Office of Chief Counsel
Internal Revenue Service
memorandum

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subject: Computation of Medical Loss Ratio under Section 833(c)(5)

This Chief Counsel Advice responds to your request for assistance regarding the computation of the medical loss ratio under § 833(c)(5) of the Internal Revenue Code ("§ 833(c)(5) MLR"). This advice may not be used or cited as precedent.

Section 833(c)(5), as amended by the Consolidated and Further Continuing Appropriations Act, 2015, provides that § 833(a)(2) and (3) shall not apply to any organization unless such organization's percentage of total premium revenue expended on reimbursement for clinical services and for activities that improve health care quality provided to enrollees under its policies during such taxable year (as reported under § 2718 of the Public Health Service Act) is not less than 85 percent. Section 2718(b) provides that health insurance providers must rebate premiums to enrollees if an organization's amounts expended on reimbursements for clinical services and for activities that improve health care quality relative to its total amount of premium revenue is less than 80 percent in the small group and individual markets or less than 85 percent in the large group market.

Question 1: If, for a reporting year, an organization did not meet the 80 percent medical loss ratio for the small group market established by § 2718, but exceeded the 85

percent medical loss ratio for the large group market established by § 2718, did the organization satisfy the 85 percent § 833(c)(5) MLR for that taxable year?

Answer 1: Section 2718 medical loss ratio rebates are computed separately for each market segment (the individual, small group, and large group markets). By contrast, the § 833(c)(5) MLR does not have separate MLR requirements for different market segments and is computed on an aggregate basis, including data from all market segments.

In this case, if the organization's § 833(c)(5) MLR computed on an aggregate basis is at least 85 percent, the organization will satisfy the § 833(c)(5) MLR for the taxable year. If the organization's § 833(c)(5) MLR computed on an aggregate basis is not at least 85 percent, the organization will not satisfy the § 833(c)(5) MLR for the taxable year.

Question 2: If an organization issued § 2718 medical loss ratio rebates to enrollees for a reporting year, does this necessarily indicate that the organization did not satisfy the § 833(c)(5) MLR for that taxable year?

Answer 2: No, the fact that an organization issued § 2718 medical loss ratio rebates to enrollees for a reporting year does not necessarily indicate that the organization did not satisfy the § 833(c)(5) MLR for that taxable year. As stated above, the § 2718 medical loss ratio is computed by market segment, but the § 833(c)(5) MLR is computed on an aggregate basis. As a result, it is possible for an organization to be required to issue § 2718 medical loss ratio rebates to enrollees by market segment for a reporting year, but on an aggregate basis satisfy the § 833(c)(5) MLR for that taxable year.

Question 3: May an organization include rebates issued to enrollees under § 2718(b) for a prior reporting year as an expense in computing its § 833(c)(5) MLR for the following taxable year?

Answer 3: Section 833(c)(5) provides that the elements in the computation of the § 833(c)(5) MLR are "as reported under section 2718 of the Public Health Service Act." This cross reference indicates that, to the extent consistent with the express language of § 833(c)(5), the meaning of the terms and the methodology used in the § 833(c)(5) MLR computation should be consistent with the definition of those same terms and methodology under § 2718. T.D. 9651. As a result, the answer for each taxable year depends on the method provided under the applicable regulations issued by HHS.

For 2011, the HHS interim final regulations provided that the § 2718 medical loss ratio was computed on data reported for the 2011 reporting year only. 45 C.F.R § 158.220(c)(1). For 2012, the HHS interim final regulations provided that the § 2718 medical loss ratio was computed on data reported for the 2012 reporting year, including rebates paid for the 2011 reporting year. 45 C.F.R. § 158.221(b)(1). For 2013, the

HHS interim final regulations provided that the § 2718 medical loss ratio was computed on data reported for the 2013 reporting year, including rebates paid for the 2011 and 2012 reporting years. 45 C.F.R. § 158.221(b)(2). For later reporting years, rebates paid in prior years are not included in the computation of the § 2718 medical loss ratio, see 45 C.F.R. § 158.221(b), and thus under § 1.833-1(c) of the Income Tax Regulations are not included for purposes of computing the § 833(c)(5) MLR. As a result, whether for a given taxable year an organization can include rebates issued to enrollees under § 2718(b) with respect to a prior reporting year as an expense in computing its § 833(c)(5) MLR depends on the HHS guidance in effect for that year.

Question 4: For purposes of computing its § 833(c)(5) MLR for a taxable year, may an organization decrease its § 833(c)(5) MLR denominator for additional federal income taxes incurred with respect to an increased incurred but not reported ("IBNR") reserve for the taxable year?

Answer 4: An organization may decrease its premium revenue by the amount of its federal and state taxes and licensing or regulatory fees as otherwise provided under § 2718(b). Section 1.833-1(b)(2) of the Income Tax Regulations.

Question 5: The Medical Loss Ratio Reporting Form issued by the Center for Consumer Information & Insurance Oversight ("CCIIO") at HHS has fields for "Adjusted incurred claims" (i.e., "amounts expended for reimbursements for clinical services paid to enrollees") as of December 31 of the reporting year and March 31 of the year following the reporting year. Which amount should be used when computing the § 833(c)(5)?

Answer 5: Under Notices 2010-79, 2011-51, and 2012-37, the Service advised organizations to use the definition of terms set forth in the HHS interim final regulations for taxable years beginning after December 31, 2009, and ending before the first taxable year beginning after December 31, 2013. The HHS interim final regulations provided that amounts expended for reimbursements for clinical services provided to enrollees should be based on claims incurred during the MLR reporting year that have been processed as of March 31 of the year following the reporting year. See 75 FR 74864, 74874 (2010). For taxable years beginning after December 31, 2013, § 1.833-1(c)(1), states that an organization must compute its reimbursements for clinical services in the same manner as those expenses are computed for the plan year for purposes of § 2718(b). For purposes of § 2718(b), reimbursements for clinical services are computed in accordance with the final regulations under 45 C.F.R. § 158.140(a). As in the interim final regulations, 45 C.F.R. § 158.140(a) provides that reimbursements for clinical services are based on claims incurred during the MLR reporting year that have been processed as of March 31 of the year following the reporting year. As a result, organizations must use the amounts reported as adjusted incurred claims as of March 31 of the year following the taxable year at issue under applicable HHS guidance.

Question 6: For purposes of computing the § 833(c)(5) MLR, which source document is more relevant, the Supplemental Health Care Exhibit issued by the National Association of Insurance Commissioners ("NAIC") or the Medical Loss Ratio Reporting Form issued by CCIIO? Should the Service require organizations to prepare reconciliations between information reported to the NAIC and information reported to CCIIO?

Answer 6: Notices 2010-79, 2011-51, and 2012-37, provide that for taxable years beginning after December 31, 2009, and ending before the first taxable year beginning after December 31, 2013, organizations should use the definition of terms set forth in the HHS interim final regulations. See 75 FR 74864, 74921 (2010), as corrected at 75 FR 82277 (2010). This information was reported on the Medical Loss Ratio Reporting Form issued by CCIIO. Similarly, under § 1.833-1 of the Income Tax Regulations, for taxable years beginning after December 31, 2013, organizations should use the definition of terms set forth in the final regulations under 45 C.F.R. § 158.110 et seq. This information is also reported to CCIIO on the Medical Loss Ratio Reporting Form. Therefore, organizations should use the Medical Loss Ratio Reporting Form issued by CCIIO for purposes of computing the § 833(c)(5) MLR. There should be no need to prepare a reconciliation between information reported to the NAIC and information reported to CCIIO, because the information reported to CCIIO should be sufficient for purposes of computing the § 833(c)(5) MLR.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call (202) 317-6995 if you have any further questions.