LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS BRANCH

Notice 2015-16

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CC:PA:LPD:PR (Notice 2015-16)
Courier's Desk, Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20044

Re: Notice 2015-16

Dear Sir or Madam:

On behalf the Electrical Workers' Voluntary Employees' Beneficiary Association Health Reimbursement Arrangement (Electrical Workers' VEBA Trust), we offer comments with respect to § 4980I of the Internal Revenue Code (Code), which provides for an excise tax on high cost employer sponsored health coverage (the "Excise Tax"), and the potential regulatory guidance to be issued under § 4980I. The Electrical Workers' Plan is a Taft-Hartley plan offered through a multi-employer voluntary employees' beneficiary association (VEBA) trust. The Plan was established in 2007 and is now a defined contribution health and welfare benefit plan, commonly referred to as a health reimbursement arrangement (HRA). The Electrical Workers' VEBA trust is governed by an eight-member Board of Trustees; four of which represent participating employers of the Northwest Line Constructors Chapter of the National Electrical Contractors Association (NECA) and four of which represent the International Brotherhood of Electrical Workers (IBEW) Local Union Numbers 77, 125, 483, and 659. The Board of Trustees also act as the plan administrator for the underlying Electrical Workers' Plan. The Trust was established in January of 2007 and today it has approximately 83 adopting employers contributing to the Trust on behalf of 2,757 eligible employees, with accumulated assets of more than $4.9 million.

Initially, we advocate a repeal of the Excise Tax and replacement of the tax with alternative legislation that would further similar goals with a more efficient, less burdensome effect. We acknowledge that the IRS and Treasury have no authority to repeal the Excise Tax, but request that they advise Congress to do so in light of the significant issues relating to its ultimate effect and implementation, as reflected in many of the comment letters submitted by individual taxpayers, employers, and industry groups. We also request that Treasury and the IRS consider delaying implementation of regulations, and advise Congress regarding these issues for further evaluation of amendments to §4980I or alternative legislation.

Alternatively, we urge Treasury and the IRS not to include health reimbursement arrangements (HRAs) as a form of "applicable coverage" under the Excise Tax for the reasons set forth below. In addition, we offer our specific comments on several issues addressed in Internal Revenue Service (IRS) Notice 2015-16 (the "Notice") relating to the potential approaches for determining the cost of coverage for HRA plans for purposes of determining the Excise Tax. Finally, we would like to identify some of the significant challenges presented by provisions of § 4980I that require payment of the tax by various third parties who have no control over the selection and aggregation of multiple types of applicable coverage that are subject to the tax. Although the IRS has not yet requested comment on the payment and

administration aspects of the tax, we urge your careful consideration of these issues as you contemplate additional requests for comment and potential regulatory guidance.

I. The Excise Tax should be repealed and replaced with alternative legislation that is more tailored to accomplish the intended goals of reducing healthcare spending and increasing federal revenue.

When originally conceived and advocated, the Excise Tax was hailed as a tax on insurance companies that would affect only insurers and wealthy executives, and its most frequently stated goals were to raise federal revenue and reduce or eliminate excessive healthcare spending. However, in its final form and through its proposed implementation, the tax will impact a much broader group, including many middle class workers. In addition, the tax will reduce or eliminate many employer-sponsored benefits, including many forms of employer-sponsored benefits that do not produce the same excessive healthcare spending and inefficiency that the envisioned "Cadillac" insurance plan generates. In order to accomplish the two primary goals more effectively, what is really needed is a repeal of the ill-advised Excise Tax and replacement with more sensible, cost-effective legislation. Several alternatives that were originally considered should be revisited and implemented in lieu of the Excise Tax. These alternatives include a number of possible ways to cap the personal income tax exemption for employer-sponsored insurance (based upon the value or cost of the insurance, employee income, or some combination of the two) or converting the exemption to an individual income tax deduction or even an income tax credit. Absent that, we urge the IRS and Treasury to use their authority under § 4980I(g) to implement an overall regulatory scheme that is more narrowly tailored to accomplish the stated goals for the Excise Tax, while streamlining the administrative burdens that will almost certainly (without significant overhaul) increase healthcare costs, reduce the level of benefits provided for the middle class and wealthy alike, and generally reduce the availability of the types of account-based benefits that do incentivize a healthier lifestyle and cost-conscious decision-making regarding healthcare.

II. Health reimbursement arrangements (HRAs) should be excluded as a form of "applicable coverage" for purposes of the Excise Tax.

As discussed below, HRAs should be excluded as "applicable coverage" under the Excise Tax for a variety of reasons. The design, unique features, and wide-ranging usage of HRAs present significant challenges in selecting and applying any method of cost determination contemplated under the proposed regulatory scheme. Moreover, the payment provisions of the Excise Tax should be more flexible and should permit or require employers to pay the tax for coverage that is administered by an unrelated third party who has no mechanism for passing liability through to employers or covered individuals. Finally, to include account-based plans, such as HRAs, as applicable coverage under the tax would run counter to one of the primary goals of the tax (restraining healthcare costs), ultimately leading to a significant reversal in the recent growth of consumer-driven healthcare decisions.

A. HRAs are not among the forms of healthcare coverage that led to the inefficiency and overutilization in America's healthcare system that Congress intended to address with the Excise Tax.

An HRA is not insurance. In contrast, it is a form of account-based, defined-contribution coverage that is limited to a finite account balance. As such, HRAs do not pool risk of all covered individuals to provide specified benefit coverages that could potentially far exceed the dollar-amount contributed, as is the case with the potential benefit coverages available under defined-benefit insurance plans as compared to premiums paid or contributed. Rather, HRAs provide reimbursement (up to the account limit) for actual out-of pocket costs incurred by the covered individual due to deductibles, co-pays, co-insurance amounts, or expenses not covered by other medical plans. Accordingly, HRAs incentivize consumerism and efficiency in order to preserve account balances for future healthcare needs. This results in covered individuals taking more ownership in their use of healthcare resources, selection of providers, comparison of relative value and cost, evaluation of the necessity of medical care treatments, and careful budgeting of healthcare expenses.

HRAs may be either funded or unfunded by an employer. Unfunded HRAs consist of a promise by the employer to reimburse medical expenses incurred during the plan year up to a certain amount. Funded HRAs typically consist of an employer contribution made into the HRA account, where the contribution amount is made available either immediately or upon the satisfaction of certain conditions (vesting requirements and/or retirement, for example). The employee may then use his or her funded HRA account to reimburse current or future medical expenses for the employee or the employee's spouse and dependents (available benefits are permitted to carry over from year to year). In addition, funded HRAs typically include an investment component allowing employee-participants to direct the investments of their HRA accounts. Because funded HRAs are a *defined contribution* plan with carry-over and investment features, many HRA participants use funded HRAs to "save for a rainy day" when future health care needs present more of a financial burden. Thus, all HRAs, but particularly funded HRAs combined with an investment component, incentivize individual ownership, which drives improved healthcare planning and consumerism. In contrast, monthly or annual premiums paid to insurance companies are forgone money, unless the insured utilizes the benefits provided under the insurance plan. Accordingly, the incentive under a *defined benefit* insurance plan is to use the benefits or lose the value of premiums-paid. These defined benefit plans often fail to incentivize the careful planning and consideration experienced with defined contribution plans like HRAs.

The intention behind the Excise Tax (also known as the "Cadillac Tax") is to reduce inefficiency and overutilization in the healthcare system caused by overly-generous group insurance plans. These types of plans shield or hide costs and incentivize providers to recommend (and insureds to use) more services, which ultimately drives up the overall cost for medical care. In contrast, the nature and design of an HRA generates more careful management of available resources and encourages the saving of account balances for long-term healthcare

needs. One of the government's stated goals in imposing the Excise Tax (in addition to increasing federal revenue) is to prompt employers to offer more cost-effective plans, with some shift of risk to employees along with mechanisms to help employees spend healthcare dollars wisely. HRAs are the very type of plan that are helping accomplish this goal, they are not the type of plan that Congress intended to cover, and they should be preserved by an exclusion in the definition of "applicable coverage" under the Excise Tax. Including HRAs in the definition of "applicable coverage" would be contrary to Congress' intent in promulgating the Excise Tax.

B. Funded HRAs have unique features and complexities that were not contemplated by the current language of § 4980I or the currently contemplated regulations.

Contributions to funded HRAs are most often held within single-employer or multi- or multiple-employer irrevocable trusts. These trusts frequently impose prohibitions on reversion of assets to the contributing employer and inurement to the employer or other third parties. In addition, these funded HRA plans and trusts are most frequently administered by independent third-party administrators or an independent board of trustees who jointly serve as the plan administrator. This adds a layer of complexity and special considerations in the administration and payment of the Excise Tax that are not properly contemplated under § 4980I or the currently anticipated regulatory scheme, as discussed in more detail under Parts III and IV below.

C. The wide- range of HRA design types, features, and usage choices present significant challenges and the likelihood of inconsistency in the determination of cost or valuation of HRAs for purposes of the Excise Tax.

The potential benefit and claims-eligibility design features of HRAs can vary widely on an employer-by-employer and employee-by-employee basis. For example, an employer may offer an integrated HRA plan (with in-service claims eligibility) for employees who are enrolled in a qualified group health plan and a retiree-only (or post-separation claims-eligibility) HRA for those who are not. Vesting requirements may also affect timing for claims-eligibility. In addition, some plans reduce, or offer employees an election to reduce, benefit coverage under their HRA plan for several reasons, including eligibility for HSA contributions, Medicare coordination, or eligibility for the premium tax credit. Finally, the use of (or spending under) HRAs varies widely based upon the unique family and healthcare needs, as well as the long-term savings desires of each employee. These factors make determination of the cost or value of an HRA unique to each individual, or at least each different type or class of employees, and present significant challenges to employers and plan administrators in the calculation of the HRA's overall benefit valuation (cost).

D. The challenges presented in coordinating the calculation and payment of the tax by third-party administrators make it administratively infeasible to include HRAs as "applicable coverage."

Funded HRAs are often implemented using free-standing, single-employer or multi- or multiple-employer irrevocable trusts. These HRA plans and trusts are most frequently administered by independent third-party administrators or an independent board of trustees who jointly serve as the plan administrator. These parties have no influence or control over (i) the frequency or amount of contributions an employer makes to the HRA, (ii) the funding sources for the employer's HRA contributions, or (iii) the choices employers make or negotiate regarding other unrelated benefits, including group insurance plans, HSAs, FSAs, etc. In many cases, the trust agreement for funded HRA plans, as well as federal regulations under ERISA and § 501(c)(9) (if using a voluntary employees' beneficiary association (VEBA) trust), would prohibit reversion of plan assets or payment of certain taxes and expenses from plan assets in order to pay the Excise Tax liability. Accordingly, a plan administrator in these cases may find that it is either prohibited from paying the tax from individual HRA accounts or from plan assets in general, or it may find that the HRA accounts for some covered individuals are depleted at the time the tax is due. Moreover, payment of the tax by assessing individual, funded HRA accounts would lead to a race by HRA participants to spend down the account prior to the due date for that tax. This would lead to poor benefit usage and produce the opposite result of one of the primary goals of the Excise Tax. If plan assets are unavailable or deemed inappropriate as a source of payment of the tax, it would be draconian, if not outrageous, to require an independent board of trustees or third-party administrator to pay the applicable Excise Tax. These independent boards or administrators have no control over the funding of the plan, the use of or spending under the plan, or the value of additional benefits that individual employers may choose or negotiate to provide to their employees, nor are they involved in the agreement or negotiation between employer and employee that gives rise to the taxable excess benefit.

E. An Excise Tax on HRAs will deplete account balances accumulated from HRA contributions, which are often negotiated in lieu of salary increases or other benefits or compensation as a means of providing long-term savings for post-retirement, pre-Medicare healthcare needs.

The tax-advantaged structure of HRAs that are funded in tax-exempt trusts, such as Section 115 trusts for governmental employers or VEBAs, are often designed to allow HRA participants to self-direct the investment of their account balance. This feature encourages employees to save unused amounts by investing those dollars on a tax-exempt basis and making available to the participant increased amounts of healthcare dollars during his or her retirement years. Many employee groups have previously negotiated for these HRA benefits in lieu of salary increases as a means of saving to help bridge the gap between retirement and Medicare eligibility. However, because § 4980I does not include a specific exemption for HRAs, or more specifically retiree-only HRAs, many of these funded HRA balances (which were negotiated many years ago in exchange for forgone salary increases or other benefits) will deplete if the

Excise Tax must be withheld and paid by the plan administrator from plan assets. The result would work to counter one of the stated goals of the Excise Tax (encouraging more efficient and considered planning for health care expenditures) and would thereby reduce the primary effect of the Excise Tax to nothing more than generation of federal revenue.

III. In lieu of an exemption for HRAs from the Excise Tax, the regulatory implementation of the Excise Tax should be more narrowly tailored to reduce the administrative complexities presented by the overbroad language of § 4980I

All of the factors described above present unique and significant challenges in the valuation of HRA plans, as well as in the administration and payment of the Excise Tax. If Treasury and the IRS decline to use their authority under § 4980I(g) to exempt HRAs as applicable coverage for purposes of the Excise Tax, then we urge the IRS and Treasury to implement an overall regulatory scheme that is narrowly tailored to accomplish the stated goals of the Excise Tax and streamlines the administrative burdens associated with compliance with § 4980I and its regulatory framework. Regulations relating to the determination of an HRA's value (cost) should afford employers and plan administrators the needed flexibility to choose the method that best fits their circumstances from a plan design, benefits usage, and administrative cost standpoint, all of which is further discussed in Part IV below. Furthermore, as discussed in Part V below, the additional layer between employers and independent plan administrators or governing boards for funded HRAs should be carefully considered, providing a process by which the Excise Tax payment obligation can be borne or passed-through to the employer, rather than paid from plan assets or paid directly by an independent, third-party plan administrator.

IV. Specific comments and recommendations relating to determination of cost issues raised in Notice 2015-16.

A. Because plan design, claims-eligibility, and use of benefits vary significantly from employer to employer and employee to employee, employers or plan administrators should be afforded flexibility in determining cost of coverage for an HRA.

Limiting the cost-of-applicable-coverage determination to only one method could penalize some covered individuals while benefiting others unfairly. The Notice points out that providing only one method to determine cost of applicable coverage would minimize administrative complexity. However, the administrative complexity involved in determining the cost of coverage for an HRA will be borne by the employer (or in some cases the plan administrator as discussed further in Part V). Accordingly, Treasury and the IRS should afford those entities the choice of selecting one or more methods of determining cost (even if more complex or burdensome) if the entity determines such method or methods best take into account the factors affecting the cost of their coverage.

Various methods of determining cost for HRA coverage may make more or less sense depending on (i) the factors that affect valuation (such as claims-eligibility and scope of

benefits), (ii) the administration and cost to make the cost determination, and (iii) the impact the valuation will have on the excess benefit calculation. For example, many retiree-only HRAs are funded with a lump-sum contribution upon separation from service. This one-time contribution can include one or more sources, including accrued sick and vacation pay, early-retirement incentive payments, or other mandatory contributions negotiated between employers and employee groups. In these cases, using a method based upon amounts newly made available for determining cost would unfairly disadvantage employees who receive a one-time, lump-sum contribution upon termination as compared to employees who receive monthly or annual contributions to their retiree-only HRAs prior to separation from service. In addition, for a retiree-only plan that is utilized to pay premiums, some participants (whether purchasing from the private market or the exchange) may choose much higher insurance coverage than others after separation from service, thereby using their HRA balances more quickly than others and driving up the cost determination for the overall HRA plan. Perhaps for these types of plans the determination of cost should be based upon the actual premium reimbursement amount for each participant. Alternatively, for HRA plans with very limited design options and elections, and consistent contribution methodology and history, benefit levels and usage may be very consistent. In these cases, the past-cost method would not only be the most accurate cost determination, but would also result in a fairly inexpensive method of determining cost. Finally, many employers have found with other types of self-insured coverage that the actuarial method is not always the most accurate predictor, and it is likely the most expensive method for determining cost. However, in cases where complexities in benefit usage, claims-eligibility, and contribution history will affect the cost determination, the actuarial method may be the best method to take all of these factors into account.

B. HRAs that are not yet claims-eligible should be excluded as applicable coverage or grouped separately for purposes of the cost determination.

The entity making the cost determination should be afforded the ability to exclude coverage under an HRA for which the participant is not yet claims-eligible. Many retiree-only HRAs and HRAs that are subject to vesting or other eligibility requirements or limitations should be excluded as applicable coverage under the Excise Tax prior to the account's claims eligibility. In many cases, funded retiree-only HRAs are not intended to be supplementary to the in-service group insurance coverage provided by the employer. Instead, these HRAs are often designed as a means of accumulating funds to bridge the gap for employees between retirement and Medicare-eligibility when they are no longer receiving employer-sponsored insurance coverage and must purchase coverage in the private market or from the exchange. Aggregating this coverage for purposes of the Excise Tax ***prior to*** the time the participant can utilize the benefits will significantly disadvantage these participants by either depleting accruing balances or driving employers to reduce contributions prior to retirement in order to avoid liability under the Excise Tax.

If HRA coverage for participants who are not yet claims-eligible status cannot be excluded as applicable coverage, then at the very least, those participants who are not yet claims-

eligible should be treated as a separate group for purposes of making the cost determination. First, usage and benefit amounts available to claims-eligible participants will unfairly increase the cost determination for HRA participants who cannot utilize their benefits due to separation, vesting, or other eligibility requirements. In addition, HRA participants who are not yet claims-eligible may choose a higher-cost medical plan, with greater benefits or a lower deductible, than participants who are claims eligible and are able to use their HRA benefits to supplement their group insurance coverage. In this scenario, the cost of HRA coverage for the non-claims eligible participants will be artificially high (based upon usage of the claims-eligible participants) and will be combined with the higher premium associated with the greater benefits selected under the medical plan. As a result, the aggregate benefit for non-claims-eligible participants will be skewed higher than the claims eligible participants who have elected reduced benefits under the medical plan. This result can be reduced or eliminated if the non-claims-eligible participants can be treated as a separate group.

C. Any cost determination adjustments to be incorporated based upon geography should apply to all applicable coverage, including account-based coverage such as HRAs, HSAs, FSAs.

Many commentators have recommended that a cost adjustment based upon geography should be added, similar to the adjustments for gender, retiree-status, and high-risk professions. The increased premium cost based upon ZIP code that exists for insured plans is driven by higher costs for medical care in those areas due to a combination of factors including cost of living, limited access, less competition, etc. These same factors also drive up usage (or reimbursement amounts) under account-based plans, such as HRAs, which in turn will correlate to a higher cost determination. For this reason, any geographical adjustment incorporated into the Excise Tax regulations should be applied to account-based coverage as well as insurance coverage.

D. Regulations should provide flexibility to employers and plan administrators as to whether demographic, historical or anticipated usage, and other actuarial information used to determine cost for funded HRA plans is based upon plan-wide or individual-employer information.

As discussed in Parts II.B above and V.A below with respect to funded HRAs, "the person who administers the plan" *(for purposes of § 4980I(c)(3))* is typically an independent board of trustees or a third-party engaged by the individual employer sponsor or by the joint board of trustees (in the case of multi- or multiple employer plans). For single-employer funded HRAs administered by a third-party or multi- or multiple employer funded HRAs administered by an independent board or third-party, regulations need to provide flexibility for the employer or plan administrator to identify the best source of data when applying the past-cost or actuarial methods for determining the cost of HRA coverage. For example, the cost determination could be (i) made at the individual employer level, (ii) based upon the experience of the overall plan (in the case of a multi- or multiple employer plan), or (iii) based upon the experience of all

participating employers (in the case of a third-party who is engaged to uniformly administer HRA plans based upon a prototype plan document and administration platform).

E. The determination of cost for HRA plans should disregard contributions and balances accumulated prior to the 2018 effective date for the Excise Tax.

As mentioned above, one of the primary purposes for the Excise Tax is to reduce excessive insurance benefits and encourage consumer driven decision-making by penalizing insurers and employers who provide lavish health care benefits commencing in 2018. However, many HRAs (which were implemented to encourage healthcare savings and consumer driven decision-making) have funded balances that have accumulated from contributions made prior to 2018 and even prior to the enactment of the Excise Tax. These prior balances and their historical usage should be excluded from the cost determination for amounts accumulated prior to 2018. Instead, the determination of cost for HRAs should be based upon factors such as contributions amounts, accumulated balances, and prior and anticipated usage ***beginning in 2018***, the effective date of the Excise Tax. To include balances accumulated prior to 2018 for purposes of making the cost determination for HRAs would not only present an additional layer of complexity to the already difficult actuarial and cost-determination process, but it would also work to contradict Congress's intent in enacting the Excise Tax.

V. Regulations should appropriately take into account the unique challenges facing independent plan administrators in valuing and paying of the Excise Tax for funded HRAs

Funded HRAs are often implemented using free-standing, single-employer or multi- or multiple-employer irrevocable trusts. These HRA plans and trusts are most frequently administered by independent third-party administrators or an independent board of trustees who jointly serve as the plan administrator. Thus, for these funded HRAs, "the person who administers the plan" (for purposes of § 4980I(c)(3)) can be an independent board of trustees or a third-party engaged by the individual employer sponsor or by the board of trustees (in the case of multi- or multiple-employer plans). These parties have no influence or control over the frequency or amount of contributions an employer makes to the HRA or the funding sources for the employer's HRA contributions. In addition, an independent plan administrator has no control over or knowledge about the choices a participating employer makes or its negotiations with employee groups regarding other unrelated benefits, including group insurance plans, HSAs, FSAs, etc., which would ultimately contribute to the excess benefit calculation and the resulting allocation of Excise Tax liability that must be paid by the plan administrator under §4980I(c)(3). As a result, the application of payment obligations under §4980I(c)(3) to the plan administrator for these funded HRA plans introduces an additional layer of administrative complexity and compliance concerns to the already complicated regulatory landscape for determining cost of applicable coverage, calculating the excess benefit amount, and payment of the Excise Tax.

A. Complexities for independent plan administrators in planning and budgeting for Excise Tax liability

Another issue arises from the indication in the Notice that employees grouped in different benefit packages would be grouped separately. This means that an HRA plan administrator will receive the employer's determination of the plan administrator's portion of the tax due based upon the employer's calculation of the excess benefit. If different groups of the same employer will be grouped separately based upon different benefit packages, the plan administrator will be liable for different tax payments for different groups under each employer, based upon information and benefit decisions outside of its control. Without control over or knowledge about the funding of the plan, use of or spending under the plan, or the value of additional benefits that individual employers may choose or negotiate to provide to their employees, independent plan administrators will have no ability to plan or budget for this payment obligation and no mechanism by which to pass-through the payment liability to the employer.

B. Complexities for independent plan administrators relating to payment of the Excise Tax.

In many cases, the trust agreement for funded HRA plans, as well as federal regulations under ERISA and Code § 501(c)(9) (if using a VEBA trust instrument) would prohibit reversion of plan assets or payment of certain taxes and expenses from plan assets in order to pay the Excise Tax liability. Accordingly, a plan administrator in these cases may find that it is either prohibited from paying the tax from individual HRA accounts or from plan assets in general, or it may find that the HRA accounts for some covered individuals are depleted at the time the tax is to be paid. Even in circumstances when payment of the tax from plan assets is permitted, to allow for payment of the tax from plan assets would lead to a race by HRA participants to spend-down or deplete the account prior to the due date for the tax. In either of these cases, it would be improper to require an unrelated board of trustees or third-party acting as the plan administrator to pay the applicable Excise Tax, when it is not a party to the agreement or negotiation that gave rise to the taxable excess benefit and has no access to employer funds. In these cases, the applicable Excise Tax should be paid by the employer, which is the party who has control over and prior knowledge of (i) the frequency or amount of contributions to the HRA, (ii) the funding sources for HRA contributions, and (iii) the choices or negotiations regarding other unrelated benefits, including group insurance plans, HSAs, FSAs, etc.

C. Complexities between independent plan administrators and employers relating to delivery of and accountability for information

Finally, employers participating in or contributing to plans administered by a board of trustees or third-party plan administrator may not have access to information regarding usage, demographics, account balances, and other information, particularly for employees that have separated from service with the employer but who have remaining account balances and claims-eligibility under the HRA plan. Section 4980I(c)(4) specifies that the employer is to calculate the tax, but regulations should provide for procedures and dates by which employers can obtain

from third-party administrators any usage, demographics, account balances, and other information needed to determine the cost of coverage, or alternatively, the third-party administrator's determination of the cost of coverage. These procedures should contemplate penalties with respect to the reporting of information back and forth between responsible parties.

Respectfully submitted,

The Electrical Workers' VEBA Trust