

Statement of Fred T. Goldberg, Jr.
Before The Committee on Ways and Means,
Subcommittee on Oversight

Hearing on IRS Implementation and Administration of
The Affordable Care Act

September 11, 2012

Mr. Chairman and Members of the Committee, it is an honor to appear before you today to testify on the administrative and compliance implications of the Affordable Care Act (the "ACA") as they affect the IRS and taxpayers. I had the pleasure of appearing before this Committee many, many years ago during my time as IRS Chief Counsel (1984-1986), IRS Commissioner (1989-1991), and Treasury's Assistant Secretary for Tax Policy (1992). Since 1992 I have been a partner at the law firm of Skadden, Arps, Slate, Meagher & Flom. I am appearing today in my personal capacity and not on behalf of Skadden or any firm client.¹

Based on my experience as Commissioner, I believe the ACA in its current form will be a needless administrative and compliance quagmire for millions of Americans and that the ACA's powerful financial incentives will lead to significant unintended consequences that policy makers very much want to avoid. At the conclusion of my Statement I make several recommendations to address these concerns.

An Administrative Quagmire: The ACA promotes access to insurance through a phased out tax credit for individuals and families who purchase coverage on the Exchanges. The law as written requires the Exchanges to determine the amount of this credit based on two-year old tax return information.

The only thing we know for sure is that two-year old tax return information is virtually certain to be wrong. That is because - in the real world - the only constant is change. The millions upon millions of tax returns filed each year demonstrate that we live in a truly vibrant and dynamic country where change is constant. Individuals form families. Families have children. Children grow up and leave. Sometimes families fall apart. Families move. Children go to school, graduate, get jobs, form new families. Real people get jobs, lose jobs; get promotions. Workers are demoted, laid off or fired; they go back to school and find second careers; they start businesses that fail, prosper, or succeed beyond their wildest imaginations. Illness, disability and death happen. Organizations form, prosper, fall apart; they change, for better or worse. The list goes on and on. What this means is that in most cases the amount of the tax credit subsidy computed by the government-run Exchanges will be wrong.

¹ I would like to acknowledge Susannah Camic, my former colleague at Skadden, Arps and currently an Assistant Professor (Tax) at the University of Wisconsin Law School (Madison), for her assistance in preparing this Statement. All errors and omissions are solely my own.

In turn, what this means is that millions of individuals and families will be required to interact with their government every year to correct these errors. On the front end these interactions will be with the Exchanges; on the back end these interactions will be with the IRS.

The business process that this system requires is extremely complicated. Following is a high-level view of what's required:

- Every fall, in the course of selling health insurance to millions of individuals and families for the coming year, the Exchanges will have to determine:
 - Whether the individual or family is eligible to purchase on the Exchange – which requires knowing, among other things, whether the individual or family is covered by employer-provided insurance or is eligible for Medicaid?
 - The amount of each purchaser's health insurance tax credit, so that the Exchange can let the individual or family know the amount of his, her or their net insurance premium after subtracting the credit. The Exchange is required to make this determination by starting with IRS tax return information that is two years out of date.
- Every fall during the course of purchasing health insurance from their Exchanges, millions of individuals and families will sort out which policy best meets their needs and the amount they chose to spend, taking account of their premium costs net of their tax credits. Because the Exchanges are starting with two-year-old tax return information, and because in most cases their personal and financial circumstances will have changed, the only thing we know for sure is that the credit computation made by the Exchange is going to be wrong most of the time. Millions of individuals and families will face one of two challenges:
 - Millions of Americans whose financial circumstances have changed in ways that entitle them to a bigger credit will endure a burdensome and sometimes degrading process of pulling together and sharing their intimate personal information with workers or contractors hired by the Exchanges in hopes of obtaining a higher credit and lower net price for the coming year.
 - Millions of Americans whose financial circumstances have improved will wrestle with the question of whether and how to reduce their tax credit and increase the net price of their insurance for the coming year – or “let it ride” and sort things out with the IRS down the road.
 - Individuals and families have been determining their tax liability, figuring out the proper amount of withholding and estimated tax payments, and sharing sensitive information with the IRS for decades. The process is far from perfect, but it works well most of the time. A threshold question is whether it

makes sense to put millions of Americans through a similar process in dealing with newly created health insurance Exchanges.

- Compounding these challenges, the foregoing is more than a fall ritual. Because individual and family circumstances change throughout the year:
 - The Exchanges will have to figure out how millions of individuals and families can change their coverage and redetermine the amount of their credits *during the year*, a task made more difficult when individuals move from one state to another.
 - In turn, individuals and families whose circumstances do change during the year will need to decide whether and how to go through the redetermination process established by the Exchanges.
- Every year, the IRS is going to prepare tax forms that allow taxpayers who purchased insurance on an Exchange to determine the amount of health insurance credit (if any) to which they are entitled.
- Every year, the millions of taxpayers who have purchased insurance on an Exchange are going to use those forms in preparing and filing tax returns.
- Every year, the Exchanges are going to share information with the IRS regarding the amount of the health insurance tax credit that each individual and family received during the prior year.
- Every year, the IRS is going to process those returns and identify three potential compliance issues that it will need to address:
 - The IRS will first determine whether the individual or family has properly computed the amount of their health insurance tax credit based on the information provided on their return. The IRS will correct any “math errors” and notify the individual or family.²
 - On an overall basis, has the family paid the amount shown as due on their return? This is an overall determination because, for example, the family may have received “too much” of a health insurance tax credit while at the same time being over-withheld on its wages. What this means is that while the size of the credit will affect the amount of tax owed, it will not determine

² DURING 2011 THE IRS ISSUED 5.9 MILLION MATH ERROR NOTICES. INTERNAL REVENUE SERVICE, 2011 DATA BOOK 38 (2011).

whether the family owes money to the IRS or is entitled to a refund from the IRS.³

- Is the information on the family's tax return correct, or has the amount of the health insurance tax credit been over or under stated?

This all may sound relatively straight forward, but it's not. Before discussing why, I want to make two points.

First, love it or hate it, the ACA is the law of the land. As demonstrated by the ongoing work of the career IRS professionals charged with implementing portions of the ACA, and as illustrated by proposed regulations recently issued by the Department of Health and Human Services allowing individuals and families to update information on their out-of-date tax returns,⁴ the Administration is taking laudable and appropriate steps to implement the ACA. They deserve bi-partisan praise for their efforts.

Second, any health care reform that relies on a system of progressive subsidies faces similar challenges. Thus, for example, the Ryan-Wyden reform proposal faces the same administrative and compliance challenges that were confronted by the ACA.

Based on my experience as IRS Commissioner, despite the Administration's praiseworthy efforts, I believe implementation of the ACA's tax credit provisions is going to be a massive administrative and enforcement quagmire.

One reason is the sheer magnitude of the undertaking. Millions of individuals and families are going to purchase insurance on the Exchanges each year. The CBO currently estimates that persons covered through purchases of insurance on the Exchanges will be 9 million in 2014 and 23 million by 2006.⁵ These are huge numbers, especially given the complexity of what's involved. IRS data helps demonstrate the enormity of what needs to be done: in 2011 the IRS issued 5.9 million math error notices, conducted 1.2 million correspondence audits, closed 4.7 million automated under reporter cases, closed 1.4 million substitute for return cases, dealt with 45 million collection cases involving returns that were filed showing a balance due, and handled through live contact 34 million taxpayer assistance requests.⁶ These activities are costly and require an experienced and well-trained workforce.

³ DURING 2011 THE IRS RECEIVED 45 MILLION RETURNS SHOWING THE UNDERPAYMENT OF TAXES DUE. INTERNAL REVENUE SERVICE, 2011 DATA BOOK 41 (2011).

⁴ 76 Fed. Reg. 51233-34 (2011) (to be codified at 45 C.F.R. pt. 155) (proposed Aug. 17, 2011).

⁵ STAFF OF THE CONG. BUDGET OFFICE, 112TH CONG., ESTIMATES FOR THE INSURANCE COVERAGE PROVISIONS OF THE AFFORDABLE CARE ACT UPDATED FOR THE RECENT SUPREME COURT DECISION (Aug. 2012).

⁶ INTERNAL REVENUE SERVICE, 2011 DATA BOOK 23, 37, 38, 41, 47 (2011).

A second reason is that despite what some policy makers like to assume, the circumstances for virtually all of these individuals and families will change from year to year in ways that will have an impact on whether they are eligible to purchase on the Exchange, the policy that best meets their insurance needs, their financial circumstances, and the amount of credit that they are entitled to receive.

Individuals and Families Who Purchase on the Exchanges: The purchase of health insurance is a very big deal for each individual and each family. It is a major financial commitment that plays a central role in his, her, or the family's well-being. By requiring the Exchanges to deal with each of these individuals and families to make upfront and (if permitted) ongoing tax credit determinations is a truly massive undertaking. It is a complex and very expensive process because – to get it right – each Exchange will need to develop a sophisticated and responsive infrastructure that can deal with each participant's unique circumstances in ways that meet the reasonable expectations of each individual and each family. And the Exchanges will need to do so in "real time" because each individual and each family will need to know in very short order the net cost of his, her or their cost of insurance for the year.

Decades of IRS experience provide considerable insight on what citizens expect – and are entitled to receive – in dealing with their government. We want our questions answered in ways we understand and in ways that make sense. We don't want bureaucratic nonsense. We want to be treated with courtesy and respect. We don't want to be treated like supplicants, dummies or big pains in the collective bureaucratic rear-end. We want to deal with real people. We don't want to deal with computers. We want our issues resolved quickly and properly. We don't want a run-around from office to office and person to person. We are sharing intimate details of our private lives and expect that information to be treated with dignity and remain confidential. And because the stakes are so significant – our health care and our money – we have high expectations and very little tolerance for the inevitable mess ups.

The Exchanges: These expectations, and the government's obligation to meet them, seem obvious. Unfortunately, in my experience policy makers either assume them away or ignore the difficulty and true costs of making it all happen in practice.

The IRS faces similar challenges in responding to taxpayers, but on a much smaller scale and with far less time pressure. The IRS has decades of experience, devotes massive resources to the effort, and does a very good job. But the IRS is far from perfect and incremental improvements are slow in coming.

The Exchanges will be well-intentioned and charged with carrying out an important task for the American people. But they will be starting from scratch – with no experienced workforce, no tested technology, and no history of dealing properly with confidential taxpayer information. It's a safe bet that they will not have anything like the resources they need to do the job the way it should be done. The Exchanges' task is made far more difficult because they must deal with every individual and family that seeks to purchase health insurance, and must do so in a window that allows for timely purchase decisions. Decades

of experience with tax administration suggest that the individual and family tax credit provisions of the ACA are going to result in a massive administrative quagmire that will leave millions of Americans angry, frustrated and more disaffected with our government. In my judgment, this is what will happen absent significant changes in responsibilities imposed on the Exchanges.

The IRS. Let's start with the dubious assumption that the IRS will not be inundated with questions at the front end about individual and family health insurance tax credits, not to mention all other aspects of the ACA. Under these circumstances, the IRS challenge will be how to deal with compliance issues at the back end.

In a sense, the IRS task has been made easier in the short run because the ACA does not impose interest and penalties for over-stated credit claims, and the IRS has decided that it will only collect those excess claims through its refund off-set program.

But that's just the short-run. Longer term, taxpayer behavior in response to the ACA and the ACA's tax compliance implications need to be considered in the context of incentives created by the ACA. To say they least, they are far from what Congress had in mind.

Inevitable Decline in Employer-Provided Insurance Coverage and an Inevitable Increase in the Tax Gap:

A central lesson of my time as Commissioner and Assistant Secretary for Tax Policy, and of my career as a tax professional, is that financial and behavioral incentives provided by the tax law have a powerful impact on the behavior of individuals, families and institutions. Speaking from experience, policy makers say we get it, just like we say we "get" the difficulty of making our policies work in practice. But you'd never know "we get it" based on the incentives embedded in the ACA.

Over the years, the tax system has developed a massive infrastructure of advisors, return preparers and other intermediaries who work with taxpayers on how to navigate, comply with, take advantage of, and minimize the impact of every conceivable aspect of the tax law. From time to time, intermediaries get out of line, but on balance they are both inevitable and a good thing for the tax system.

Given the stakes, the infrastructure of intermediaries is already emerging and there is already widespread consideration of the ACA's incentives and their potential implications. For example:

- The modest "penalties" on businesses that drop or do not provide group coverage are tiny relative to the cost of providing group coverage – this means that businesses have a strong economic incentive to not start or drop group coverage for their employees.
- The credit for small businesses that do have group plans lasts for only two years. While this might sound attractive, the provision distorts the decision whether to

hire more employees and the two-year time limit means that small businesses are pocketing a short term benefit while making an expensive and uncertain long term commitment. For these reasons, the small business tax credit is a modest incentive for small businesses to continue their policies in the short run and provides no meaningful incentive for small businesses to start group coverage for their employees. As with other businesses, the far more powerful incentives run in the opposite direction.

- The cap on the penalty tax paid by individuals and families who do not buy health insurance is far below the cost of buying insurance. Especially for young, relatively healthy individuals, the economic incentive is to take advantage of the pre-existing conditions rule and only buy insurance when needed.
- The fact that excess health insurance tax credits claimed by individuals and families are not subject to interest and penalties provides economic incentives to error on the high side, go along with Exchange credit computations that are too high, or just plain lie to obtain excess credits.
- The foregoing economic incentive is enhanced because the IRS will pursue collection only through its refund off-set program.
- About 80% of all individuals and families receive tax refunds, and those refunds average about \$2,500. Under these circumstances, the IRS enforcement policy creates economic incentives for individuals and families who purchase on Exchanges to reduce the amount of the over-withholding that gives rise to refunds.

The foregoing has two implications. First, there will be a significant decline in employer-provided coverage and the small business incentive will be ineffectual. Second, there will be significant non-compliance among individuals and families through the failure to purchase coverage until needed, the over-statement of health insurance tax credits (good faith and otherwise), and a longer term reduction in tax refunds that will increase IRS collection issues as a result of more "balance due" tax returns.

I understand that all of this may sound unseemly, and some of it is. But decades of experience with tax administration tells us that this is going to happen. And I believe it will.

Is There Anything That Can Be Done to Reduce the Impact of These Challenges?

I believe the answer to this question is yes. Now that Chief Justice Roberts and four of his colleagues have determined – correctly in my view – that the revenue provisions of the ACA are all about the government's taxing authority, it is time to stop pretending.

First, do not give the Exchanges responsibility for determining the amount of tax credits that individuals and families are entitled to receive based on two-year old tax return information. This will not be part of their core competency and there is no reason it should be. They have

more than enough challenges as is. Let folks figure it out for themselves. This will make things far easier, timely and less costly for individuals, families and the Exchanges. It will eliminate the need for the IRS sharing of tax return information with yet more government agencies, and will eliminate the need for individuals and families to share intimate details of their personal lives with yet another government bureaucracy that has not been steeped in the tradition of taxpayer privacy and confidentiality.

Second, now that the Supreme Court has spoken, it is time to build on the fact that the revenue provisions of the ACA are tax provisions, and should be structured and administered accordingly. From the standpoint of how they are structured, the penalties and incentives that are intended to encourage employers to establish and retain group policies for employees will be ineffective unless they are increased substantially. Likewise, the penalties on individuals and families who are eligible but fail to purchase coverage on the Exchanges will also be ineffective unless they are increased. These are legislative policies that belong to Congress and the Administration, not the IRS. But based on decades of taxpayer behavior, it is a safe bet that taxpayers will have a clear understanding of the economic implications of these provisions and they will respond accordingly. As a result, well-informed employers will terminate or not adopt group plans for their employees, and well-informed individuals and families will not purchase policies on the Exchanges until the need arises.

From a compliance standpoint, the current sanctions for over-stating the amount of the health insurance tax credit are an empty vessel. If they are going to work, they should be the same as those for any other tax liability – charge interest, integrate with existing penalty provisions, and allow the IRS to use all of the compliance tools at its disposal. To be clear, the IRS will use (as it always should and sometimes does) a broad-based approach to compliance that includes, taxpayer education and taxpayer services; waivers, installment agreements, and offers in compromise; and a large dose of tolerance and forbearance in the context of efforts by individuals and families to navigate a new and challenging regime.

The IRS and taxpayers have been dealing with each other for many decades. While the relationship is not perfect, it works extraordinarily well. The IRS has years of experience that will allow it to implement a system of phased-out tax credits for individuals and families. It will do so in the contest of a deep and unwavering commitment to taxpayer confidentiality. And subject to one major caveat – adequate funding – I am quite certain it will do a terrific job. There is no way to replicate this capacity with the newly formed Exchanges, and there is no reason to try.