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in the Spirit of Cooperation . . .**

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March 19, 2013

RE: **Written Statement for the Record
U.S. House Ways and Means Committee
Hearing on Tax Reform and Tax Provisions Affecting State and Local
Governments**

Chairman Camp, Ranking Member Levin, and Members of the Committee:

We urge the committee to include in tax legislation this year a provision to correct the effect on local government employees of Revenue Ruling 2006-36 relating to health reimbursement arrangements (HRAs) and the forfeiture on death of accounts held in voluntary employees' beneficiary association (VEBA) trusts, and in trusts for which income is not includable under Section 115 of the Internal Revenue Code ("funded HRAs"). In 2008, Congress corrected this problem for state-level employees and we believe that Congress should correct it for local-level public employees as well.

Hundreds of local governments in Minnesota use funded HRAs both for active employees and retirees. These programs benefit tens of thousands of local government employees and retirees. To be eligible for contributions to funded HRAs, employees must be enrolled in employer-sponsored group health plans. No employees or retirees are allowed to choose between taxable cash compensation and employer contributions, but taxable compensation is often less when employers make contributions to funded HRAs. Employees vest in their HRA contributions, and they are permitted to direct notional investments in their accounts. Peer reviewed research in Minnesota demonstrates that the use of funded HRAs reduces trend in health care inflation while increasing utilization of preventive care.

When first introduced in Minnesota, funded HRAs allowed participants without spouses or tax dependents to designate beneficiaries of their accounts upon death. As with any health plan that permits coverage for non-dependents, funded HRAs were designed so that the "imputed value" of coverage for a beneficiary would be taxable to the participant on death. Prior IRS guidance provided a simple mechanism where the VEBA withheld and forwarded income and employment taxes. In this manner, the IRS collected its tax on death, and adult children, grandchildren or other beneficiaries of participants could use the balance for reimbursement of medical expenses.

Revenue Ruling 2006-36 broke with established precedent regarding the right to provide health coverage for non-dependents subject to imputed income rules. Instead, it required that these accounts be forfeited on death. Many employees and retirees had already built significant savings in these arrangements with the reasonable expectation that they would be treated the same under the tax law as other participants in group health plans. Revenue Ruling 2006-36 is bad tax policy, because it treats similarly situated public employees differently without a good reason. It also results in bad health policy, since funded HRAs help reduce health care costs and encourage preventive care.

Public Law 110-458 (H.R. 7327), the Worker, Retiree, and Employer Recovery Act of 2008, exempted from the forfeiture requirement HRA plans for certain public employees participating in state public retirement systems. These plans are virtually identical to HRA arrangements administered by local units of government. But the law is narrowly drafted to benefit a relatively small number of employees while providing disparate treatment to similarly situated individuals in local units of government. This year, Congress should finish the job and fix the problem for local government employees.

We strongly support the enactment of legislation like the bills introduced in the last Congress as H.R. 2698 (Reichert) and S. 1366 (Cantwell). Such legislation would bring fairness where it is needed. These bills do not require that income be imputed to decedents, but the impact of funded HRAs in reducing trend means that participants will pay less for health care in the long run. This means that fewer dollars will be shielded from taxation, and more will be paid to participants in the form of taxable wages.

Because we believe that the use of funded HRAs amounts to good public policy both from a tax standpoint and from a health care cost containment standpoint, we would support changing the law for state and local plans going forward. However, we do very much support the substantial partial corrections offered in the Reichert and Cantwell bills, which would apply to plans in place prior to 2008, when the unexpected Revenue Ruling was issued. At a minimum, we would request a clarification that reimbursements to non-dependents from funded HRAs on death may be permitted where the value of coverage is imputed to the decedent.

We would be happy to provide the Committee with further information at any time.

Sincerely,

A handwritten signature in black ink that reads "Jeremy Kovash". The signature is written in a cursive style with a large initial "J" and "K".

Jeremy Kovash
Executive Director / CEO
Lakes Country Service Cooperative