Request for Comments Regarding Application of § 501(c)(29) of the Internal Revenue Code

Notice 2011-23

SECTION 1. PURPOSE

This Notice addresses the requirements for tax-exemption for qualified nonprofit health insurance issuers described in new § 501(c)(29), added to the Internal Revenue Code (Code) by § 1322(h) of the Patient Protection and Affordable Care Act (Affordable Care Act), enacted March 23, 2010, Pub. L. No. 111-148. This Notice provides guidance on the annual filing requirement for qualified nonprofit health insurance issuers that intend to apply for recognition of exempt status under § 501(c)(29), as well as the effective date of exempt status for certain applicants. The IRS intends to issue a revenue procedure on how and when qualified nonprofit health insurance issuers described in § 501(c)(29) may apply for recognition of exempt status. This Notice includes a request for public comments.

SECTION 2. BACKGROUND

Section 1322 of the Affordable Care Act requires the Department of Health and Human Services (HHS) to establish the Consumer Operated and Oriented Plan program (CO-OP program). The purpose of the CO-OP program is to foster the creation of qualified nonprofit health insurance issuers to offer qualified health plans in individual and small group markets. The CO-OP program will make
available to qualified nonprofit health insurance issuers loans to provide assistance in meeting start-up costs and/or repayable grants to provide assistance in meeting any state solvency requirements. HHS has published a request for comments regarding the CO-OP program. See Planning and Establishment of Consumer Operated and Oriented Plan Program; Request for Comments Regarding Provisions of Consumer Operated and Oriented Plan Program, 76 Fed. Reg. 5774 (Feb. 2, 2011).

Section 1322(h) of the Affordable Care Act added § 501(c)(29) to the Code. Section 501(c)(29) sets out rules for tax-exemption under § 501(a) of the Code for a qualified nonprofit health insurance issuer that has received a grant or loan under the CO-OP program.

SECTION 3. QUALIFIED NONPROFIT HEALTH INSURANCE ISSUERS

Section 1322(c)(1) of the Affordable Care Act defines a qualified nonprofit health insurance issuer (“Qualified Issuer”) as an organization (a) that is organized as a nonprofit, member corporation under State law; (b) substantially all of the activities of which consist of the issuance of qualified health plans in the individual and small group markets in each State in which it is licensed to issue such plans; and (c) that meets additional requirements set forth in subsections (c)(2) through (6).

Section 1322(c)(2) of the Affordable Care Act provides that an organization shall not be treated as a Qualified Issuer if (a) the organization, a related entity, or a predecessor of either was a health insurance issuer as of July 16, 2009; or (b) the organization is sponsored by a State or local government, any political
subdivision thereof, or any instrumentality of such government or political subdivision. Section 1322(c)(3) requires a Qualified Issuer to satisfy certain governance requirements. Section 1322(c)(4) requires a Qualified Issuer to use any profits that it makes to lower premiums, to improve benefits, or for other programs intended to improve the quality of health care delivered to its members. Section 1322(c)(5) requires a Qualified Issuer to meet all state law requirements that other issuers of qualified health plans are required to meet in any state where the issuer offers a qualified health plan. Section 1322(c)(6) provides that a Qualified Issuer may not offer a health plan in a state until that state has in effect (or the Secretary of HHS has implemented for the state) the market reforms required by part A of title XXVII of the Public Health Service Act, as amended by the Affordable Care Act.

Section 1322(b)(2)(C) of the Affordable Care Act requires a Qualified Issuer receiving a grant or loan under the CO-OP program to enter into an agreement with HHS, which requires it to meet (and continue to meet) both the requirements under § 1322 to be treated as a Qualified Issuer, and all requirements of the loan or grant agreement. Such an agreement must include a requirement that no portion of the funds made available by any loan or grant under the CO-OP program may be used for carrying on propaganda, or otherwise attempting, to influence legislation, or for marketing.

A Qualified Issuer that has received a loan or grant under the CO-OP program may apply to the IRS to be recognized as an organization described in § 501(c)(29) of the Code and exempt from taxation under § 501(a) of the Code.
The Qualified Issuer will qualify for exempt status under § 501(c)(29) only for periods that it is in compliance with the requirements of § 1322 of the Affordable Care Act and any loan or grant agreement with HHS. Under § 1322(b)(2)(C)(iii) of the Affordable Care Act, HHS must notify the Secretary of the Treasury of any determination under § 1322 of a failure that results in the termination of a Qualified Issuer’s tax-exempt status under § 501(c)(29) of the Code.

If a Qualified Issuer that has received a loan or grant under the CO-OP program does not apply for recognition of exempt status as an organization described in § 501(c)(29) or loses exempt status, it may be subject to Federal income taxation under appropriate provisions of the Code. If a taxable Qualified Issuer qualifies as an insurance company for Federal income tax purposes, it will be subject to the special tax rules of Subchapter L of the Code.

SECTION 4. CONDITIONS FOR TAX EXEMPTION

An organization is described in § 501(c)(29) of the Code only if:

1. The organization is a Qualified Issuer that has received a loan or grant under the CO-OP program and is in compliance with all requirements of § 1322 and any loan or grant agreement with HHS.

2. The organization has given notice to the Secretary of the Treasury in the manner prescribed by regulations that it is applying for recognition of its exempt status as an organization described in § 501(c)(29);

3. No part of the organization’s net earnings inure to the benefit of any private shareholder or individual, except as provided in § 1322(c)(4) of the Affordable Care Act (which requires profits to be used to lower premiums, improve benefits,
or for other programs intended to improve the quality of health care delivered to
the organization’s members);

4. No substantial part of the organization’s activities consist of carrying on
propaganda, or otherwise attempting, to influence legislation; and

5. The organization does not participate in, or intervene in (including the
publishing or distributing of statements), any political campaign on behalf of (or in
opposition to) any candidate for public office.

SECTION 5. ADDITIONAL INFORMATION REPORTING REQUIRED

Section 6033 of the Code requires a tax-exempt organization described in §
501(c)(29) to file an annual information return. Section 1322(h)(2) of the
Affordable Care Act amended § 6033 of the Code to require an organization
described in § 501(c)(29) to provide certain additional information on its annual
information return. In addition to the general information required, it must report
the amount of reserves required by each State in which the organization is
licensed to issue qualified health plans, and the amount of reserves on hand.

SECTION 6. APPLICATION OF TAX ON EXCESS BENEFIT TRANSACTIONS

Section 4958 of the Code imposes an excise tax, payable by the disqualified
person, on each excess benefit transaction between an applicable tax-exempt
organization and a disqualified person. Section 4958 also imposes an excise tax
on organization managers who knowingly participated in an excess benefit
transaction, unless participation was not willful and was due to reasonable cause.
Section 1322(h)(3) of the Affordable Care Act amended § 4958(e)(1) to provide
that an organization described in § 501(c)(29) is an “applicable tax-exempt organization” subject to § 4958.

SECTION 7. APPLICATIONS FOR RECOGNITION OF EXEMPTION

The IRS intends to publish a revenue procedure describing how an organization may apply for recognition of exempt status as an organization described in § 501(c)(29). Until the revenue procedure is published, the IRS will not accept applications. The revenue procedure will provide that a Qualified Issuer may not submit its request for recognition of exemption under § 501(c)(29) until it has entered into an agreement with HHS under § 1322(b)(2)(C) of the Affordable Care Act.

The revenue procedure also will address the effective date of a Qualified Issuer’s tax exemption. The Treasury Department and the IRS intend to recognize a Qualified Issuer that has received a loan or grant under the CO-OP program as exempt effective from the later of the date of its formation or March 23, 2010, provided that the Qualified Issuer's purposes and activities have been consistent with the requirements for exemption since that date. To be recognized as exempt from the date of its formation, a Qualified Issuer must have complied with the conditions of exemption described in clauses (ii)-(iv) of § 501(c)(29)(B).

SECTION 8. ANNUAL FILING REQUIREMENT PRIOR TO RECOGNITION OF EXEMPT STATUS

A Qualified Issuer claiming exempt status under § 501(c)(29) that has filed or intends to file an application for exemption should file Form 990, Return of
Organization Exempt from Income Tax, for taxable years that end before it receives a determination letter. The Qualified Issuer must indicate on its return that it is being filed in the belief that the Qualified Issuer is exempt under § 501(a), but the IRS has not yet recognized its exemption.

SECTION 9. EFFECTIVE DATE

The provisions of § 1322 of the Affordable Care Act, including the addition to the Code of § 501(c)(29) and the amendments to §§ 6033 and 4958 of the Code described above, are effective beginning on March 23, 2010, the date of enactment of the Affordable Care Act.

SECTION 10. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments regarding the provisions described above, including, in particular, the need, if any, for guidance regarding such provisions. Comments are specifically requested regarding:

1. Any special factors the IRS should consider when establishing the procedures for applying for recognition of tax-exempt status under § 501(c)(29);

2. The proposed effective date of a Qualified Issuer’s tax exemption, as described in section 7 of this notice; and

3. Any special considerations regarding the application to Qualified Issuers of the prohibition on private inurement in § 501(c)(29)(B)(ii), the limitation on lobbying activities in § 501(c)(29)(B)(iii), the prohibition on political activities in § 501(c)(29)(B)(iv), the taxation of excess benefit transactions under § 4958, and the taxation of unrelated business taxable income under § 511.
Comments should be submitted in writing on or before May 27, 2011. Please include “Notice 2011-23” on the cover page. Comments should be sent to the following address:

Internal Revenue Service
CC:PA:LPD:PR (Notice 2011-23)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Internal Revenue Service
Courier’s Desk
1111 Constitution Ave., N.W.
Washington, DC 20224

Submissions may also be sent electronically to the following e-mail address:

Notice.Comments@irs counsel.treas.gov

Please include “Notice 2011-23” in the subject line.

All comments will be available for public inspection and copying.

SECTION 11. DRAFTING INFORMATION

The principal author of this notice is Justin Lowe of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this notice, contact Mr. Lowe at (202) 283-9486 (not a toll-free call).