
National League of Cities Comments on Proposed Regs on Health Insurance Provider Fee.

Clarence Anthony of the National League of Cities has commented on proposed regulations (REG-118315-12) on the annual health insurance provider fee under the Affordable Care Act, seeking clarification that governmental employers who self-fund their benefit plans on a pooled basis, and the pools in which they participate, fall under the self-insured employer exclusion and, thus, aren't covered entities subject to the fee.

June 3, 2013

The Honorable Daniel Werfel

Acting Commissioner

Internal Revenue Service

CC:PA:LPD:PR (REG-118315-12)

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

RE: Health Insurance Providers Fee Notice of Proposed Rulemaking — Comments and Request to Testify

Dear Acting Commissioner Werfel:

The National League of Cities ("NLC") on behalf of cities and towns throughout the country appreciates the opportunity to provide comments to Treasury and the Internal Revenue Service ("Treasury") on the Notice of Proposed Rulemaking ("Proposed Rule"), Health Insurance Providers Fee, as published in the Federal Register on March 4, 2013 (78 Fed. Reg. 14034), and subsequently corrected on March 22, 2013 (78 Fed. Reg. 17612). Many of these cities and towns have joined together to form public entity health care pools to provide health care insurance coverage to their employees. Without the benefit of these pools, many of these entities would not be large enough to self-insure and all would face either larger or more unpredictable costs to provide these essential benefits.

Section 9010 imposes an annual fee on covered entities engaged in the business of providing health insurance for any U.S. health risk. ACA §§ 9010(a)(1) and (c)(1). Generally, section 9010 provides that the term "covered entity" does not include: (1) any employer to the extent the employer self-insures its employees' health risks; (2) any governmental entity; (3) certain nonprofit entities that do not engage in certain political activities and receive more than 80-percent of revenues from

Medicaid, Medicare, and SCHIP; and (4) non-employer established VEBAs.

While the Proposed Rule defines the term "governmental entity" to include political subdivisions of a state, it does not include instrumentalities of a governmental entity. 78 Fed. Reg. at 14042.

The preamble notes that instrumentalities that provide health insurance may qualify for other exclusions under section 9010, such as the exclusion for employers that self-insure their employees' health risks. 78 Fed. Reg. at 14037. Treasury invites comments on the types of instrumentalities, if any, that would be covered entities under the general definition and the extent to which they would qualify for exclusions consistent with the statute. Our detailed comments are below.

We also request an opportunity to testify at the public hearing on June 21, 2013.

I. Background

NLC is the country's largest and oldest national organization serving over 19,000 cities and towns throughout the country and 49 state municipal leagues. Founded in 1924, NLC helps city leaders build better communities through federal advocacy, research, and information sharing between and among cities and towns and state municipal leagues.

State municipal leagues are intergovernmental organizations comprised of member cities and towns within a state. They were formed and operate to improve the operations of their municipal government members and promote the welfare of citizens of those municipalities by faciliating and coordinating research and programs that (i) advance the efficient and effective operations of member municipalities, (ii) promote governmental efficiency and effective governance, and (iii) coordinate and effect advocacy and communications with the legislative, administrative and judicial branches of state and federal governments on issues affecting member municipalities.

Many governmental entities are authorized under state law to join together to self-insure health benefits for their employees through risk-sharing pools, trusts or other group arrangements (collectively, "Pools"). These entities are operated exclusively for the benefit of the municipal employers. An NLC affiliate, the NLC Risk Information Sharing Consoritum ("NLC-RISC") is an association of state municipal league intergovernmental risk-sharing Pools in thirty-four states. NLC-RISC member Pools offer property, liability, workers' compensation, unemployment, and/or employee benefit programs to their combined 16,000+ member cities, towns, counties and other local government entities.

NLC-RISC member Pools are universally exempt from tax under Code § 115 or as VEBAs under Code § 501(c)(9). Many have private letter rulings recognizing that they perform an essential government function on behalf of their municipal participants with all of a Pool's income accruing solely for the benefit of their participating public employers and not for private interests.

Those Pools that provide health benefits to local government employees and their families are all comprised of governmental entities that would be excluded from the fee were they to provide health benefits through their own separate health plan, under both the governmental entity exclusion and the self-insured employer exclusion. In many cases, cities and towns are too small to effectively self-insure some or all health benefits for their own employees. Thus, when cities and towns join together to provide health coverage through a Pool, they enjoy economies of scale, which helps to lower the cost of the coverage for both the municipalities and their employees. They also enjoy enhanced stability by having a larger risk pool.

On behalf of cities and towns throughout the country who have joined together to form public entity

health Pools, we submit this comment letter to request an express exclusion for these Pools in the final rule. Although we believe Pools fit within the self-insured employer exclusion (or VEBA exclusion for those Pools that are VEBAs), they are instrumentalities of governments and thus are not included in the governmental entity exclusion under the Proposed Rule. We are concerned that without an express inclusion in the definition of governmental entities not subject to the fee or an express exclusion from the fee as self-insured employers, the Pools or the municipal employers covered under a pooled arrangement could be interpreted as being covered entities subject to the fee.1

We believe that the overarching intent of Congress is to exclude governmental entities that self-insure their employees' health benefits from the health insurer fee. This is evident by the existence of both the governmental entity exception and the self-insured employer exception. These exceptions should apply whether the governmental entity provides the self-insurance alone or does so jointly with other governmental entities through a Pool.

II. Recommendations

We recommend that Treasury define governmental entity in the final rule to expressly include a Pool through which political subdivisions jointly self-insure their employees' health benefits. Alternatively, we recommend that Treasury specifically include Pools, and the governmental entities that self-insure their employees' health risks through Pools, in the self-insured employer exclusion.

1. Governmental Entity Exclusion

Treasury should expressly include Pools in the definition of governmental entity. ACA § 9010(c)(2)(B) broadly excludes any governmental entity from the definition of covered entity. However, the Proposed Rule narrows the definition of governmental entity to not include instrumentalities of states or local political subdivisions. 78 FR at 14042.

In the discussion of instrumentalities in the preamble to the Proposed Rule, Treasury refers to instrumentalities within the meaning of Rev. Rul. 57-128. That revenue ruling confirmed the tax-exempt status for federal employment tax purposes of an interstate association of several state insurance departments. In the ruling, the IRS applied a six factor test in determining whether the association was an "instrumentality of one or more states or political subdivisions." All Pools satisfy this six factor test, and therefore are either instrumentalities of their public entity participants or are intergovernmental agencies in their own right under state law. Thus, it appears that Pools may not be exempted from the definition of covered entity as "governmental entities" under the Proposed Rule.

Pools are comprised of counties, municipalities, school districts, authorities and other local political subdivisions and are established under state intergovernmental cooperation laws. Their sole purpose is to provide health benefits to the employees and employees' dependents of their municipality participants. As a result, they have been recognized by the IRS as performing an essential government function on behalf of their participants — with all of their income accruing solely to their participating governmental employers — and are therefore exempt from taxation under Code § 115(1), in accordance with Rev. Ruling 90-74, 1990-2 C.B. 34.

Not excluding Pools from the definition of covered entity because they may also be deemed governmental instrumentalities is inconsistent with the rationale for their Code § 115 tax exemption, as expressed in Rev. Ruling 90-74, which states in pertinent part that:

Political subdivisions insure against casualty risks and other risks arising from employee negligence,

workers' compensation statutes, and employee health obligations. Insuring against these risks satisfies governmental obligations. Any private benefit to employees from insuring against these various risks is incidental to the public benefit.

* * *

[T]he income of an organization formed, operated, and funded by one or more political subdivisions (or by a state or one or more political subdivisions) to pool their risks in lieu of purchasing insurance to cover their public liability, workers' compensation, or employees' health obligations is also excluded under section 115(1) if private interests do not, except for incidental benefits to employees of the participating states or political subdivisions, participate in or benefit from the organization.

(Emphasis added). See Rev. Rul. 90-74, 1990-2 C.B. 34. Based on this published ruling, the Service has issued numerous section 115 private letter rulings to state or municipal health insurance funds for active and/or retiree health benefits.

Thus, as governmental instrumentalities or agencies that perform an essential government function, Pools should not be treated any differently under ACA § 9010 than the governmental entities that use them to provide health benefits to the governmental entities' employees. Pools are funded solely by local taxpayers and governed by public officials on a tax-exempt, non-profit basis. Like the governmental entities that use them, Pools should not be subject to the health insurer fee. We therefore respectfully request that the final rule expressly include this type of governmental "instrumentalities" in the definition of governmental entity.

We note that this approach would be consistent with the definition of government entity in the Code § 4980H employer shared responsibility proposed rule, which defines government entity as expressly including any "agency or instrumentality" of "a state or political subdivision thereof." See 78 Fed. Reg. 241. We see no reason why the health insurer fee should depart from the commonly used definition of government entity.

2. Self-Insured Employer Exclusion

We strongly support Treasury expressly including Pools in the definition of governmental entity excluded from the health insurer fee. Alternatively, Treasury should expressly include governmental entities that use Pools, and the Pools themselves, in the definition of self-insured employer.

Section 9010 and the Proposed Rule provide that the term "covered entity" does not include any employer to the extent that the employer self-insures its employees' health risks. ACA § 9010(c)(2)(A); 78 Fed. Reg. at 14042. The Proposed Rule defines self-insured employer as an employer that sponsors a self-insured medical reimbursement plan within the meaning of Treas. Reg. § 1.105-11(b)(1)(i), including plans that do not involve shifting risk to an unrelated third party, as described in Treas. Reg. § 1.105-11(b)(1)(ii). 78 Fed. Reg. at 14042.

The local governments that comprise a governmental risk-sharing Pool jointly fund their employees' health benefits plans on a pooled basis in which they share the risk and do not shift the risk to a licensed health insurer or other unrelated third party. The government participants are inextricably bound to the Pool and each other by the intergovernmental obligations they assume for the establishment and funding of the Pool itself. With ultimate governing authority and financial accountability for each Pool vested in its public entity participants, those Pools are not unrelated third parties (or health insurers).

As explained earlier, the way Pools operate and how they are funded make their participating

governmental employers “self-insured employers” within the meaning of Treas. Reg. § 1.105-11. For that reason, we respectfully request that the final rule clearly provide that governmental employers who self-fund their benefit plans on a pooled basis, and the Pools in which they participate, both fall within the self-insured employer exclusion and thus are not covered entities subject to the health insurance fee.

* * *

We appreciate the opportunity to comment on the Proposed Rule. If you have any questions, please contact Carolyn Coleman, Director, Federal Relations, 202.626.3023, coleman@nlc.org or Erin Rian, NLC-RISC Program Manager, 202.626.3122, erian@nlcmutual.com.

Sincerely,

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Executive Director

National League of Cities

Washington, DC

FOOTNOTE

1 We note that as governmental entities, Pools are not MEWAs under ERISA § 3(40) and thus, should not be included within the definition of “covered entity” as MEWAs.