

Notice 2015-16

MAR 16 2015

From: Cliff Craig <CCraig@ci.puyallup.wa.us>
Sent: Thursday, March 12, 2015 7:57 PM
To: Notice Comments
Subject: Notice 2015-16
Attachments: IRS Notice 2015-16 Excise tax on High Cost plans - Cadillac Tax Comments.docx

Here are my comments.

I am proposing an alternative method of calculating the cost of self insured plans that can be a fairly simple standardized approach, and one that may help resolve a number of significant issues that may pertain to local governments.

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RE: 4980I(d)(1)(E)

Per Notice 2015-16

In addition, § 4980I(d)(1)(E) implies that coverage provided under a plan maintained primarily for members of the military or for members of the military and their families by the Government of the United States, the government of any State or political subdivision thereof, or any agency or instrumentality of any such government is not applicable coverage. See § 4980I(d)(1)(E) (providing that governmental plans are included in applicable coverage and defining governmental plans as "coverage under any group health plan established and maintained primarily for its civilian employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any such government.") (Emphasis added.)

From JCX-18-10

Governmental entities are generally not exempt from the fees imposed under the provision. There is an exception for exempt governmental programs including, Medicare, Medicaid, SCHIP, and any program established by Federal law for providing medical care (other than through insurance policies) to members of the Armed Forces, veterans, or members of Indian tribes.

Per US Code:

(E) Governmental plans included

Applicable employer-sponsored coverage shall include coverage under any group health plan established and **maintained primarily for its civilian employees** by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any such government.

Comments:

"Non-civilian employees" is a broader term than "military." In the political subdivisions of the various states non-civilian refers to uniformed public safety officers – Police and Fire. Like the military, these officers place their lives on the line every day to ensure the safety of our citizens. In some cases state legislation has mandated the healthcare of its retired public safety officers for the remainder of their life.

Clarification needed:

When the state has mandated that a local government provide healthcare for life for certain public safety officers – does this constitute an insured plan?

It does not fit under the definition. The state requires the costs to be paid by the local government, so the plan of healthcare benefits is established by the state, but not primarily for its civilian employees. The employees belong to the city.

In such a case, IF these benefits are deemed to be an insurance plan, who is the "insurer" and who does the tax liability belong to – the plan-establisher (state) or the actual employer ?

2. Self-Insured Methods

b. Actuarial Basis Method

Under § 4980B(f)(4)(B)(ii)(I), a self-insured plan making an actuarial estimate of the cost of providing coverage must take into account factors prescribed in regulations. For purposes of § 4980I, Treasury and IRS are considering whether to propose a broad standard under which the cost of applicable coverage for a group of similarly situated individuals would be equal to a reasonable estimate of the cost of providing coverage under the plan for individuals in that group for the determination period, using reasonable actuarial principles and practices. Under this standard, an estimate of cost would be an estimate of the actual cost the plan is expected to incur for a determination period, not the minimum (or maximum) exposure that the plan could have for that period.

Comments regarding Actuarial Basis Method:

It has been my experience that actuarial projections are extremely volatile, and often excessively conservative. The table below provides a history of our self insured governmental plan, with the actuary's recommended rates and those adopted for budgetary purposes. As you can see, the actuary projected "required" rates as much as 12.4% higher than budgeted in 2010, and as much as 13.4% lower than budget in 2013. During the entire period from 2009-2015, the budgetary rates were applied. Fund balance was maintained at or very near the targeted range, based on a rolling most recent 4-6 months of claims.

Healthcare Rates - Actuary Recommended vs Budget			
The actuary's approach was flawed in that it		Actuary	Budget
	2009	12.6%	5.0%
	2010	17.4%	5.0%
	2011	0.0%	0.0%
	2012	-6.1%	5.0%
	2013	-8.4%	5.0%
	2014	8.8%	5.0%
	2015	7.4%	5.0%
	Total	31.7%	30.0%

1. Used multiple layers for margin of safety

2. Disregarded expected receipt of reimbursements for stop loss claims

3. Was heavily focused on the most recent 18 months. In essence the assumption was that the most immediate experience of normal, high or low claims would continue through to the end of the next year. Longer term trend of three or more years was disregarded. For a relatively small employee pool this can distort rates greatly.

In contrast, the budgetary rates were developed considering the claims trend over the last few years, current year estimates based on seasonal trends and considering fund balance needs. It also attempted to smooth the rate changes to ensure adequate funding, with predictability – looking to achieve maximum fund balance reserves over a two or three year period.

Self insured programs, especially with smaller pools can be subjected to significant distortion in the rates from one year to the next or between classes.

Additionally, retiree healthcare is often separated out from the active employee pools in self insurance plans for various reasons, even though the benefits provided are essentially the same. However, retirees as a stand alone class may require rates that are two or three times the amounts for the active employees. These rates should not be considered as "excess benefits" when it is the same level of care as provided for the general population. There needs to be a mechanism that smooths out volatility from one year to the next, potential rate distortion between classes and the significant differential between active employees and retirees all of which can be driven by a relatively small number of high cost claims.

The standard that defines an "excess benefit" is essentially a plan that is more luxurious than the one that was provided in the federal employees benefit plans in 2010 with implied inflation of 55% to 2018. That is a very large pool that is not subject to wide variation from year to year or between classes. It should be possible to compare the entity's plan in a manner that draws on the stability of the larger group to restate costs proportionately equivalent to the federal plan.

A possible other method of calculating program cost follows.

1. Rather than requiring rates as developed by the actuaries, reasonable rates based on the actuarial projections and their estimates of claims incurred but not reported (IBNR) should be allowed. The concern that a company might manipulate the rates from year to year has a compensating control in that self insurance plans are required by the state to maintain a certain level of fund balance, considering actuary calculations of IBNR. Management will adjust rates as necessary to ensure compliance or risk loss of the self insurance program.
2. To the extent that the benefits provided are essentially the same multiple groups should be permitted to be combined into a single composite plan an option. Rates for each class should be applied to the number of units to determine the total revenue for the composite plan. That represents Total Plan Cost. Membership should then be aggregated into the employee only and other than employee only classes. The rates designated in the FEBP (as adjusted for inflation) should be applied to the respective units. This represents the Total Allowed Cost. If the Total Plan Cost is greater than the Total Allowed Cost the difference between the Total Plan Cost and the Total Allowed Cost would determine the initial amount subject to the excise tax. The plan cost amounts that apply to each individual or family unit can be determined by dividing the Total Plan Cost by the Total Allowed Cost and multiplying the result by the FEBP rates for the same class.
3. In calculating the Total Plan Cost for retirees, electing to treat those over 65 as similarly situated as those under 65 means that the lower of the two rates maybe used for this purpose.
4. In the event a run of high claims causes a plan to exceed the threshold and triggers the excise tax, a three or five year averaging might be employed. Or, perhaps a simpler alternative would be to carry forward amounts under the allowed total from year to year to be applied against those years when total costs exceed the allowed costs.

A sample calculation based on current City budgeted rates follows:

Example of proposed actuarial cost method alternative:

Assumption:

Federal Employee Benefit Plan - implied rates:

5.6% Implied rate of annual inflation between 2010 100% and 2018 155%

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Implied inflation in Federal Employees Plan	100	106	112	118	124	132	139	147	155

Assumed Federal Plan rates for this analysis

Employee only rates:	6,581	6,951	7,343	7,756	8,193	8,654	9,141	9,656	10,200
Other than employee only rates	17,742	18,741	19,796	20,911	22,089	23,332	24,646	26,034	27,500

Budgeted City rates for 2015:

Active employees	9,060
Family	22,248
Retiree over 65	18,576
Retiree under 65	28,128

City Plan Budgeted Rates at 5% increase over prior year. (Actuary proposed 7.4% increase)

Active Employees Plan - Total Plan Costs

	Count	Budgeted Rate	Annual Total	
Employee only:	47	9,060	425,820	
Family	233	22,248	5,183,784	
	280	31,308	5,609,604	Total Plan Costs for Active Employees

Active Employees Plan - Allowed Costs

	Count	FEBP Rate	Annual Total	
Employee only:	47	8,654	406,746	
Family	233	23,332	5,436,436	
	280	31,987	5,843,182	Total Allowed Costs for Active Employees

Excess Benefit Amount (233,578)

Retirees Plan - Total Plan Costs - using age specific rates

	Count	Budgeted Rate	Annual Total	
Over 65	27	18,576	501,552	
Under 65	13	28,128	365,664	
	40	46,704	867,216	Total Plan Costs for Retirees

Retirees Plan - Allowed Costs

	Count	FEBP Rate	Annual Total	
Over 65	27	8,654	233,663	
Under 65	13	8,654	112,504	
	40	17,308	346,167	Total Allowed Costs for Retirees

Excess Benefit Amount **521,049**

Excess Benefit Excise tax **208,420**

Retirees Plan - Total Plan Costs - assuming "similarly situated" rates

	Count	Budgeted Rate	Annual Total	
Over 65	27	18,576	501,552	
Under 65	13	18,576	241,488	Using lower "Over 65" rate
	40	37,152	743,040	Total Plan Costs for Retirees

Retirees Plan - Allowed Costs

	Count	FEBP Rate	Annual Total	
Over 65	27	8,654	233,663	
Under 65	13	8,654	112,504	
	40	17,308	346,167	Total Allowed Costs for Retirees

Excess Benefit Amount **396,873**

Excess Benefit Excise tax **158,749**

Assuming the Active Employees Plan and the Retirees Plan provide essentially the same benefits and are allowed to be merged for computing the tax :

Merged Plans - Total Plan Costs:

	Count	Budgeted Rate	Annual Total
Active employees only	47	9,060	425,820
Active families	233	22,248	5,183,784
Retirees over 65	27	18,576	501,552
Retirees under 65	13	18,576	241,488
			6,352,644

Total Plan Costs for merged plans

Merged Plans - Allowed Plan Costs:

	Count	FEBP Rate	Annual Total
Active employees only	47	8,654	406,746
Active families	233	23,332	5,436,436
Retirees over 65	27	8,654	233,663
Retirees under 65	13	23,332	303,320
			6,380,166

Total Allowed Costs for merged plans

Excess Benefit Amount (27,522)

In this example assumed Federal Employee Benefit Plan rates are derived by dividing the 2018 limit by the annual rate of inflation from 2010-2018 implied by the 55% increase over 2010. The initial calculation is based on keeping the active employees plan and the retirees plan separate and determining the taxability of each plan separately. That indicates a Total Plan Cost for active employees of \$5,609,604 as compared to a Total Allowed Cost of \$5,843,182. The Total Plan Cost is \$233,578 less than the allowed amount. There is no excess benefit and no excise tax is due for this plan.

The initial calculation for the Retirees Plan is done maintaining separate rates for over 65 and under 65 as budgeted. Total Plan Cost is \$867,216 compared to \$346,167 Allowed Cost for this plan, resulting in an excess benefit of \$521,049 and \$208,420 excise tax due.

Assuming that the over 65 and under 65 retirees are similarly situated for the purpose of this calculation and using the lower of the two rates generates a Total Plan Cost of \$743,040 compared to \$346,167 Allowed Cost for this plan, resulting in an excess benefit of \$396,873 and \$158,749 excise tax due.

Because these plan provide essentially the same benefits, the City would choose to merge the two plans for this calculation if the option were available. In this case, and assuming "similarly situated" retirees the Total Plan Cost is \$6,352,644 compared to an allowed cost of \$6,380,166. The Total Plan Cost is \$27,522 less than the allowed amount. There is no excess benefit and no excise tax is due for this plan. That is an appropriate outcome considering the plans are essentially the same.

Individual Costs:

Total plan Costs divided by
allowed costs of merged plan 99.57%

Times Federal Employee benefit Rates

Employee only	8,617
Family	23,232

With respect to reasonable overhead expenses, Treasury and IRS invite comments as to whether additional guidance on what constitutes reasonable overhead expenses would be beneficial, including (1) whether a presumption should be adopted that, for self-insured plans with a third party administrator, reasonable overhead expenses are reflected in the third party administrator fee, and (2) whether a safe harbor should be adopted that would allow a self-administered, self-insured plan to assume that the amount of reasonable overhead expenses is equal to a defined percentage of claims.

Comment: Yes, a safe harbor should be adopted, especially for the use of those entities that do not have a model in place to allocate overhead costs to the self insured healthplan.

VII. REQUEST FOR COMMENTS

Treasury and IRS invite comments on the issues addressed in this notice and on any other issues under § 4980I. As noted earlier, Treasury and IRS intend to issue another notice inviting comments on certain additional issues not addressed in this notice. It is expected that the comments responding to the notices will be used to inform proposed regulations that will be issued in the future for further public notice and comment.

Public comments should be submitted no later than May 15, 2015. Comments should include a reference to Notice 2015-16. Send submissions to CC:PA:LPD:PR (Notice 2015-16), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2015-16), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044, or sent electronically, via the following e-mail address: Notice.comments@irs.counsel.treas.gov. Please include "Notice 2015-16" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.