless, we urge Treasury and the IRS, at a minimum, to adopt a method that enables employers to determine the cost of HRA coverage based on the amounts made available to participants each year and to exclude administrative costs, if any, because administrative costs are not considered when determining the cost of coverage for health FSAs and HSAs.

Finally, we request that Treasury and the IRS provide guidance clarifying that the “person that administers the plan benefits” is the ERISA plan administrator and not the third party administrator.

II. Definition of Applicable Coverage

While Code Section 4980I generally applies to all employer-sponsored coverage that is excludable from taxation by an employee under Code Section 106, it also specifically addresses health FSAs, Archer MSAs, and HSAs and provides that they constitute applicable coverage. The statute does not, however, explicitly indicate that HRAs are to be considered applicable coverage and included when calculating the Cadillac Tax. As such, it is unclear whether Congress’ intent was to specifically exclude HRAs from the Cadillac Tax. It seems probable that HRAs should be excluded because including them in the Cadillac Tax calculation (1) increases moral hazard; (2) defeats the purpose of consumer-directed health care; and (3) disincentivizes employee participation in wellness programs. Unlike health FSAs and HSAs, a properly designed HRA achieves the essential goals of health care reform.

A. Moral Hazard

The term “moral hazard” is frequently used in discussions regarding reforming the health care system because it has been proven that the behavior of individuals changes when they are insured against any type of loss. With regard to health insurance, moral hazard is manifested in the tendency of individuals to increase their utilization of insured medical care rather than uninsured medical care. The most popular solution to the moral hazard problem is to implement consumerism in employer-sponsored health plans by utilizing consumer-directed health plans. Therefore, many

employers provide their employees with high deductible health plans coupled with employer-funded HRAs. This allows the employees to accumulate funds by rolling their HRA balances over, year after year, earn interest on such amounts, and utilize the funds when they believe medical care is necessary. As such, HRAs (along with high deductible health plans) accomplish the “consumerism” behavior that helps contain rising health care costs. One purpose of the Cadillac Tax is to reduce moral hazard. However, HRAs also accomplish this same goal by encouraging employees to spend their funds wisely and to take an active role in their medical care.

B. Consumer-Directed Health Care

As discussed above, the purpose of consumer-directed health care is to encourage individuals to become actively involved in making their own health care decisions by giving them a financial incentive to (1) understand their own individual health care costs and options; (2) manage their medical care and health care finances; and (3) make prudent decisions regarding these costs and options. Consumer-directed health care also provides individuals with the flexibility to design their own health care plan by selecting health care options and their own providers. In fact, the U.S. Department of Health and Human Services explains on its website that:

the Affordable Care Act puts consumers back in charge of their health care. Under the law, a new “Patient’s Bill of Rights” gives the American people the stability and flexibility they need to make informed choices about their health.

An employer-funded HRA account, in which employees can accumulate funds and carry them over year to year, is an integral way of effectuating this goal, while encouraging participation in wellness activities so that they can live healthier and more rewarding lives. Discouraging employer-funded HRA accounts by including HRAs in the Cadillac Tax calculation runs counter to the goals of the ACA—achieving more effective use of health care dollars.

C. Wellness Programs

In addition to offering stability and flexibility to the American people, another goal of the ACA was to encourage employers to implement and expand wellness programs. The Department of Labor (the “DOL”) explains this goal on its Affordable Care Act and Wellness Program Fact Sheet as follows:

Implementing and expanding employer wellness programs may offer our nation the opportunity to not only improve the health of Americans, but also help control health care spending. The Affordable Care Act creates new incentives and builds on existing wellness program policies to promote employer wellness programs and encourage opportunities to support healthier workplaces. The Departments of Health and Human Services (HHS), Labor and the Treasury are jointly releasing proposed rules on wellness programs to

reflect the changes to existing wellness provisions made by the Affordable Care Act and to encourage appropriately designed, consumer-protective wellness programs in group health coverage.

Wellness plans are designed to improve an individual's overall health and well-being, and to avoid and even treat, chronic health conditions. HRAs play an integral role in employer wellness programs. For example, an employer may wish to make an HRA contribution for individuals who participate in a wellness program or might otherwise link HRA contributions to employee behaviors that have a positive impact on employee health. Most of our clients provide financial contributions to HRAs for their employees upon the completion of either a health risk assessment or a biometric screening. If HRAs were to be considered applicable coverage, then employers would have less flexibility in designing their wellness programs. Employers will be forced to reduce their contributions to HRAs to avoid paying the Cadillac Tax. This may result in fewer employees participating in wellness programs, which, as mentioned above, are considered to be an integral part of health care reform.

D. HRAs Are Dissimilar from Health FSAs and HSAs

Health FSAs and HSAs do not accomplish all of the foregoing goals of health care reform (*i.e.*, decreasing moral hazard, achieving the purposes of consumer-directed health care, and incentivizing participation in wellness programs) because they are distinctly different forms of health savings accounts.

1. Health FSAs

Due to the "use-it-or-lose-it" rule, which generally requires unspent funds at the end of the plan year to be forfeited, health FSAs do not encourage participants to accumulate funds in their account and spend their money wisely. However, employees still receive the immediate tax benefit of decreasing their taxable compensation and paying for medical expenses on a pre-tax basis. In contrast to HRAs, health FSAs are not subject to the Medicare Secondary Payer ("MSP") rules. This means that health FSAs do not have to comply with the complex MSP rules, while HRAs must comply.

2. HSAs

HSAs provide greater benefits than just the ability to reimburse medical expenses. The rules and regulations applicable to HSAs allow individuals to not only accumulate funds for the payment of medical expenses in later years, but they also allow individuals to (1) invest the funds; (2) utilize them as emergency savings accounts; and (3) convert them into retirement plans.

With HSAs, an individual can pay for his or her out-of-pocket medical expenses with current income, save his or her receipts, and withdraw the funds as reimbursements years later. As such, an HSA can easily be utilized as an emergency savings account. HSAs are also "tax advantaged" because the funds that were originally contributed on a pre-tax basis will accumulate

on a tax-free basis and any investment growth will be distributed tax-free if utilized for medical expenses. This means that HSA contributions will accumulate and individuals will pay no taxes on medical expenses and only income taxes (no penalty) on non-qualified withdrawals after age 65. In addition, individuals can avoid income taxes on traditional Individual Retirement Account (“IRA”) assets by directly transferring them to an HSA. As long as the money is utilized for qualified medical expenses, the individual will avoid ever having to pay taxes on that IRA money. Thus, an HSA is different from an HRA because it can be utilized as an additional tax-free savings vehicle for retirement.

Furthermore, unlike HRAs, medical expenses that are reimbursed from HSAs are not adjudicated by a plan sponsor. This means that an ineligible HSA reimbursement is only discovered if, and when, an individual is audited and the examiner discovers that ineligible expenses were reimbursed. Finally, like health FSAs, HSAs do not have to comply with the complex MSP rules.

For the enumerated reasons listed in this Section II, we urge Treasury and the IRS to clarify in future guidance that HRAs are excluded from applicable coverage and the calculation of the Cadillac Tax.

III. Determination of the Cost of Applicable Coverage

After the Notice was released, our clients came to us with some grave concerns regarding the feasibility of continuing to offer their employees HRAs in light of the uncertainty surrounding the calculation of the Cadillac Tax. One significant concern was how they would plan for the future. Employers are unsure how to determine the cost of providing HRA coverage since Code Section 4980I does not include special rules for HRAs nor does it consider the unique nature of HRAs. For example, HRAs are generally notional accounts that are only funded when a claim is made and generally are linked to participation in wellness programs.

If the cost of applicable coverage under an HRA is based on the amounts made available to a participant each year (excluding carryovers), employers will have greater certainty as to any potential Cadillac Tax that would be payable from year to year and could plan accordingly. Regardless, because employers do not know whether an employee will receive an HRA contribution, they will be unable to determine to a finite degree of certainty whether they will be subject to the Cadillac Tax. For example, an employee may elect not to participate in a wellness program and therefore is ineligible to receive an HRA contribution. As such, employers will likely be forced to assume that 100% of their employees will be eligible for HRA contributions when calculating the potential Cadillac Tax liability, even if some of their employees ultimately are not eligible to receive HRA contributions. This will result in an “inflated” number for employers who are forecasting whether they need to reduce other benefits to avoid the Cadillac Tax. Therefore, employers will either have to decrease the amount of the financial contribution to the HRA to stay below the Cadillac Tax threshold or discontinue the use of HRAs, which may eliminate employees’ incentive to participate in wellness programs.

The Notice also addresses whether there should be multiple methods for determining the cost of coverage under an HRA and whether to permit, or require, employers to use the actuarial basis method to determine the cost of coverage under an HRA. We urge Treasury and the IRS to provide multiple methods for determining the cost of coverage. Each employer has different demographics, locations, size, etc. In addition, we urge Treasury and the IRS to permit employers to utilize the actuarial basis method rather than requiring it. Many small employers cannot afford to hire an actuary to complete such a determination and the complexity of the determination may be cost prohibitive.

The Notice states that the IRS might permit employers to add together all claims and administrative expenses attributable to HRAs for a period (separately for each level of coverage if the employer allocation differs by employee election) and then divide that sum by the number of covered employees (at each level of coverage). This method would likely be extremely difficult to administer and not indicative of the true employer contribution to the HRA for the taxable period because claims will be made from carryover HRA accounts and by employees who have carryover HRA accounts, but are not currently receiving contributions to their HRA because they are not “active” participants. In addition, administrative costs should not be considered a portion of premiums to an HRA when they would not apply statutorily to a health FSA, Archer MSA, or HSA. In addition, this offers little ability for planning since the employer will have no way of knowing the total amount of claims before the beginning of the plan year and the number of participants.

As such, we urge Treasury and the IRS to allow multiple methods of calculating HRA contributions and to exclude administrative costs from the premium calculation.

IV. Person That Administers the Plan Benefits

Code Section 4980I(c)(2)(C) provides that the “coverage provider” that will pay its portion of the Cadillac Tax when the health coverage is self-insured is the “person that administers the plan benefits.” Code Section 4980I(f)(6) states that the “person that administers the plan benefits” shall include the plan sponsor if the plan sponsor administers benefits under the plan. While “person that administers the plan benefits” is not defined, the most reasonable interpretation would be that this phrase should be interpreted to be the plan “administrator” as defined in Section 3(16) of the Employee Retirement Income Security Act of 1974 (“ERISA”). We request that Treasury and the IRS provide guidance on this issue and clarify that the ERISA plan administrator is the “person that administers the plan benefits” and not the third party administrator.

V. Conclusion

As discussed above, Health FSAs and HSAs are clearly different from HRAs because they do not accomplish some of the most important goals of the ACA—decreasing moral hazard and incentivizing employees to utilize funds wisely and participate in wellness programs—all of which help contain rising health care costs and promote healthier and longer lives.

Unlike HRAs, health FSAs actually encourage employees to spend health care dollars in an unwise manner since the funds must generally be utilized by the end of the plan year. In addition,

the rules that apply to HSAs allow them to be utilized as tax-free investment vehicles for retirement rather than for the reimbursement of eligible medical care expenses. For these reasons, we urge Treasury and the IRS to exempt all HRA contributions from the Cadillac Tax calculation because HRAs minimize rising health care costs and promote employee enrollment in wellness programs. The inclusion of HRA contributions in the Cadillac Tax calculation will force our clients, and other employers, to either eliminate their HRAs entirely or severely restrict them to a point that their benefits become nominal and the cost of administration outweighs the intended benefit.

If Treasury and the IRS include HRA contributions in the calculation of the Cadillac Tax, we urge them to consider exempting HRAs sponsored by not-for-profit entities since those employers do not receive any tax incentive to contribute to HRAs and there is no loss of revenue to Treasury.

Furthermore, if Treasury and the IRS include HRA contributions in the calculation of the Cadillac Tax, we strongly urge Treasury and the IRS to offer multiple methods of determining the cost of applicable coverage. This will allow employers to utilize the method that most fairly represents their workforce demographics.

At a minimum, however, we urge Treasury and the IRS to adopt a method that enables employers to determine the cost of HRA coverage based on the amounts made available to participants each year and to exclude administrative costs, if any, because administrative costs are not considered when determining the cost of coverage for health FSAs and HSAs.

Finally, we request that Treasury and the IRS provide guidance clarifying that the "person that administers the plan benefits" is the ERISA plan administrator and not the third party administrator.

We appreciate this opportunity to comment regarding the excise tax on high cost employer-sponsored health coverage under Section 4980I of the Code in connection with the Notice. If you have any questions, or if we can be of any assistance in your consideration of the issues summarized above, please do not hesitate to contact me at (904) 598-6106 or lcarrasco@srglaw.com.

Sincerely,

A handwritten signature in black ink that reads "Lisa Rhein Carrasco". The signature is written in a cursive, flowing style.

Lisa Rhein Carrasco