The Patient Protection and Affordable Care Act: A Preliminary Analysis of the Challenges Facing the IRS in Implementing Health Care Reform
The Patient Protection and Affordable Care Act: An Initial Analysis of the Implementation Challenges

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INTRODUCTION

On March 23, 2010, the President signed into law Public Law 111-148, the Patient Protection and Affordable Care Act (known by the short title Affordable Care Act). The new law, later amended by the Health Care and Education Reconciliation Act (HCERA), enacts significant changes to America’s health care system. Health care reform will likely be the most extensive social benefit program the IRS has been asked to implement in recent history. Although most Americans do not now interact with the IRS in connection with their health insurance, many provisions of the new law will require IRS involvement at some point in the future.

The majority of the tax-related provisions in the law have delayed effective dates. However, a recent Associated Press poll found more than half of Americans believe the health care law will raise taxes on individuals this year. For example, the new W-2 reporting requirement has raised numerous concerns that reporting the value of health insurance on an employee’s W-2 may cause the amount to be taxed. In October, the IRS announced it would delay implementation of the W-2 reporting requirement for a year. An IRS news release explains the delay is designed to give employers more time to prepare and update their systems. However, the release also states: “The IRS continues to stress that the amounts reportable are not taxable.”

Given the confusion about the law, the IRS must conduct considerable education and outreach to the affected taxpayers. In addition, the IRS will be the face of health care reform for taxpayers, but in many circumstances it will not be the decision maker. For example, exemptions for the individual penalty and many aspects of the premium tax credit likely will be determined by the state-level exchanges.

The IRS will have to determine the best way to administer decisions made by these other entities in the least burdensome manner for both the taxpayer and itself. The IRS has extensive experience implementing new legislation with very little lead time. But this challenge is bigger. Given the enormously complex task it now faces, the IRS should use its time wisely to conduct research and bring to bear the knowledge it has gained from its administration of the Earned Income Tax Credit (EITC), First-Time Homebuyer Credit (FTHBC), and Making Work Pay Credit to strengthen its health care implementation plans.

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2 For example, the premium tax credit, individual responsibility requirement, and employer requirement are effective January 1, 2014. See Patient Protection and Affordable Care Act of 2009, Pub. L. No. 111-148, §§ 1401, 1501, 1513, as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-443.


Although the IRS has been working to implement the major provisions that directly affect taxpayers, it has not publicly discussed the particular challenges it faces. The National Taxpayer Advocate believes a public discussion regarding the scope and design of IRS health care activities will ensure that the agency has the funding and resources it will require to effectively deliver the program. Moreover, early public discussion will help identify areas that could cause problems or confusion for taxpayers. This early discussion will allow the IRS, the National Taxpayer Advocate, and others to propose “fixes” for problem areas – whether administrative or legislative.

For these reasons, the National Taxpayer Advocate would like to begin the dialogue with this discussion about the health tax provisions and related challenges to further the public’s understanding of their complexity and scope. Included in this piece are “process maps” of each of the three major provisions that have yet to be implemented to help describe the administrative challenges the IRS is facing. With proper planning and funding, the IRS is fully capable of implementing health care reform. However, a comprehensive assessment of the potential issues and challenges that lie ahead is a prerequisite for success.

Background

An Overview of the Four Main Health Tax Provisions

Although the Patient Protection and Affordable Care Act contains a number of tax-related provisions, this discussion will focus on the four main ones:

- Small Business Tax Credit – Beginning in tax year 2010, a tax credit is available to eligible for-profit and tax-exempt small employers with less than 25 full-time employees that pay at least half the cost of single coverage for their employees. The amount is based on the number of full-time employees and their average annual wages. The credit is targeted to small businesses and tax-exempt organizations employing low and moderate income workers.

- Premium Tax Credit – Beginning in 2014, the Affordable Care Act creates a refundable tax credit for coverage under a qualified health plan. The credit is available to eligible individuals and families with incomes below a specified threshold (subject to an income phase-out range) and subsidizes the purchase of health insurance through an exchange.

- Individual Responsibility Requirement – Beginning in 2014, individuals will be required to maintain minimal essential health care coverage for themselves and their dependents or be subject to an annual penalty. The law makes exceptions for individuals with certain religious objections, those who are not lawfully present in the United States, and incarcerated individuals. The new law provides exemptions from

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6 Single coverage is the cost of covering a single individual under a health insurance plan. This is compared with Family coverage, which is generally the cost of covering two or more individuals under a health insurance plan.

7 Internal Revenue Code (IRC) § 45R.

8 IRC § 36B.
The penalty for persons with a hardship waiver, who cannot afford coverage, who have incomes of less than 100 percent of the federal poverty level, who are members of an Indian tribe, or who are not covered for a period of less than three months.\(^9\)

**Employer Requirement** – Beginning in 2014, employers with 50 or more full-time employees that do not offer minimum essential health insurance coverage or offer unaffordable coverage will be liable for an additional tax if one or more employees purchase insurance through an exchange and receive a premium tax credit.\(^10\)

**IRS Implementation of the Small Business Tax Credit Leaves Unanswered Questions**

The Small Business Tax Credit in IRC § 45R is the first major health care tax provision to take effect. As noted above, the credit is available to employers with less than 25 full-time employees that pay at least half the cost of single coverage.\(^11\) The credit is based on the number of full-time employees and their average annual wages, with the full amount available to employers with less than ten full-time employees and less than $25,000 in average annual wages.\(^12\)

In mid-April, the IRS began mailing postcards to millions of small businesses providing a brief description of the new tax credit and directing the businesses to visit the IRS website or consult a tax professional to find out if they qualify.\(^13\) In mid-May, the IRS issued Notice 2010-44 with more details and examples of the various requirements of the credit. The IRS also provided a three-step form for employers to determine eligibility, a set of frequently asked questions, and a YouTube video on the credit.\(^14\)

Eligible employers will use new Form 8941, *Credit for Small Employer Health Insurance Premiums*, to claim the small business tax credit, while tax-exempt small employers will use a revised Form 990-T, *Exempt Organization Business Income Tax Return*, which will be available for the 2011 filing season.\(^15\) With respect to for-profit businesses, the credit is claimed as a general business credit against tax and is not refundable.\(^16\)

\(^9\) IRC § 5000A. If an individual does not have qualifying health insurance, the individual will be subject to a penalty of the greater of $695 per person per year (up to a maximum of $2,085 per family), or 2.5 percent of household income. The penalty is phased in beginning in 2014 until it reaches the full amount of $695 per person in 2016.

\(^10\) IRC § 4980H.

\(^11\) The credit is equal to 35 percent (25 percent for tax-exempt small employers) of an employer’s premium payments taken into account for purposes of the credit. In tax year 2014, the percentage increases to 50 percent (35 percent for tax-exempt small employers) and the credit is limited to two years, without regard to any years prior to 2014. IRC § 45R(b), (g).

\(^12\) The amount of the credit phases out as the number of full time employees exceeds 10 and the average annual wages exceed $25,000. The credit is completely phased out once the employer has 25 full time employees or average annual wages of $50,000 or more. IRC § 45R(c).


\(^15\) *Id.*

\(^16\) *Id.*

\(^17\) IRC §§ 38(b)(36), 45R. For tax-exempt employers, the credit is a refundable credit not to exceed the employer’s payroll taxes during the year. IRC § 45R(f)(1).
To date, the IRS has only had to deal with outreach to small businesses on the new tax credit. However, the 2011 filing season will be the first opportunity for taxpayers to claim the credit and for the IRS to discover what problems exist with implementation. As previously seen with the First-Time Homebuyer and Making Work Pay credits, new credits create taxpayer problems that the IRS does not always foresee.\textsuperscript{18}

The small business credit requires the employer/taxpayer to take a number of steps to determine eligibility and calculate the proper amount. To determine whether it is eligible for the credit and compute the size of the credit under IRC § 45R, an employer must:\textsuperscript{19}

1. Determine which employees to take into account for purposes of the credit;
2. Determine the number of hours of service those employees perform;
3. Calculate the number of the employer’s Full-Time Equivalents (FTEs);
4. Determine the average annual wages paid per FTE; and
5. Determine the premiums paid by the employer that are taken into account for purposes of the credit.

Because this is the first year to claim the credit, small employers will be struggling through these calculations for the first time. At this point, it is unclear how the IRS Compliance and Criminal Investigation (CI) functions plan to handle claims. The complex calculations leave room for error and the dollars at stake create the potential for fraud. It is also unclear whether, post-filing season, the IRS plans to conduct outreach to small employers who do not claim the credit but the IRS believes might be eligible.

\textit{IRS Overall Implementation Efforts Are Still in the Initial Stages}

The IRS is in the initial stages of implementing the main provisions of the law that take effect in future years. The IRS has set up a health care program office to lead the implementation efforts, and through the program office, it has established four teams that are

\textsuperscript{18} For a discussion of the First-Time Homebuyer and Making Work Pay Credits, see National Taxpayer Advocate Fiscal Year 2011 Report to Congress 1 (TAS Continues to Believe that the IRS Should Do a Better Job of Meeting Taxpayers Needs and TAS Will Continue to Advocate for Improved Taxpayer Services).

\textsuperscript{19} For example, for the 2010 taxable year, a taxable eligible small employer has 12 FTEs and average annual wages of $30,000. The employer pays $96,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the employer’s state) and otherwise meets the requirements for the credit. The credit is calculated as follows:

1. Initial amount of credit determined before any reduction: (35% x $96,000) = $33,600.
2. Credit reduction for FTEs in excess of 10: ($33,600 x 2/15) = $4,480 (the 2/15 percentage is the average number of FTE in excess of ten over 15). IRC § 45R(c)(1).
3. Credit reduction for average annual wages in excess of $25,000: ($33,600 x $5,000/ $25,000) = $6,720 (the $5,000/$25,000 percentage is the average annual wages in excess of $25,000 over $25,000). IRC § 45R(c)(2).
4. Total credit reduction: ($4,480 + $6,720) = $11,200.
5. Total 2010 tax credit equals $22,400 ($33,600 - $11,200).

The National Taxpayer Advocate has repeatedly asked that TAS be included in these teams and has offered her senior advisors to serve on them. The National Taxpayer Advocate is concerned the IRS declined to include TAS members on the teams, increasing the risk that the IRS will make operational decisions that are best for itself without adequate consideration of taxpayer impact.

The IRS has also established an executive-level team – of which TAS is a member – to discuss implementation of the new provisions at a more general level. The main efforts of the executive team center around a series of process maps TAS developed that outline the main provisions in the new law. TAS designed these process maps, contained in charts 1–6, to help the IRS understand how these provisions will operate as well as what types of interaction the IRS will have with taxpayers, other government agencies, and other entities. Most importantly, the process maps can assist in identifying potential problems for taxpayers and the IRS, as well as areas for IRS outreach and education.

Despite the exclusion of TAS from the IRS’s health care implementation teams, TAS is undertaking its own efforts. The National Taxpayer Advocate convened an internal team of TAS executives and other employees who meet bi-weekly to discuss the various provisions and identify potential problems and implications for taxpayers, the IRS, and TAS. In addition to developing the process maps discussed above, TAS is training its own employees and the Low Income Taxpayer Clinics on the provisions in the health care law.

Over the past few months, TAS has developed a course that provides an overview of the new law as well as in-depth training on the small business tax credit. This course was available as an option at TAS’s 2010 Symposium (an all-employee technical training event) and was recently provided to TAS’s leadership and all of its Local Taxpayer Advocates. TAS has also converted the course into a series of online classes that every TAS employee will take over the next few months. While this is only the beginning of TAS’s education efforts regarding health care reform, TAS is proud that its employees are already beginning to think

20 The four teams are:
- Individual Education and Compliance;
- Employer Education & Compliance;
- Premium Assistant & Tax Credit Reconciliation; and
- Customer Service and Operations.

The teams reported on their activities on December 7, 2010, to the leadership of the IRS Operating Divisions, MITS, Appeals, and Research. The National Taxpayer Advocate was excluded from this meeting and to date has not received a copy of the briefing document.

21 Low Income Taxpayer Clinics are authorized by IRC § 7526 and represent low income taxpayers before the IRS and assist taxpayers in audits, appeals, and collection disputes. LITCs can also help taxpayers respond to IRS notices and correct account problems. Early in 2010, TAS began providing training to employees on the various health tax provisions in the new law. TAS executives and senior-level employees received in-depth training and TAS staff developed a training course providing an overview of the new law, with a focus on the small business tax credit and the remaining major tax provisions. This training course was offered as an option for TAS employees at the August 2010 Symposium. IRS employees who attended TAS’s Symposium were also able to attend the course. Following the success of the course, TAS converted it into a three-part online course. Some portions of the course are included in TAS’s annual Filing Season readiness training, which all TAS employees will take in early 2011. The remaining sections of the health care course will be rolled out during 2011 and will be required training for all TAS employees. This is just the first step in TAS’s efforts to train its employees on the new law and TAS will be developing additional training courses in 2011 and beyond as the IRS implements the new provisions.
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through the potential impact of the new provisions so it can most effectively advocate for taxpayers who experience difficulties.

THE IRS FACES EXTENSIVE CHALLENGES IN IMPLEMENTING HEALTH CARE TAX PROVISIONS.

The IRS must deal with a number of new issues as it moves forward with implementing the health care provisions, including:

- Gathering new information;
- Communicating with entities and government agencies (including federal, state-based, public and private groups);
- Creating new form(s) to obtain data from taxpayers;
- Establishing a new definition of income; and
- Addressing privacy concerns.

The health care tax provisions require the IRS to gather a significant amount of new information that it does not currently have. This new information includes:

- Insurance plan information, including who is covered under the plan and the dates of coverage;\(^{22}\)
- The costs of health insurance plans;\(^{23}\)
- Whether a taxpayer had an offer of employer-sponsored health insurance;\(^{24}\)
- The cost of employer-sponsored insurance;\(^{25}\)
- Whether a taxpayer received a premium tax credit;\(^{26}\) and
- Whether a taxpayer has an exemption from the individual responsibility requirement.\(^{27}\)

This is different from the type of information the IRS typically deals with, and some taxpayers may feel uncomfortable about sharing it with the IRS. As a result, some taxpayers could be tempted to not file a tax return or file a return with incorrect or incomplete information, creating problems for both the taxpayer and the IRS.

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\(^{22}\) Information will be used to determine if the individual responsibility requirement is met.

\(^{23}\) Information will be used to calculate the premium tax credit.

\(^{24}\) Information will be used to determine eligibility for the premium tax credit and applicability of the employer responsibility requirement.

\(^{25}\) Information will be used to determine applicability of the employer responsibility requirement.

\(^{26}\) Information will be used to calculate the premium tax credit and determine applicability of the employer responsibility requirement.

\(^{27}\) Information will be used to determine if the individual responsibility requirement is met.
Obtaining this new information will also require the IRS to communicate with entities and government agencies that it may not deal with now, including:

- New insurance exchanges;\(^{28}\)
- Employers;\(^{29}\)
- Insurance companies;\(^{30}\) and
- Government insurance programs.\(^{31}\)

This new information will likely come to the IRS via new forms or an electronic exchange. This means the IRS will need to either create new systems or update current ones to make them capable of communicating with groups outside the IRS, such as the exchanges. For example, in determining whether an individual is eligible for a premium tax credit and the amount of the credit, the IRS will have to quickly verify the household income information a taxpayer provides to the exchange.\(^{32}\) The amount of data the IRS will have to exchange with outside groups and the speed with which this will need to be done depend almost entirely on IRS systems, and the challenges the IRS faces because of its systems needs cannot be overstated.

The IRS will likely have to develop a new form or forms to collect health care information from taxpayers, as there is not enough room available on the current Form 1040. Because of the complexity of the new provisions, it is important that any new forms be easy to understand and not add to taxpayer confusion. The IRS should also ensure that, unlike the form for claiming the FTBHC, any new forms can be filed electronically, eliminating the need for large numbers of taxpayers to file paper returns.\(^{33}\)

The IRS will use the information provided by taxpayers and outside entities to determine whether an individual may be subject to the responsibility requirement penalty or is eligible for a premium tax credit. The prompt delivery of taxpayer refunds will depend on the IRS’s ability to quickly process and match this information to prevent refund holds. At the same time, the IRS will have to minimize the payment of refunds to taxpayers it later determines are subject to the responsibility requirement penalty (which would result in improper payments).\(^{34}\)

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\(^{28}\) The IRS will need to know who purchased health insurance through the exchange and who received the premium tax credit.

\(^{29}\) The IRS will need insurance information about their employees.

\(^{30}\) The IRS will need information about who is covered during the year.

\(^{31}\) The IRS will need information about who is covered during the year.

\(^{32}\) For a detailed discussion of the mechanics of the premium tax credit, see discussion \textit{infra} and the process maps contained in Charts 1 – 3.


\(^{34}\) Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204. An improper payment includes a payment that should not have been made or was made in the wrong amount (including overpayments and underpayments). \textit{Id. at} § 2(f)(2)(A).
It is likely that the biggest challenge the IRS will face is communicating the new law to taxpayers. Taxpayers will go to the exchange to apply for the premium tax credit or an exemption from the individual responsibility requirement, but the IRS will be the agency left enforcing these provisions at the end of the year. Thus, the IRS will collect from taxpayers if they received too large a premium tax credit, and the IRS will impose a penalty on taxpayers who did not have health insurance and did not qualify under one of the exemptions. So although taxpayers may contact the exchanges during the year for assistance, they will hear from the IRS at the end of the year when their tax accounts are affected.

Because many of the new provisions force the IRS to rely on other government agencies and enforce their potentially controversial decisions, the IRS needs to ensure it owns the messages delivered to the public about these provisions. In its own self-interest, the IRS should educate taxpayers about the importance of updating their premium tax credit eligibility information with the exchanges because the IRS will be the agency that ultimately collects from taxpayers if their credits are too large. Further, the IRS should educate taxpayers about the economic consequences of failing to purchase health insurance because the IRS will be collecting the penalty.

The IRS is the best-equipped agency to explain the complex tax issues in the new health care law. Leaving the messaging up to other agencies increases the risk that taxpayers will run into problems during the filing season as well as the risk that the IRS will have to do additional (unfunded) work to resolve these problems.

In addition to these overarching concerns, the IRS will face additional concerns specific to certain provisions.

**Premium Tax Credit**

*Background*

The premium tax credit is designed to help low and middle income individuals and families purchase health insurance through the exchange. The tax credit is refundable, payable in advance to the insurer, and available to eligible individuals and families with income from 133 to 400 percent of the federal poverty level (FPL).  

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35 For a detailed discussion of the mechanics of the premium tax credit and the individual responsibility requirement, see infra.

36 IRC § 36B(c)(1)(A). The federal poverty level is the official poverty line as defined by the Office of Management and Budget based on the most recent data available from the Bureau of the Census. IRC § 36B(d)(3)(A) (referring to 42 U.S.C. § 1397l(c)(2)).
The premium tax credit carries a number of eligibility requirements.37 The amount is tied to the second lowest cost “silver plan” in the area38 and is on a sliding scale based on a percentage of household income.39 Individuals with incomes of up to 133 percent FPL will not be expected to pay more than two percent of their household income for health insurance. This increases to nine and a half percent of household income for individuals between 300 to 400 percent FPL.40

To receive the credit, a taxpayer would go to the exchange (either in person or online) and enroll in a health insurance plan.41 The taxpayer would provide the exchange with his or her most recent tax return, which contains necessary information about family size and household income,42 and must also provide additional identifying information, including citizenship or immigration status.43 The exchange then verifies the information44 and informs the taxpayer whether he or she is eligible for a tax credit and the amount of the credit.45

Individuals whose circumstances change during the year (change in income, marriage, birth of a child, etc.) should update their eligibility information with the exchange for recalculation of their tax credit. A reconciliation process takes place at the end of the year when the taxpayer files a return.46 If the taxpayer received too little of a credit, he or she will...
receive a refund for the underpayment. If the taxpayer received too much, he or she will be responsible for repaying it, either through a reduction in the refund or as taxes owed. However, the law limits the recapture of any overpayment if the taxpayer’s household income is below 500 percent FPL. Individuals below 200 percent FPL will have any overpayment owed capped at $600. This amount will increase as percentage of FPL increases, until it reaches $3,500 for individuals between 450 to 500 percent FPL. Taxpayers whose household income is above 500 percent of FPL will be responsible for repaying the entire amount of the overpayment.

The Advanceable and Refundable Nature of the Premium Tax Credit Will Likely Cause Problems for Both Taxpayers and the IRS.

In implementing the premium tax credit (hereinafter referred to as “the credit”), the IRS can learn a good deal from its previous experiences with administering refundable credits, particularly the EITC. The target group for the credit will likely overlap significantly with the EITC population, and the credit itself shares numerous characteristics (complicated eligibility calculations, refundability, significant dollars at stake) with the EITC. The IRS’s experience with and past research on the EITC and the EITC-eligible population can help inform and improve implementation of the new credit.

The IRS should also examine why the recently repealed Advanced EITC did not work and what lessons it can learn to apply to the premium credit. Many recipients appeared to prefer receiving their EITC in a lump sum at the end of the year, instead of in ratable amounts throughout the year. This issue may be similar to one the IRS will face with the advanceable, refundable premium tax credit, so the IRS may want to consider how to promote the advanced nature of the credit to make it more attractive to taxpayers.

A major challenge in implementing the credit is the new measure of income on which the credit is based, which is household income. Unlike every other current provision of the tax code, the credit is based on the income of all individuals in the taxpayer’s household, not just the income reported on their return(s). The IRS does not now record or identify household income, and taxpayers are unaccustomed to calculating this information. This

47 If an individual was eligible for a tax credit but did not claim it during the year, he or she can claim the credit on his or her return and receive a refund for the amount the taxpayer is entitled to (presuming the taxpayer meets the other eligibility requirements).

48 IRC § 36B(f)(2)(B)(i) (as amended by the Medicare and Medicaid Extenders Act of 2010, Pub. L. No. 111-309). This marks a change to the reconciliation rules as originally passed, which limited the repayment for taxpayers under 400 percent FPL to $400. The change was the result of concerns of the cliff effect of the repayment provision. The new provision replaces the flat structure with a scaled structure that starts at lower levels for lower income taxpayers.

49 For example, the EITC Qualifying Child Residency Certification Study was designed to assess the impact of a residency certification requirement on EITC claims. The study offered a sample group of potentially ineligible taxpayers the opportunity to precertify that their qualifying child or children met the residency requirement of the EITC. IRS, IRS Earned Income Tax Credit (EITC) Initiatives: Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests, available at http://www.irs.gov/pub/irs-utl/final_eitc_initiatives_report_final_121708.pdf (last visited Nov. 18, 2010).

50 The Advance EITC allowed employees who are eligible for the EITC and have one qualifying child to receive their EITC throughout the year in their paycheck. The Advance EITC is repealed, effective December 31, 2010. FAA Air Transportation Modernization and Safety Improvement Act, Pub. L. No. 111-226, § 219.

change will force the IRS to reprogram its systems to capture this data and educate taxpayers about how to compute it.

Another challenge will likely arise from the IRS’s role in verifying the income information taxpayers provide to the exchanges to establish eligibility for the credit. Who will the taxpayer turn to in order to resolve a discrepancy between the information he or she provides and what the IRS has on its records? Although the exchange decides whether an individual is eligible for the credit, many individuals may contact the IRS if they discover discrepancies involving their income information. The IRS will need to train its assistors about how to handle these calls, despite the fact that the exchanges are the decision makers on eligibility. Will the IRS transfer the taxpayer to the appropriate exchange or simply provide the taxpayer with the appropriate contact information?

The reconciliation process of the new credit may be the most difficult aspect for the IRS to administer. Taxpayers who did not update their household information during the year may find they owe a significant amount of money at the end of the year – money they likely do not have. The need for reconciliation arises because eligibility for the credit is based on tax return data that is two years old. In the interim, many taxpayers will have experienced at least some change in circumstances.\(^\text{52}\) If taxpayers do not realize the importance of updating their information with the exchange – even after their initial eligibility determination is made – a large number of taxpayers will likely owe at least some money.

The IRS will need to work with outside entities – such as the exchanges, employers, and family service agencies – to continually educate taxpayers about the need to update their information with the exchanges whenever they have a life change such as a change in family size or income. For the IRS, launching a coordinated information campaign on this scale may be unprecedented. This aspect of the premium tax credit is one of the most critical provisions. It is also one area where the IRS’s effectiveness can make a tremendous impact on the potential downstream consequences for both taxpayers and the IRS itself.

One thing the IRS can do to help taxpayers navigate the reconciliation process is consider providing taxpayers with pre-filled forms. The IRS should already have information the taxpayer previously provided to the exchange during the application process. The IRS can use this information to partially fill in forms and then ask taxpayers to verify or update the information. These forms may give taxpayers an idea of what information was used to calculate their initial eligibility, since it will have been more than a year since they applied for the credit.

\(^{52}\) Initial eligibility for the credit is based on an individual’s income for the tax year ending two years prior to the enrollment period. For enrollment in 2014, eligibility will be based on income from tax year 2012.
Individual Responsibility Requirement

Background

Beginning in 2014, all U.S. citizens and legal residents will be required to have qualifying health insurance. An individual who does not have qualifying health insurance will be subject to a penalty of the greater of $695 (per person) per year, up to a maximum of $2,085 per family, or 2.5 percent of household income.

The law provides exemptions from the responsibility requirement for:

- Religious grounds;
- Individuals who are not U.S. citizens or an alien lawfully present in the U.S.; and
- Individuals who are incarcerated.

The law also provides exemptions from the penalty for:

- Hardship;
- Members of Indian tribes;
- Individuals with incomes below the filing threshold;
- Individuals without insurance for less than three months; and
- Individuals who cannot afford coverage.

Once the responsibility requirement penalty is effective, taxpayers will have to report on their tax returns whether or not they have health insurance. However, the IRS can only collect this penalty through refund offsets. The new law prohibits the

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53 IRC § 5000A(a). In order to meet the responsibility requirement, the health insurance plan must provide minimum creditable coverage (as defined in PPACA).

54 The penalty will be phased in according to the following schedule:

- 2014 - $95 or 1 percent of household income.
- 2015 - $325 or 2 percent of household income.
- 2016 - $695 or 2.5 percent of household income.

Beginning in 2017, the penalty amount will be increased annually by the cost of living adjustment. IRC § 5000A(c)(3).

55 IRC § 5000A(d)(2).

56 IRC § 5000A(d)(3).

57 IRC § 5000A(d)(4).

58 IRC § 5000A(e)(5).

59 IRC § 5000A(e)(3).

60 IRC § 5000A(e)(2).

61 IRC § 5000A(e)(4).

62 Exemption applies if the taxpayer's required contribution for the coverage month exceeds eight percent of the individual’s household income. IRC § 5000A(e)(1).

63 The IRS will verify health insurance coverage using information from insurance companies and employers.
IRS from filing a lien or levying on any property to collect the responsibility requirement penalty.\textsuperscript{64}

*The Unique Nature of the Individual Responsibility Requirement Penalty Will Challenge the IRS’s Audit Selection and Collection Processes.*

The individual coverage responsibility requirement and associated penalty will pose a different set of challenges to the IRS. Some taxpayers who do not want to share their healthcare information with the IRS may not file returns or may file incomplete ones. In some instances, the IRS will receive information from insurance companies that certain individuals have coverage and therefore are not subject to the penalty. Other individuals will not have coverage and some will be lower income individuals who are due tax refunds. Even if these taxpayers file returns and do not have health insurance, the IRS would owe them money after collecting the penalty.

This raises the question of how the IRS will deal with taxpayers who do not file returns. From an economic perspective, it may not make sense for the IRS to go after certain nonfilers because the IRS’s available information indicates they are likely owed refunds. In other cases, the IRS will not be aware that taxpayers should be subject to the penalty. Individuals who operate entirely in the cash economy (and for whom the IRS receives no Forms W-2 or Forms 1099), do not purchase health insurance, and do not file tax returns may never attract the attention of the IRS because the IRS will not know who they are.\textsuperscript{65}

To get at the underlying goal of the new law – health coverage for the vast majority of Americans – will the IRS audit every taxpayer who does not report having coverage? Or will the IRS establish certain tolerances, as it does with other programs? Unlike the traditional tax penalty, which is designed to enhance voluntary compliance or deter tax evasion, this penalty is designed to enforce a mandate.\textsuperscript{66} If the IRS does establish tolerance levels for auditing taxpayers without insurance coverage, this approach may limit the overall effectiveness of the responsibility requirement.

Exemptions from the requirement and the penalty will present different challenges. It appears that exemptions from the coverage requirement will be made at the exchange level. However, there may be cases where the IRS can already identify a taxpayer as being eligible for an exemption, *e.g.*, if the taxpayer is a member of an Indian tribe or is Amish. In those situations, the IRS should be able to use this information to identify cases in which taxpayers have an exemption from the penalty and alert them to go to an exchange within a set period of time before the penalty is applied.

\textsuperscript{64} IRC § 5000A(g)(2)(B). However, the IRS may use its full collection authorities to collect amounts due under other provisions of the health care law.

\textsuperscript{65} However, some of this same group may end up visiting hospital emergency rooms without health insurance, thereby costing the United States money in the form of uncompensated care and undermining the savings built into the new law. The Health Insurance Portability and Accountability Act (HIPAA) contains specific rules protecting patient confidentiality, specifically the use and disclosure of individuals’ health information. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191.

\textsuperscript{66} National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 2 (A Framework for Reforming the Penalty Regime).
The hardship exemption, for which there are no guidelines at this point, will also create difficulties for the IRS. It appears the exchanges will make the determination, but taxpayers will contact the IRS when they face the penalty and are looking for an exemption. Additionally, taxpayers appealing a hardship exemption determination may turn to the IRS even though the IRS does not make the decisions. In most instances, the IRS is being asked to be the collection face of this provision, but not the decision maker. This puts the IRS, and its employees, in the awkward position of collecting a penalty and potentially being unable to work with taxpayers who claim they don’t owe it.

As a result of the potential collection issues, refund offsets will likely present a significant challenge for TAS and the IRS. If a taxpayer owes back taxes (distinct from this penalty), the IRS and TAS may override a current year refund offset and manually refund the full amount if the taxpayer comes in early enough in the process. However, this action can only be taken in instances of economic hardship and is only available for tax debts. Neither the IRS nor TAS has the discretion to stop a refund offset to satisfy a non-tax debt such as past-due child support.

Due to the size of the responsibility requirement penalty and the IRS’s role in collecting it, many taxpayers subject to the penalty and suffering an economic hardship may come to TAS seeking an offset bypass refund. It is unclear at this point whether or not debt stemming from the penalty will be considered a tax debt that qualifies for the provisional authority to bypass and issue a refund. Moreover, the IRS definition of hardship is different from the definition contained in the responsibility requirement. The practical result is that taxpayers who do not otherwise qualify for a hardship exemption from the exchange may experience a hardship that qualifies for an offset bypass refund from the IRS.

Once a penalty is assessed, the protection against using liens or levies to collect will require the IRS to isolate the amount from other tax liabilities for which there is no limit on the IRS’s collection powers. However, to ensure that it collects the penalty from taxpayers who are owed refunds, the IRS must be able to quickly match information provided by taxpayers and others to determine whether a taxpayer is subject to the penalty. Otherwise, the...

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67 IRM 21.4.6.5.12.1, Offset Bypass Refund (OBR) (Mar. 2008). Under certain hardship circumstances, the IRS may issue manual refunds of excess credits without first satisfying an IRS outstanding balance. This type of refund is called an Offset Bypass Refund (OBR). An OBR must be issued before the posting date of the original return.

68 IRM 21.4.6.5.6, Hardship Refund Request (Mar. 2008).

69 IRM 21.4.6.4.2, Treasury Offset Program (TOP) Offset (Oct. 2007). The Treasury Offset Program (TOP) is a program designed to intercept IRS refunds and offset them to non-tax debts such as unpaid student loans and child support.

70 The legislative language of IRC § 5000A does not appear to contain any language that prohibits the issuance of manual offset bypasses relative to the individual responsibility requirement penalty. TAS is also not aware of any IRS Office of Chief Counsel decision on this issue.

71 Under IRC § 5000A(e)(5), a hardship is determined by the Secretary of Health and Human Services and is related to the availability of affordable qualified health insurance. The IRS and TAS consider hardship refund requests on a case by case basis. Generally, the inability to provide shelter, food, medical needs, and employment related transportation qualifies as a hardship.
IRS will issue refunds to taxpayers who owe a penalty and then may find itself unable to recoup the improper payment.\textsuperscript{72}

**Employer Requirement**

**Background**

Under the employer requirement, employers with 50 or fewer employees are not required to offer health insurance coverage and are not subject to any penalty if their employees receive the premium tax credit. However, employers with more than 50 employees that do not offer health insurance and have at least one full-time employee who receives a premium tax credit are subject to a fee of $2,000 per full-time employee, with the first 30 full-time employees excluded from the assessment.\textsuperscript{73} Employers with more than 50 employees that offer health insurance and have at least one full-time employee who receives a premium tax credit are subject to a fee of the lesser of $3,000 for each employee receiving a premium credit or $2,000 per full-time employee.\textsuperscript{74}

When an exchange determines that an individual is eligible for a premium tax credit because his or her employer does not provide minimum creditable coverage, the employer will need to be notified of the potential liability. However, it is unclear how the assessment and appeals process will work.

**The Employer Requirement Will Raise Significant Compliance and Privacy Concerns for the IRS.**

The employer requirement also presents a unique set of issues. Because the penalty is tied to the employer having fewer than 50 full-time employees, employers may lay off or fire employees or refrain from hiring in order to avoid the penalty. The implications of hiring additional employees are significant, especially for employers who are close to the threshold of 50. This new penalty may act as a disincentive to hire additional employees based on the potential economic impact. Other employers may simply recharacterize employees as independent contractors to avoid the penalty.

The employer penalty is subject to the standard deficiency procedures in IRC §§ 6211-6261.\textsuperscript{75} This means that employers will receive a notice of deficiency under IRC § 6212 if the IRS finds they are subject to the penalty. However, the IRS has yet to determine whether, in the early years of implementation, it will first issue warning notices either before or after assessment. One possibility is to use a soft notice for the first few years to

\textsuperscript{72} For a more detailed discussion of the IRS’s need to process information reporting documents before filing season, see National Taxpayer Advocate 2009 Annual Report to Congress 338 (Legislative Recommendation: Direct the Treasury Department to Develop a Plan to Reverse the “Pay Refunds First, Verify Eligibility Later” Approach to Tax Return Processing).

\textsuperscript{73} IRC § 4980H(a).

\textsuperscript{74} IRC § 4980H(c). If an employer offers health insurance to its employees and that coverage is deemed unaffordable, the employee can apply to the Exchange for an affordability waiver to be able to purchase insurance through the Exchange. Unaffordable coverage is defined as coverage with a premium that exceeds 9.5 percent of the employee’s household income.

\textsuperscript{75} IRC § 4980H(e). This is different from how employment tax liabilities are typically assessed.
encourage employers to either meet the obligations of the employer requirement or pay the penalty.\textsuperscript{76}

Once a penalty is assessed, how the IRS designs the appeal process will affect employers’ perception of how fairly the provision is administered. Employers will need enough information to appeal the penalty if appropriate, but the IRS must protect confidential taxpayer information. Whether or not an employer is liable for the penalty is dependent on how many of its employees received the premium tax credit. For an employer that offers qualified health insurance, its employees can receive the premium tax credit only if the insurance offered is unaffordable – a determination based on the employee’s household income. An employer knows what it is paying an employee in salary, but most employers do not have or want information about their employees’ household economic status. It may be difficult to administer the appeal process without sharing at least some of these data.

Moreover, identifying specific employees who chose to go to the exchanges and trigger the penalty for the employer may lead to retaliation. The IRS will have to walk a fine line between providing employers with the information they need to defend against the penalty and protecting individual taxpayers who do not want to share their personal health care and household income information with their employer.

THE IRS NEEDS TO EVALUATE HOW BEST TO MOVE FORWARD WITH ITS IMPLEMENTATION EFFORTS.

After taking a closer look at the specifics of the main health care tax provisions, it is clear that the IRS’s implementation efforts must be far more extensive than those for other new programs and tax credits. While the IRS has formed a program office charged with implementing the new health care law, the unprecedented complexity and scope of this law make clear that the IRS’s traditional implementation and enforcement efforts are inadequate to meet this challenge. The IRS will need to do more than set up a program office, write new computer code, and provide training to employees in advance of the filing season. To implement the new program effectively, the IRS must undertake a comprehensive review of how it will administer the new provisions in light of the challenges and potential ramifications taxpayers face.

\textsuperscript{76} An IRS Notice of Deficiency informs a taxpayer of the tax the IRS plans to assess and gives the opportunity for the taxpayer to respond prior to assessment. In comparison, a soft notice encourages the taxpayer to voluntarily correct a discrepancy in a tax return. If a taxpayer receives a soft notice and repeats the behavior the following year, the taxpayer’s account is flagged. Internal Revenue Service Advisory Committee, Wage and Investment Subgroup Report (Nov. 10, 2010), available at http://www.irs.gov/taxpros/article/0,,id=231501,00.htm; IRS, Addressing Underreporting – The Soft Notice Approach, available at http://www.irs.gov/pub/irs-utl/addressing_underreporting_-_the_soft_notice_approach.pdf (last visited Dec. 15, 2010).
CONCLUSION

The new health care law will require a massive undertaking by the IRS – one that will require the IRS to think outside its traditional “revenue collection” box. The IRS faces a daunting task, not only in implementing the health care provisions within its own systems and organization, but in conducting the outreach needed to educate taxpayers about the new law as well.

Because of the far-reaching scope of these provisions, the IRS needs to do more than simply establish a separate program office. It should consider hiring phone employees dedicated solely to health care. These phone employees would have experience with social work and case management, which are critical when dealing with a social program like health care. Additionally, the Commissioner should establish a cross-function Executive Steering Committee to advise the program office. This committee should include representatives from all of the operating divisions as well as TAS, Appeals, Research, CI, MITS, Counsel, and Communications and Liaison.

While the National Taxpayer Advocate believes the IRS is capable of implementing this new law given sufficient funding and staffing, this discussion is designed to identify potential challenges and concerns with how the law may be administered and give Congress and the IRS enough time to address them.

77 See Most Serious Problem: The IRS Mission Statement Does Not Reflect the Agency’s Increasing Responsibilities for Administering Social Benefits Programs, supra; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75 (Running Social Program Through the Code).
78 Id.
APPENDICES

CHART 2.2.1, Premium Tax Credit: Overall Process

Taxpayer

- Taxpayer applies for credit through the Exchange
  - See Exchange Process map

- Taxpayer applies for credit on their return
  - See Return Process map

- Taxpayer does not apply for the tax credit
  - Is taxpayer eligible for the credit?
    - Yes
      - Does the IRS notify the taxpayer of their eligibility?
        - Yes
          - IRS could use return information to partially fill form
        - No
          - Blank form
    - No
      - IRS does nothing

- What information does the IRS send the taxpayer?
  - Partially filled in form
  - Blank form

- Does the taxpayer submit forms?
  - Yes
    - See return process map
  - No
    - Taxpayer loses the credit for that year

- Need to consider 6103 issues
  - What is the Exchange process for assisting these taxpayers?
    - Yes
      - Taxpayer loses the credit for that year
    - No
CHART 2.2.2, Premium Tax Credit: Exchange Process

1. Taxpayer goes to Exchange to get the credit
2. Does taxpayer have a copy of their tax return?
   - Yes: Exchange directs the taxpayer to the IRS to get a copy of their return/transcript
   - No: Exchange notifies the taxpayer of discrepancy in information
3. Has the taxpayer experienced a change in circumstances since the return was filed?
   - Yes: Taxpayer contacts the IRS for a copy of their return
   - No: Taxpayer contacts the IRS to resolve discrepancy
4. Taxpayer’s information is verified with the IRS
5. Is taxpayer’s information correct?
   - Yes: Taxpayer receives the credit (assuming all other eligibility requirements are met)
   - No: Exchange notifies the taxpayer of discrepancy in information
6. IRS directs taxpayer to the Exchange to resolve discrepancy
7. Does taxpayer have documents supporting change?
   - Yes: Taxpayer contacts the Exchange to resolve discrepancy
   - No: Taxpayer contacts the IRS to resolve discrepancy
8. Is taxpayer able to resolve discrepancy?
   - Yes: Taxpayer receives the credit (assuming all other eligibility requirements are met)
   - No: Taxpayer is not eligible to receive the credit or receives a different amount based on IRS information
9. Does taxpayer appeal the decision?
   - Yes: What is the appeal process?
   - No: Taxpayer must wait until they file their return at the end of the year or have additional information to resolve discrepancy
CHART 2.2.3, Premium Tax Credit: Return Process

1. Taxpayer applies for premium tax credit on tax return
2. IRS verifies information on the tax return
   - Verifies insurance coverage with insurance company
   - Verifies citizenship or immigration status with SSA/DHS
   - Verifies household income and family size
3. Is taxpayer’s return selected for audit?
   - Yes: Taxpayer receives full value of premium tax credit
   - No: IRS contacts the taxpayer and explains reason for reduced credit amount
4. Is information correct?
   - Yes: Taxpayer goes through IRS exam process
   - No: IRS contacts taxpayer
5. Does the IRS notify the taxpayer or the Exchange of the taxpayer’s eligibility for advance tax credit?
   - Yes: Taxpayer goes through IRS exam process
   - No: Taxpayer does nothing

Note: The diagram illustrates the process flow for taxpayers applying for the premium tax credit, including verification steps, audit selection, and potential challenges.
CHART 2.2.4, Premium Tax Credit: Reconciliation Process

Does taxpayer file a tax return at the end of the year?

- Yes
  - IRS verifies information on return (insurance coverage, household income, family size)
  - Does information match?
    - Yes
      - IRS notifies taxpayer of the need to file tax return
    - No
      - IRS notifies taxpayer about discrepancy and sends notice of corrected credit amount

- No
  - IRS receives information return from the Exchange
  - IRS notifies taxpayer of the need to file tax return
  - IRS files substitute return for the taxpayer

Does taxpayer file a tax return?

- Yes
  - IRS files substitute return for the taxpayer

- No
  - IRS notifies taxpayer of the need to file tax return
  - IRS files substitute return for the taxpayer

Is taxpayer's credit amount different than what they received during the year?

- Yes
  - Taxpayer does not owe money and is not entitled to an additional credit amount

- No
  - IRS notifies taxpayer of the need to file tax return
  - IRS files substitute return for the taxpayer

Does taxpayer appeal amount of credit?

- Yes
  - IRS files substitute return for the taxpayer

- No
  - IRS notifies taxpayer about discrepancy and sends notice of corrected credit amount

Is taxpayer appeal successful?

- Yes
  - IRS files substitute return for the taxpayer

- No
  - IRS notifies taxpayer about discrepancy and sends notice of corrected credit amount

Is taxpayer receiving a smaller credit amount?

- Yes
  - IRS notifies taxpayer of the need to file tax return
  - IRS files substitute return for the taxpayer

- No
  - IRS notifies taxpayer about discrepancy and sends notice of corrected credit amount

Is taxpayer's household income less than 500% FPL?

- Yes
  - Taxpayer receives additional credit amount as a reduction in taxes owed or a refund

- No
  - IRS notifies taxpayer of the need to file tax return
  - IRS files substitute return for the taxpayer

Is taxpayer's household income less than 200% FPL?

- Yes
  - Taxpayer must repay the entire overpayment

- No
  - IRS notifies taxpayer of the need to file tax return
  - IRS files substitute return for the taxpayer

Taxpayer's liability for overpayment is limited to $600.

Taxpayer's liability for overpayment is determined by percentage of FPL, but is limited to $3,500.
CHART 2.2.5, Individual Responsibility Requirement

1. Taxpayer does not file tax return
2. Does IRS receive verification of coverage from insurance company?
   - Yes
     - Does taxpayer have any gaps in coverage for more than 3 months?
       - Yes
         - IRS contacts taxpayer
         - Taxpayer is subject to penalty
       - No
         - IRS contacts taxpayer
         - Taxpayer is not subject to penalty
     - No
       - IRS contacts taxpayer
       - Taxpayer is not subject to penalty
3. Does IRS contact taxpayer for return?
   - Yes
     - IRS contacts taxpayer
     - Taxpayer is not subject to penalty
   - No
3. Does taxpayer have any gaps in coverage for more than 3 months?
   - Yes
     - IRS contacts taxpayer
     - Taxpayer is subject to penalty
   - No
     - IRS contacts taxpayer
     - Taxpayer is not subject to penalty
4. Does taxpayer have an exemption from insurance or penalty?
   - Yes
     - IRS contacts taxpayer
     - Taxpayer is not subject to penalty
   - No

### Chart 2.2.6, Employer Requirement

<table>
<thead>
<tr>
<th>Does employer have more than 50 employees?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>Does employer offer health insurance coverage?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>Does any employee receive the premium tax credit?</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>Employer pays a penalty of the lesser of: $3,000 per employee receiving the credit or $2,000 per FTE.</td>
</tr>
<tr>
<td>Penalty does not apply</td>
</tr>
<tr>
<td>Employer is subject to penalty of $2,000 per FTE, with the first 30 FTE excluded.</td>
</tr>
<tr>
<td>Penalty does not apply</td>
</tr>
</tbody>
</table>

*Table: Employer Requirement*

- **Employer Requirement does not apply**
- **Employer is subject to penalty of $2,000 per FTE, with the first 30 FTE excluded.**
- **Penalty does not apply**
The Patient Protection and Affordable Care Act: A Preliminary Analysis of the Challenges Facing the IRS in Implementing Health Care Reform

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