COLORADO PERA®

Colorado Public Employees' Retirement Association
Mailing Address: PO Box 5800, Denver, CO 80217-5800
Office Locations: 1301 Pennsylvania Street, Denver
1120 W. 122nd Avenue, Westminster
303-832-9550 • 1-800-759-PERA (7372)
www.copera.org

July 8, 2015

SENT ELECTRONICALLY, VIA THE FOLLOWING E-MAIL ADDRESS:
Notice.comments@irscounsel.treas.gov

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

The Colorado Public Employees' Retirement Association ("Colorado PERA") appreciates this opportunity to submit comments on the issues raised by IRS Notice 2015-16 regarding the Excise Tax on High Cost Employer-Sponsored Health Coverage (the "40% Excise Tax") under Internal Revenue Code section 4980I. Colorado PERA is an instrumentality of the state of Colorado and is mandated by law to offer a health benefits program for its retirees and their dependents. Colorado PERA's health benefits program ("PERACare") offers self-insured health care, dental, and vision coverage on an after-tax basis to over 100,000 retired and disabled public employees of the State of Colorado (and other participating state, school, and local governmental employers) and their dependents. For pre-Medicare (under age 65) retirees, PERACare provides HMOs, PPOs, and High Deductible Health Plans (HDHPs). For Medicare-eligible retirees, PERACare provides Medicare HMOs and Medicare supplement plans. Retirees and dependents covered by PERACare reside in virtually all 50 states.

As health care costs continue to rise, Colorado PERA has focused on strategies to control costs while continuing to provide its retirees a health care program focused on quality and choice. PERACare provides benefit structures at the bronze and silver levels. Currently, less than 5% of PERACare's annual costs are attributable to plan administration, and over 95% of its costs are directly attributable to the payment of claims.

Colorado PERA-affiliated employers contribute an annual amount equal to 1.02% of their annual payroll for active employees ("1.02% employer contributions"). Pursuant to Colorado law, Colorado PERA uses those contributions to pay a subsidy toward the retirees' cost of coverage, limited to a maximum of $230 per month for pre-Medicare participants and a maximum of $115 per month for Medicare-eligible participants. The retirees pay the remaining premium, after the subsidy, on an after-tax basis. If not for the 1.02% employer contribution (a "pre-tax" employer premium payment), PERACare would not even be subject to the 40% Excise

Tax because the PERACare plans would not then constitute employer-provided coverage. The 1.02% employer contribution is mandated by Colorado law, and the Colorado PERA Board of Trustees has no authority to eliminate or change the amount of this contribution.

Because PERACare, rather than Colorado state employers, will be responsible for paying the 40% Excise Tax, and PERACare cannot make its administration more efficient, the only possible outcome is that every penny of the 40% Excise Tax will be passed on to PERACare's retired participants, directly increasing the amount of their after-tax payments. State governmental retiree systems do not have the authority to increase the amount of retiree pension checks, as Colorado PERA pension benefits are set by the state legislature. As a result of the 40% Excise Tax, the retirees will face increased healthcare costs with no prospect of an increase in income. This result is opposite of 40% Excise Tax intended purpose of putting more taxable income into the retirees' pockets. While the retirees will absorb the entire impact of the 40% Excise Tax, the IRS will not gain any additional tax revenue as retirees will continue to pay their increased premiums on an after-tax basis. The result is a "no-win" situation for our retirees.

Against this background, we offer the following comments.

1. **Pre- and post-age 65 retiree benefits should be permissively aggregated, regardless of whether such benefits are identical.** We respectfully request that any future rule regarding pre- and post-Medicare-eligible retirees be clarified to allow these two groups to be permissively aggregated for purposes of cost determination, even if the two groups have different coverages. Section 4980I(d)(2) provides that, in the case of applicable employer-sponsored coverage which provides coverage to retired employees, the plan may elect to treat a retired employee who has not attained the age of 65 and a retired employee who has attained the age of 65 as "similarly situated beneficiaries."

Congress was aware that the costs and types of benefits offered to pre-Medicare-eligible retirees differ significantly from post-Medicare retirees—a reality reflected in PERACare's benefit structure. Yet, the statute specifies that the two groups are "similarly situated." Accordingly, we suggest that the proposal set forth in Notice 2015-16 requiring the disaggregation of different benefit types should exempt pre- and post-Medicare retirees, and that any future rules allow for the aggregation of costs for pre- and post-age 65 retirees even if the coverages for such groups are different.

2. **Because retiree health plans are intrinsically more expensive than health plans covering active employees, retiree plans should have greater access to appropriate actuarial adjustments.** Retiree-only governmental plans have different actuarial concerns than health plans covering active employees. Like other retiree health plans, PERACare's experience demonstrates the assumption generally accepted in the healthcare industry that retired individuals consume medical services at a higher rate than active employees with similar age and gender characteristics. This phenomenon may be attributable to any one of the following:

- People who choose to retire may be in poorer health than active employees of the same age, or they may simply have more time to seek medical services.
- Retiree plans necessarily have an older population than active plans.
- PERACare's retiree population typically require high-cost specialty medications to a greater degree than an active population; and
- PERACare covers many Medicare beneficiaries with no part A coverage.
- It is also generally accepted that lower- or fixed-income people generally elect more expensive coverage with fewer out-of-pocket costs because they are afraid that their cash flow is insufficient to cover such costs.
- Retiree-only plan participants are more likely to be widely dispersed geographically as the retirees move away from their original place of employment, subjecting them to greater cost variations than an active population.

Thus, based on PERACare's experience, it is a fallacy that the higher costs attributable to retiree medical plans are the result of richer, "Cadillac" benefits. Instead, the higher costs result from the unique characteristics of retiree communities. For this reason, age and gender adjustments for PERACare retirees are not enough on their own.

We respectfully request that any future 40% Excise Tax rules allow for "stacking" of the dollar-limit adjustments for age and gender, status as a "qualifying retiree," and/or high-risk professionals. PERACare participants often fall into multiple, if not all, of the groups that warrant a dollar-limit adjustment and thus, they should receive the benefit of all of the adjustments to which they are entitled (i.e., rather than being limited to use of a single adjustment).

All of PERACare's participants (whose average age is 59-1/2) should count as "qualifying retirees" for actuarial purposes, based upon factors other than age. In fact, the age 55 limit for this purpose may be viewed as arbitrary in light of PERACare's population of retirees. PERACare covers disabled participants who are younger than age 55. In addition to former teachers, maintenance personnel and library workers, PERACare provides benefits to former state troopers, correction officials, and other individuals who have spent 20 years or more in high-risk professions—a group of professionals who often retire prior to age 55 due to their hazardous work and who constitute high-demand medical consumers at any age. In order for PERACare and other retiree-only plans to continue providing retiree participants with quality coverage at a reasonable cost, the adjustments should be permitted on a cumulative basis, rather than an exclusive basis.

3. **The IRS should establish a safe harbor for calculating the cost of benefits based upon actuarial value.** We respectfully suggest that any future rules permit safe harbor protection based upon the actuarial value of the coverage provided. As many commenters will no doubt point out, the determination of value is integral to other provisions of the ACA, such as the Employer Shared Responsibility penalties and the designation of "bronze," "silver", "gold'

and "platinum" level coverage offered on the Exchanges. It seems inconsistent for the ACA to designate "bronze" level coverage (which pays at least 60% of the benefits covered under the plan) as "minimum value" and then, depending on its cost, subject it to an Excise Tax for "excess" benefits. As explained above, due to PERACare's participants' unique characteristics, high cost coverage does not equate with "rich" coverage. Therefore, a safe harbor from imposition of the 40% Excise Tax is appropriate for plans at either the silver (70%) or bronze (60%) levels.

This type of safe harbor approach is not inconsistent with the statutory language of section 4980I. The various actuarial levels of coverage (e.g., bronze, silver) can be monetized by determining the average cost on the Exchanges for bronze and silver coverage, and establishing cost benchmarks for such plans in the employer market (i.e., turning actuarial values into costs).

4. Governmental retiree plans should be afforded a safe-harbor pursuant to which all coverage is treated as other-than-self-only coverage. Another safe harbor that may be appropriate for retiree plans in light of their intrinsically higher costs is to allow all coverage under a retiree plan to be treated as other-than-self-only coverage for purposes of the annual applicable dollar limits set forth in Code section 4980I(b)(3)(C). This approach is already recognized in Code section 4980I(b)(3)(B)(ii). The expanded limit for retiree plans could lessen any incentive that plan sponsors might otherwise have to terminate retiree plans.

5. The methods for calculating COBRA costs should provide flexibility, especially for very large governmental systems. For self-insured plans, the IRS proposes to use the two methods available for calculating COBRA applicable premiums: the actuarial basis method and the past cost method. The IRS is considering requiring plans to use the same valuation method for at least five years. Generally, the past cost method is difficult to implement because many plans find it necessary to significantly change their benefits frequently – certainly more frequently than every five years. We encourage the IRS to provide maximum flexibility by allowing plans to change methodologies as the circumstances may require.

Additionally, any actuarial basis method should accommodate employers of different sizes. For a very large governmental health system like PERACare, a single year of claims experience may be sufficient to calculate or estimate the expected cost of the plan. For smaller systems, on the other hand, two or three years of claims experience may be sufficient to make a reasonable cost determination.

Other Considerations for Special Treatment of Retiree-Only Plans

In addition to the specific comments and suggestions above, we respectfully request that the IRS take notice of the following. First, Notice 2015-16 mentions that employers have for the past several years been required to report the cost of employee healthcare benefits on each employee's Form W-2. While this existing requirement may make cost determinations more routine for employers, the same is not true for providers of retiree medical benefits which have

never been required to provide Forms W-2 to retiree participants and are not required to determine costs for W-2 purposes. This may be another indication that the 40% Excise Tax was not intended to apply to governmental retiree medical benefit plans.

Finally, questions remain as to whether the courts will determine that the imposition of the 40% Excise Tax on a state retiree medical plan is unconstitutional. It is worth noting that all of PERACare's funds are provided by Colorado taxpayers – whether by state employers or by the retirees themselves. In general, the federal government is precluded from directly taxing the States and their instrumentalities. Such direct taxation alters the balance of authority between the federal government and the states in contravention of the Tenth Amendment to the U.S. Constitution[1], the Anti-Commandeering doctrine[2], and the doctrine of Intergovernmental Tax Immunity[3]. Once the 40% Excise Tax is collected from a state system, the federal government is free to use the Excise Tax to fund federal programs unrelated to the ACA and unrelated to the State that pays it. In this way, the 40% Excise Tax impermissibly forces the State to function both as the federal government's tax assessor and its tax collector. For these reasons, a court could (and very well may) strike down the 40% Excise Tax as unconstitutional as applied to governmental health plans. Although Congress specifically states in section 4980I that governmental plans are subject to the Excise Tax, it is unlikely that Congress intended the 40% Excise Tax to apply in a way that violates the U.S. Constitution. Thus, some regulatory leeway should be applied to governmental plans.

We appreciate the opportunity to comment on the issues addressed by IRS Notice 2015-16. If you have any questions or comments, please call Joni L. Andrioff, Partner, Steptoe & Johnson LLP, at 202-429-8064.

Sincerely,

Donna Baros
Chief Benefits Officer

[1] "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."
[2] See, e.g., Prigg v. Pennsylvania, 41 U.S. 539 (1842).
[3] See, e.g., McCulloch v. Md., 17 U.S. 316 (1819); Davis v. Michigan Dep't of Treasury, 489 U.S. 803 (U.S. 1989).