INTERNAL REVENUE SERVICE'S IMPLEMENTATION AND ADMINISTRATION OF THE DEMOCRATS' HEALTH CARE LAW

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

SEPTEMBER 11, 2012

Serial No. 112–OS16

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

80–693 WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

DAVE CAMP, Michigan, *Chairman*

WALLY HERGER, California
SAM JOHNSON, Texas
KEVIN BRADY, Texas
PAUL RYAN, Wisconsin
DEVIN NUNES, California
PATRICK J. TIBERI, Ohio
DAVID G. REICHERT, Washington
CHARLES W. BOUSTANY, JR., Louisiana
PETER J. ROSKAM, Illinois
JIM GERLACH, Pennsylvania
TOM PRICE, Georgia
VERN BUCHANAN, Florida
ADRIAN SMITH, Nebraska
AARON SCHOCK, Illinois
LYNN JENKINS, Kansas
ERIK PAULSEN, Minnesota
KENNY MARCHANT, Texas
RICK BERG, North Dakota
DIANE BLACK, Tennessee
TOM REED, New York

SANDER M. LEVIN, Michigan
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York

JENNIFER M. SAFAVIAN, *Staff Director and General Counsel*
JANICE MAYS, *Minority Chief Counsel*

SUBCOMMITTEE ON OVERSIGHT

CHARLES W. BOUSTANY, JR., Louisiana, *Chairman*

DIANE BLACK, Tennessee
AARON SCHOCK, Illinois
LYNN JENKINS, Kansas
KENNY MARCHANT, Texas
TOM REED, New York
ERIK PAULSEN, Minnesota

JOHN LEWIS, Georgia
XAVIER BECERRA, California
RON KIND, Wisconsin
JIM MCDERMOTT, Washington

CONTENTS

INTERNAL REVENUE SERVICE'S IMPLEMENTATION AND ADMINISTRATION OF THE DEMOCRATS' HEALTH CARE LAW

TUESDAY, SEPTEMBER 11, 2012

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:46 a.m. in room 1100, Longworth House Office Building, the Honorable Charles Boustany (Chairman of the Subcommittee) presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

Boustany Announces Hearing on the Internal Revenue Service's Implementation and Administration of the Democrats' Health Care Law

Tuesday, September 04, 2012
UPDATE: NEW TIME
ALL OTHER DETAILS OF THE HEARING REMAIN THE SAME.

Congressman Charles W. Boustany, Jr., MD, (R–LA), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced the Subcommittee will hold a hearing on the Internal Revenue Service's ("IRS") implementation and administration of the Patient Protection and Affordable Care Act and Health Care and Education Reconciliation Act of 2010 ("Democrats' health care law"). The hearing will take place on Tuesday, September 11, 2012, in room 1100 of the Longworth House Office Building, beginning at 9:45 A.M.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

Enacted in large part on March 23, 2010, the Democrats' health care law contains 47 tax or tax-related provisions, some of which are already in effect and others that will become effective over the next 18 months. These provisions include, the individual mandate and employer mandate taxes, restrictions on the use of Flexible Spending Arrangements and Health Savings Accounts, a new 3.8 percent tax on investment income, newly mandated information reporting on health insurance coverage, new taxes on medical devices, a new Medicare payroll tax, the health insurance premium subsidy, and new requirements for tax-exempt hospitals and group health insurance plans.

The IRS is charged with implementing and administering these new provisions on top of its existing duties under the Internal Revenue Code, which include collecting $2.4 trillion in taxes, processing 145 million individual tax returns, issuing $345 billion in tax refunds, and administering numerous non-revenue provisions such as the Earned Income Tax Credit and various green energy subsidies.

Along with its review of the IRS's new duties, the Subcommittee will consider: (1) how the IRS's new duties under the health care law will affect both taxpayers and the IRS's core revenue-collection function; (2) the IRS's progress in implementing various provisions of the health care law, both those that are already in effect and those that are not yet in place; and (3) how the agency will coordinate with other Federal departments, state governments, and stakeholders to implement the new tax provisions.

In announcing the hearing, Chairman Boustany said, **"In recent years, the Subcommittee has held hearings on the IRS's budget, its administration of our complex and convoluted Tax Code, and an estimated $100 billion in taxpayer dollars that have been lost to fraud, waste, and abuse over the past decade. Under President Obama's health care law, the IRS is now charged with administering much of the health care law. It is imperative that we take a close look at these new duties and consider the impact they will have on the agency and the taxpayers it serves."**

FOCUS OF THE HEARING:

The hearing will focus on the IRS's implementation of various tax provisions enacted in the Democrats' health care law and consider how the agency's implementation of the law will affect taxpayers and its core revenue-collection mission.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Tuesday, September 25, 2012**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721 or (202) 225–3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Chairman BOUSTANY. This hearing will now come to order. Good morning and welcome to today's hearing on the Internal Revenue's implementation and administration of the President's health care law.

Before we begin this morning, it is appropriate to recall that 11 years ago, almost to the hour, our Nation was savagely attacked. After these 11 years, each of us can certainly recall exactly what we were doing at that time.

The horror of the day should give us the resolve to continue doing our business and demonstrate that we will not be intimidated or deterred.

More than a decade has passed but the attacks of the day still outrage, the tragedies still overwhelm, and the acts of heroism still inspire us.

We still mourn those lost on that day and all those who have given their lives since in the defense of liberty. We are thankful for those who continue to stand and volunteer to serve our country both at home and abroad.

We will take a recess from this Subcommittee's proceedings at 10:45, so that those who wish to join the 9/11 remembrance in the Capitol can do so, and then we will promptly reconvene at 11:30 to resume the hearing.

We are going to watch the clock pretty closely and we will stop at around 10:45.

The Internal Revenue Service has enormous responsibility. It is tasked with administering our very convoluted tax system and a Tax Code that has changed nearly 5,000 times in the past 10 years alone.

The agency is charged with collecting roughly $2.5 trillion, distributing hundreds of billions of dollars in tax credits, and enforcing 4,000 pages of tax laws, and 80,000 pages of tax regulations.

The agency's core revenue collection function has increasingly been crowded by its responsibility to administer many social programs.

Through the years, Congress has sought to advance a multitude of non-revenue objectives through the Tax Code, energy policy, housing policy, and of course, health care policy.

Making the IRS both revenue collector and administrator of these activities has diverted the IRS' resources from its central mission and can diminish taxpayer service.

In 2010, Congress passed President Obama's health care law, expanding nearly 1,000 pages and passed "so you can find out what is in it," in the famous words of then-Speaker Nancy Pelosi.

The health care law contained 47 tax provisions and charged the IRS with vast new responsibilities.

These included the implementation and administration of the largest entitlement created in more than a generation, new penalty taxes on individuals and employers who fail to provide or buy government approved health insurance, the need to quickly create vast new information technology systems, and the list goes on and on.

The President's health care law has put the Federal Government in charge of approving health insurance plans, subsidizing them, punishing those who do not buy government approved plans, and many other aspects of our health care system.

The Internal Revenue Service has been saddled with the responsibility of carrying out many of these new Federal activities.

More than creating new burdens on the IRS, the President's health care law has led to new tax rules and regulations that will pose significant challenges to both individuals and job creators.

The Administration's own documents state that the compliance burden of the new rules it has thus far written pursuant to the President's health care law will add nearly 80 million man hours

each to individuals and job creators. This is just the 17 regulations that have been issued so far. There are more to come.

Eighty million hours that will not be spent creating new wealth, providing health care, or doing anything productive.

Eighty million hours simply complying with new rules from Washington.

This is the burden from just the IRS' new rules, the 17 new rules that have been promulgated. When you add the new regulations from HHS, the Department of Labor, and other agencies, the burden on our sluggish economy goes still higher.

As a former surgeon and owner of a small medical practice in Louisiana, I certainly know how taxes, rules and regulations from Washington can impede not only a small business but also patient care.

I am especially interested in hearing from the IRS and our witnesses today about how the new law will operate in the real world, in real time.

The object of this hearing is to assess the IRS' efforts to administer the law, including its efforts on the Service's core mission, and how decisions made now to implement it will affect both the agency and taxpayers as the provisions continue to come into effect.

Ladies and gentlemen, this is also not a hearing to beat up the IRS, an agency run by good men and good women. I want to emphasize that. Dedicated public servants who have an incredibly difficult job.

The agency did not write the health care law. The previous Congress did. It passed the law. Now we are finding out what is in it and what it means for the country and for the Internal Revenue Service and for taxpayers.

I look forward to the testimony and questioning of our witnesses. Now, I am pleased to yield to the distinguished Ranking Member from Georgia, Mr. Lewis.

Mr. LEWIS. Thank you, Mr. Chairman. First of all, I want to thank you for pausing to observe what happened to our country 11 years ago today. It is my hope and prayer that Americans all over will pause and observe what happened.

Mr. Chairman, I want to thank you for holding this hearing on the Affordable Care Act. We are always pleased to discuss our landmark health reform law which will expand health coverage to over 30 million Americans.

Because of the Affordable Care Act, children today cannot be denied insurance benefits due to preexisting conditions, and young adults can stay on their parents' insurance until age 26.

Seniors are already saving hundreds of dollars on their prescription drugs and receiving free preventive services.

This morning, the Department of Health and Human Services announced that the Affordable Care Act has saved people with private insurance over $2 billion.

We must ensure that the Internal Revenue Service continues to move with all deliberate speed to deliver hundreds of billions of dollars of Federal tax credits to American families and small businesses, which will make health insurance affordable.

I am confident that the tax provisions of the Affordable Care Act will be carried out on schedule.

Today, I look forward to learning where we are in the process, the problems we have seen, and the issues that remain.

I want to thank all of the witnesses for their recommendations to address these issues. I also look forward to hearing from the agency about the resources it needs to fulfill its duties under the health reform law.

I continue to have serious concerns about the effect of recent budget cuts on taxpayers, tax collection, and agency operations.

This year, the agency's budget was cut by over $300 million. This cut harmed taxpayers and tax administration. For fiscal year 2013, the IRS requested a budget increase of $360 million for administration of the health reform law. Almost 75 percent of this money will be spent on technology needed to deliver hundreds of billions of dollars in tax credits.

I look forward to hearing more about the IRS budget request and how the amount requested will help the agency complete its work on the health care law while protecting Federal tax dollars.

Thank you very much, Mr. Chairman.

Chairman BOUSTANY. Thank you, Ranking Member Lewis. Next, it is my pleasure to welcome two panels of witnesses before us today.

Today's witnesses have extensive experience with the IRS and tax compliance, and I am delighted to have all with us.

Our first panel will consist of Deputy Commissioner Steven T. Miller. I want to welcome him again before our Subcommittee. We appreciate you being willing to come before us today.

Steven T. Miller, Deputy Commissioner for Services and Enforcement at the Internal Revenue Service.

Deputy Commissioner Miller, the Committee has received your written testimony, and it will be made part of the formal hearing record. You will have 5 minutes for your oral remarks as is customary. You are recognized for 5 minutes, sir.

STATEMENT OF STEVEN T. MILLER, DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT, INTERNAL REVENUE SERVICE

Mr. MILLER. Thanks so much, Mr. Chairman. Chairman Boustany, Ranking Member Lewis, Members of the Subcommittee, thanks for the opportunity to update you on the IRS' staged implementation of the tax law portion of the Affordable Care Act.

As I begin, let me say that there is no doubt that implementation of the ACA has required and will continue to require a concentrated effort on our part.

However, the IRS has a successful history of such efforts. In this case, the IRS is taking full advantage of the fact that the major exchange related provisions, with respect to those, we will have time to plan our implementation and communicate with taxpayers.

The IRS began both short term implementation and long term planning immediately upon passage of ACA. Our efforts focused on two things. First, to quickly implement tax law changes that were retroactively or immediately effective.

Examples in this first category include the small business health care tax credit, the expansion of the adoption credit, and specific

industry provisions such as those that focused on qualified therapeutic projects and the indoor tanning industry.

In terms of those provisions that had future effective dates, we moved quickly to put a structure and process in place to plan and implement these provisions.

Because many ACA tax provisions are substantial and require long term planning, the IRS established enterprise-wide governance and planning processes, both in its business operations and its information technology divisions. This is a significant undertaking and a lot of work still lies ahead. However, by involving top leadership and using established best practices, we have made important progress.

We have prioritized our work based on the particular effective date of a provision and/or the need for the Government or taxpayers to build the systems necessary to support the new law.

This approach is taken whether we are talking about our IT work or how we prioritize our guidance to the community.

The IRS' most substantial implementation efforts relate to our work with the exchanges and the premium tax credit. In this area, we are working on the secure delivery of information to HHS as well as other work that will ensure that advanced premium tax credits are available beginning in 2014.

The Department of Health and Human Services is the lead agency defining the structure and operations of the exchanges with Treasury and the IRS defining some of the associated rules.

As part of our efforts, we are working to provide clear and flexible guidance to the community, and we have done this after engaging in a robust dialogue with those impacted.

For example, we have worked closely with large employers to get them key pieces of guidance and time to set up their systems and procedures, including a number of simplifying safe harbors to assist in measurement and compliance.

In terms of guidance on ACA more generally, we have to date issued a variety of regulations, more than 40 notices, as well as a variety of revenue rulings, procedures, announcements, and frequently asked questions.

While there is much yet to be done, we have already accomplished a great deal.

In addition to building necessary systems and issuing guidance, we are working on how taxpayers will interact with the IRS as they file their returns. This involves both service and compliance.

We do have some time as most of these interactions begin during the 2015 tax filing season. Still, we are already engaged in discussions with tax return preparers and software developers so the taxpayers have what they need at the time they file their 2014 tax return.

Let me speak to one area in particular, as there have been numerous questions about how the IRS will verify individual coverage.

The IRS process for verifying coverage will be very similar to the one we have used for years to verify wages and withholding. The IRS will match what is reported on the tax return with the information reported by insurers.

We will follow up with taxpayers who appear to have over paid, under paid, and/or were not eligible for an exemption.

This will take the form of written correspondence. Revenue agents will not be doing this work. As required by the statute, we will not use levies, liens, or criminal prosecutions if taxpayers have unpaid amounts related to the individual coverage provision.

Thank you for the opportunity to testify on our planning and implementation efforts related to ACA's tax provisions. It is a large undertaking but over the last several years, there have been thousands of tax law changes, some larger than others, and the IRS has implemented them all.

Our work to date on ACA is going well. We have the processes and structure in place to succeed.

I would be happy to answer any questions.

[The prepared statement of Mr. Miller follows:]

WRITTEN TESTIMONY
OF
STEVEN T. MILLER
DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
HEARING ON
IMPLEMENTATION OF TAX LAW CHANGES IN
THE AFFORDABLE CARE ACT
SEPTEMBER 11, 2012

INTRODUCTION

Chairman Boustany, Ranking Member Lewis and members of the Subcommittee, thank you for the opportunity to update you on the IRS' staged implementation of the tax law changes contained in the Affordable Care Act (ACA).

Whenever Congress passes changes to the tax law, the IRS must take the necessary steps to educate and communicate with taxpayers about the changes, update relevant forms and publications, change or re-program its information technology systems, and implement appropriate programs to sustain high levels of compliance with the new provisions. The ACA is no exception.

Both short-term implementation and long-term planning began immediately upon passage of the legislation. Our efforts focused on: (1) ensuring tax law changes that were retroactively or immediately effective were implemented in an expedited manner; and (2) putting structures and processes in place to begin planning for provisions with future effective dates.

EARLY IMPLEMENTATION EFFORTS

The IRS moved quickly to implement a number of tax law provisions in the ACA that immediately went into effect upon enactment. Let me discuss a few provisions that the IRS implemented immediately upon enactment of the ACA in 2010.

The IRS conducted an extensive outreach and implementation program for the Small Business Health Care Tax Credit. Shortly after the ACA was passed, the IRS determined the necessary steps to both implement the credit and track these efforts. The IRS conducted significant outreach, communication, and educational activities to inform small businesses and tax professionals about the credit.

We created a special page on our web site, IRS.gov, just for the Small Business Health Care Tax Credit. From there, taxpayers could use a step-by-step guide to see if they

qualified for the credit and how to claim it. There are also links to a Question and Answer section, a special You Tube video, legal guidance, news releases, and information flyers.

The ACA also expanded the existing adoption tax credit. The dollar value of the Adoption Credit was not only increased from $12,150 to $13,170 but was also made refundable. In 2010, we issued guidance on the expanded adoption credit and updated forms and instructions so that eligible taxpayers could claim the newly expanded adoption credit on their 2010 tax returns.

Taxpayers and practitioners could also find on IRS.gov a step-by-step procedure for claiming the credit, including a link to "Instructions for Form 8839" which has a detailed list of the acceptable required documentation. The documentation required can vary depending on whether it is a domestic or foreign adoption.

This online article also spells out what happens if a taxpayer's return claiming the credit is selected for review. For example, the taxpayer will receive a notice from the IRS explaining the steps he or she must take, such as providing certain documentation to resolve the issue.

Finally, the IRS quickly communicated with taxpayers and issued guidance relating to the ACA provision requiring group health plans and health insurance issuers that provide dependent coverage of children to continue to make such coverage available for an adult child until age 26. The ACA amended the Internal Revenue Code to give certain favorable tax treatment to this coverage for adult children. The IRS guidance explained that the statutory provision provides that health coverage provided for an employee's children less than 27 years of age is generally tax-free to the employee, effective March 30, 2010.

PREMIUM TAX CREDITS

The IRS' most substantial implementation effort relates to the delivery of premium assistance tax credits that will help millions of American families afford health insurance starting in 2014.

The Department of Health and Human Services (HHS) is the lead agency on defining the structure and operations of the Affordable Insurance Exchange or, "Exchanges," with Treasury/IRS defining the associated rules for how tax credits can help subsidize the coverage available through the Exchanges.

Starting in 2014, individuals who do not have access to affordable employer-sponsored insurance or other minimum essential coverage may be eligible to receive advance premium tax credits for private insurance that they purchase through the Exchanges. HHS will publish guidance on how the Exchanges will administer the advance payments of the credits. It is important to note that the advance payments of the credit will be paid directly to the insurer, and cannot be accessed directly by the taxpayer.

Taxpayers will reconcile these advance payments on their tax returns. If the actual credit is larger than the sum of advance payments, the taxpayer will be entitled to a refund. If the actual credit is smaller than the sum of the advance payments, the taxpayer will owe the difference, subject to caps for certain individuals included in the ACA, as amended.

Separately, the ACA provides an important role for tax return information in helping to determine eligibility for both Medicaid and premium tax credits. IRS staff has been working closely with HHS and the states on developing secure and efficient systems.

MINIMUM COVERAGE PROVISION

The ACA also stipulates that starting in 2014 individuals who can afford health insurance coverage, and are not eligible for exemptions, must either purchase minimum essential coverage, or make a payment with their tax returns.

The individual minimum coverage provision is projected to affect only a small percentage of the total population when it comes into effect in 2014. The Congressional Budget Office and Joint Committee on Taxation previously estimated that approximately four million people – approximately 1 percent of the projected population – will make a payment (or, in the case of dependents, have a payment made on their behalf) in 2016. Let me be clear that the payment only applies to taxpayers who can afford insurance but do not purchase it. There are also a number of individuals who will be exempt from the individual coverage provision, such as those with income below the tax filing threshold or those whose premiums are not affordable.

Taxpayers will get a form at the end of every year from their insurer to use when they prepare their tax returns. It is important to note that the information that insurers provide to the IRS will show the fact of insurance coverage, and will not include any personal health information.

In most cases, taxpayers will file their tax returns reporting their health insurance coverage, and/or making a payment, and there will be no need for further interactions with the IRS. The IRS process for verifying coverage will be very similar to the one that the IRS has used for years to verify wages and withholding. The follow-up will generally be performed by written correspondence, and will allow taxpayers time to gather the information needed to respond, or get help in understanding the details of the provision.

In this regard, let me clear up one misconception. Generally, revenue agents – who are specially trained on more complicated aspects of the tax code – would not work on resolving these types of issues, just as they don't work on resolving mismatches between W-2s and income tax returns today. Typically, these issues are addressed and resolved through written correspondence.

The law also clearly specifies that the IRS will not use levies or file notices of federal tax lien if taxpayers have unpaid amounts related to the individual coverage provision. Moreover, taxpayers will not be criminally prosecuted for non-payment of this amount.

IMPLEMENTATION EFFORTS

Because these and other tax provisions included in the ACA are substantial and require long-term planning, the IRS has established enterprise-wide governance and planning processes, both in its business operations as well as its information technology division. These planning efforts have had the benefit of independent reviews by both the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA).

Our budget requests in recent years reflect the need to invest in information technology (IT) systems to generally update our tax systems as well as administer the premium tax credit and other tax law provisions of the ACA. Of the funding requested in our FY 2012 and FY 2013 budgets related to ACA tax law implementation, 82% and 92%, respectively, was in our Operations Support account, which funds our IT and operations investments.

CONCLUSION

Mr. Chairman, thank you again for this opportunity to testify on the IRS' planning and implementation efforts related to the tax provisions contained in the ACA. Through the involvement of top leadership and by employing leading and best practices, important progress on implementation has been made. This is a great tribute to the highly dedicated and professional men and women of the IRS who have devoted themselves to this project. I would be happy to answer your questions.

Chairman BOUSTANY. Thank you, Mr. Miller. We have a lot of uncertainty out there today amongst the business community and families with regard to what is going to happen with taxes. Of course, we know about all the expiring tax provisions that are coming at the end of the year unless Congress duly acts.

I would like to point out that the House has acted in July to avert rates from going up. I hope that the other body across the Capitol will move forward and do so hastily to eliminate this uncertainty that is ongoing.

With that having been said, clearly we know there is a lot of uncertainty related to ACA, the implementation, the tax implications.

I know the IRS has begun issuing regulations in accordance with the President's health law with many more coming. In fact, I have these two binders right here. These are the regulations, revenue proceedings, revenue rulings, and Treasury decisions to date, encompassing some 17 new regulations the IRS has published so far, that will require nearly 80 million hours of compliance work by taxpayers annually. Eighty million hours so far.

This is according to the IRS and the Office of Management and Budget materials published in the Federal Register.

This includes over 25 million hours for information reporting by tax exempt organizations, over 40 million hours for small businesses, and almost three million hours for the self employed.

This additional 80 million hours is based only on what regulations have been published already, not on those coming. That is my understanding.

Mr. Miller, can you give us an estimate of the regulatory burden expected once the President's law is fully implemented?

Mr. MILLER. First, I guess, Mr. Chairman, I do not know the 80 million figure, so I am not prepared to speak to whether that is correct or not. I am assuming it is correct, but I do not have that figure.

Chairman BOUSTANY. This is from IRS and OMB.

Mr. MILLER. I do not have a sense at this point for a total number of hours. Until we do the regulations and complete that work, that really is not possible.

Chairman BOUSTANY. I understand. Given what we have so far, is it possible to estimate the economic cost to our economy on this? Are you aware of any estimates of the economic burden this will impose on American taxpayers?

Mr. MILLER. Sir, you are talking to the Administrator, Mr. Chairman. I would not be able to speak to the economics of the situation, only to our working through the provisions and getting the guidance out to folks that need to comply.

Chairman BOUSTANY. This will certainly be a question we will need to further investigate with Treasury and others.

The President's law creates new insurance subsidies and employer mandate taxes, which are tied to the subsidies. Under the language of Section 1401 of that law, the subsidies are only available to individuals enrolled through an exchange established by the state. That is the statute.

Yet, in August last year, the IRS proposed a rule that ran counter or seemingly ran counter to the plain language of the statute, providing for subsidies in states regardless of whether that state chose to create an exchange or not.

This gives rise to employer mandate taxes that are not provided for by the statute and some have alleged it was done at the urging of political appointees at the Treasury Department and the White House.

I know your position as Administrator is well taken, and I understand that. Can you publicly state whether the IRS had received any communication from political appointees at Treasury or anyone at the White House urging this reading of the statute?

Mr. MILLER. Let me start with how our regulatory process works, which is a tripartite discussion between the Department of Treasury, Office of Tax Policy, our Office of Chief Counsel, our lawyers, and the Internal Revenue Service itself, Doug Shulman and myself.

The jurisdictions, the Office of Tax Policy, really plays lead on policy matters. We take a look and see, as the IRS, is the proposed rule "administratable," can we do it. We all have a part in talking to stakeholders about the rule.

Our Chief Counsel's Office really speaks to what are the permissible reading's of a particular statutory provision.

In this case, we probably did have discussions with the Administration, and that is not a surprise because where there is a multiagency regulation, generally that will happen. Who in particular was briefed, I do not know.

What I can say and what I want you to take away from this, Mr. Chairman, is the decision as to whether our reading of Federal versus just state was correct was made by our Counsel's Office at the IRS. We believe it is the correct legal interpretation.

Chairman BOUSTANY. This was not solely an IRS determination but it was done with legal counsel at IRS in combination with those at Treasury and the White House?

Mr. MILLER. You are putting the White House in there, and I do not know they were involved. The decision on whether the regulation contained a provision—to step around that a little bit, our position, and it is the IRS' position, is that you cannot read that statutory provision alone. You need to look at not only the text but the context, the purpose, and the structure of the statute.

Our reading that a Federal exchange can provide a subsidy is a preferred reading, and it is the finding of the Chief Counsel's Office at the IRS.

Chairman BOUSTANY. Okay. What we would like as a subcommittee are the dates and participants at all meetings, notes from those meetings. Certainly documents relating to that determination that the insurance premium subsidies apply to the Federal exchanges, Federally created exchanges.

This is clearly something we dispute because the reading in the statute seems very clear. As you cite other aspects of the law, we would like to know what other aspects in the law were used in that determination by legal counsel and all outside input, including if indeed there was input from White House political advisors, but certainly I know Treasury was involved in this because it is a policy matter.

Mr. MILLER. Right.

Chairman BOUSTANY. If you could provide that to us as promptly as possible, we would certainly appreciate it.

Mr. MILLER. We will be glad to respond.

Chairman BOUSTANY. Thank you. With that, I will be happy to yield to my friend, the Ranking Member, for questions.

Mr. LEWIS. Thank you very much, Mr. Chairman. Mr. Miller, at this moment today, do you expect IRS to be ready for the health care law by 2014?

Mr. MILLER. Absolutely, Mr. Lewis.

Mr. LEWIS. You do not have any reservation, you are ready?

Mr. MILLER. We are ready. We will be ready. Based on what I know, based on our level of effort to date, based on the planning and structures we have put in place, we will be ready on the exchange related provisions and other provisions of the ACA.

Mr. LEWIS. Will the administration of the health care law harm the IRS' core revenue collection mission?

Mr. MILLER. I do not believe so. I will step back from that question, Mr. Lewis. I do not recognize core versus non-core in terms of the IRS' work. This is what we do. Congress passes a statute, whether it is a charitable deduction or whether it is a home mortgage deduction, some of those things have varied purposes, but they are in the Tax Code.

We consider the ACA to be our core work. It is part of our core work.

Mr. LEWIS. Mr. Commissioner, has the IRS been listening to and working with outside stakeholders to provide guidance that is responsive to their needs?

Mr. MILLER. We have. In fact, I would note for the Chairman, in that big book, a whole bunch of that book are requests for comments and suggested safe harbors, and all the types of things we ought to be doing to engage the business community and others before we put out final rules.

Mr. LEWIS. As part of carrying out the health reform law, does the IRS plan to conduct education, maybe workshops, activities, outreach to taxpayers, employers and tax professionals? What has the IRS done so far?

Mr. MILLER. Again, here we are guided in our approach by the effective date of the provision. For example, the early provisions, we did something in excess of 1,500 meetings with small business over the tax credit for small business. We have done a couple of hundred meetings with folks in the tanning industry.

We have tried to engage those folks. As we move into 2013, we will obviously start working on what is going to happen with the health care credits later in that year.

This past year, we engaged more than 10,000 return preparers at our various tax forums around the country to try to educate them on what is here today and what is coming in the next year.

We have a very active outreach program.

Mr. LEWIS. Mr. Miller, for the year 2013, the IRS requested about $270 million for technology and operational support to deliver new tax credits.

I want you to explain to Members of the Committee why additional money is needed for the IRS' computer system and how the computer system will be used to deliver the tax credits.

Mr. MILLER. IT builds are considerable. The first that is necessary is we are obligated under the statute to provide some taxpayer information, to provide income and family size, so that the exchanges can do their work as people come in to sign up and get the right amount of advance premium.

That work continues. We are working incredibly well with HHS and CMS to make sure that happens. That will be in place for the open season, which begins in late 2013. That is the first build.

We also have a build where we will have to receive the information returns from various parties to ensure that the correct amounts are being paid out and verify that. That work becomes very important as we have the filing season for 2014.

We have a whole array of work with respect to the exchange related provisions, and then there are some other provisions as well that require IT work.

We do have significant building to do in the IT arena.

Mr. LEWIS. Thank you very much, Mr. Miller. I yield back, Mr. Chairman.

Chairman BOUSTANY. Ms. Jenkins, you are recognized for five minutes.

Ms. JENKINS. Thank you, Mr. Chairman. Thank you for holding this hearing, and thank you, Commissioner Miller, for being here.

Commissioner Shulman has said the President's health care law, and I quote "Fragmentation of operational workload increases the difficulty of execution and will require an extraordinary amount of coordination with other players in the health care system."

For example, HHS will have to reach out to IRS to verify income and family size. Homeland Security might have to verify immigration status. The Social Security Administration might have to verify citizenship.

All of this is occurring while a trillion in subsidies will be flying out the door.

Are you aware of any previous law that has ever required the IRS to interact so extensively with other governmental agencies, and what sort of stress will this extension interaction place on the IRS' core function?

Mr. MILLER. We share taxpayer information under very stringent restrictions with an awful lot of folks, with the state tax authorities, the state Medicaid authorities, with Social Security. We have a long history of doing it. It does not stress us.

It does require us to work very hard to ensure that the safeguards are in place, that that taxpayer information is protected.

Ms. JENKINS. No extra heavy lift on your part to coordinate?

Mr. MILLER. As I mentioned, the IT work itself is a decent lift for us. We are working on that and we will succeed on it, but it is a decent lift.

Ms. JENKINS. Okay. The insurance premium subsidy will be based on a new definition of IRS household income, which is affected by the make up of families' income, their personal finances and other personal matters.

Under the President's health care law, individuals are responsible for informing governmental officials at the insurance exchange if they have changes to their household income during the year. This would be the adjusted size of their subsidy; is that correct?

Mr. MILLER. I am less familiar with that piece of that because that is not really the IRS piece.

It is true that when you come in the door to sign up for coverage and for an advance premium, there will be a discussion of what is your tax situation, what is the appropriate amount of the premium.

As things change during the year, I believe there is an obligation to come back and talk to the exchange about whether that impacts the amount of the premium.

Ms. JENKINS. If I lose a current job or get demoted, lose pay or get a raise, any change in all of that, as you understand, I would need to inform a governmental official at the exchange?

Mr. MILLER. I do not know. I am quite sure it is not any change, Congresswoman. I cannot speak to that because that is an HHS sort of job to define that.

Ms. JENKINS. Is there somebody that could get us that information?

Mr. MILLER. I would think HHS would be the place to go for that.

Ms. JENKINS. Okay. Thank you. I yield back.

Chairman BOUSTANY. Mr. Kind.

Mr. KIND. Thank you, Mr. Chairman. Thank you, Mr. Miller, for your testimony here today and the service that the IRS provides our Nation overall.

I guess, Mr. Chairman, the big news this week for the Affordable Care Act that was revealed was Mitt Romney's embrace of some of the provisions that are part of the Affordable Care Act.

To tell you the truth, it is not too surprising. For anyone who has read the actual legislation and understands what is in it and the provisions contained there, there has been wide embrace on both sides of the aisle on a variety of provisions.

I think Mitt Romney in the light of honesty and full disclosure admits himself there is a lot in the Affordable Care Act that he can work with, that he would like to preserve if he was elected President.

I thought that was a very revealing comment, but also not surprising given that he is the one that implemented his own health care reform, much of which was adopted with the Affordable Care Act here in Congress.

Whether it is preexisting conditions, young adults staying on their parents' plans, I think the Governor has acknowledged there is a lot of good aspects of the Affordable Care Act that should be preserved and should be protected. I thought that was a very revealing and helpful comment.

I agree with Mr. Lewis. I think it is helpful for us to have from time to time oversight in hearings to see about the implementation of the Affordable Care Act, especially the IRS' role in all of this.

I think we have heard Mr. Miller testifying in regard to some of the resources that IRS is requesting and what that money is going to be used for.

My sense is, and correct me if I am wrong, that the vast amount of the resources will be used as far as outreach and education and also some of the infrastructure needs that the IRS has in implementing the Affordable Care Act; is that right?

Mr. MILLER. That is correct. The biggest amount of the $360 million asked for in 2013 is actually for the IT build that we have talked about. A very small amount of it is enforcement or service,

much of the balance is infrastructure to set up the processes to succeed.

Mr. KIND. Mr. Lewis also asked you to respond to the outreach that is currently being conducted to the variety of stakeholders out there, whether it is businesses, individuals, tax preparers, things of that nature.

How would you describe that relationship and that communication with a lot of the requests for information coming into the IRS today?

Mr. MILLER. I think it has been robust. I think the second panel will be a perfect panel to talk to about that issue. I think overall, we have gotten a great response. Obviously, there is a great deal of interest, and most things, I think, people can live with and some things, they are continuing to talk to us about, which is the nature of a decent discussion, I believe.

Mr. KIND. Will the IRS be involved at all in the enforcement of the Affordable Care Act, the requirement for health insurance for individuals?

Mr. MILLER. We will. That is a tax provision.

Mr. KIND. To what extent will you be involved with that? Will this be conducting audits of individuals or businesses or what?

Mr. MILLER. I think, if I understand the question, Mr. Kind, and I alluded to this in my oral, with respect to the individual coverage provision, the IRS will, I believe—we have talked about this—there will not be revenue agents involved in this. These will not be audits. This will be a matching process. It will be something similar to what we see when we get in bank information with interest on it.

There will be a match to see whether there has been insurance. There will be correspondence with the individual, if it looks like they are not entitled to an exemption, and they will have the ability to converse with us about whether or not there should be a payment or not.

To the extent there is a payment, the statute is very clear in what we can and cannot do. We cannot do liens. We cannot do levies. We cannot do seizures. We cannot do criminal prosecutions.

The vast majority of people in this category, they will pay the money they owe. That is the way the American system works. More than 70 percent of the money that we collect from the balance of dues is collected not through drastic collection action, but when we correspond with someone, when we give notice or other correspondence.

I have no doubt that most people will comply with the payment. Those that do not, we have a limited amount that we will be able to do with respect to them, and we have talked about that at the end of the day, it might be an offset of——

Mr. KIND. Some opponents in the past of the Affordable Care Act claim the IRS is going to have to staff up to the tune of 16,000 enforcement agents. Is there any basis for that number?

Mr. MILLER. There is no basis for that number.

Mr. KIND. Thank you, Mr. Miller. Thank you, Mr. Chairman.

Chairman BOUSTANY. Thank you, Mr. Kind. Before we go to Mr. Marchant, just a quick follow up. I know you mentioned a significant amount of money requested for IT implementation. I just

want to remind you that Mr. Lewis and I sent a letter not long ago. We are still waiting on a response.

It is about the IRS and what is going on with the money and the allocation for IT.

Mr. MILLER. We will get you that letter this week.

Chairman BOUSTANY. I appreciate it. Thank you. Mr. Marchant?

Mr. MARCHANT. Thank you, Mr. Chairman. Mr. Miller, I would like to explore the new concept to the IRS of the household income. Since it is a brand new concept, is it a legal concept to the IRS at this point?

Mr. MILLER. It is in the statute itself. It is defined in the statute. It is a statutory provision.

Mr. MARCHANT. Has the IRS made preliminary findings on what constitutes a household?

Mr. MILLER. I think we have. I think the statute sets it out. The statute basically says modified or adjusted gross income, which basically is off your tax return. The only twist to that is you have to add in for your family size, where you are taking a dependent, and that dependent is filing a tax return, that dependent's income has to be added in as well. That is the only real difference. There are very few people in that category, Congressman.

Mr. MARCHANT. Is it the IRS that will be the final person who decides what constitutes that household unit or will it be the exchanges?

Mr. MILLER. I believe, if I am understanding the question, that the IRS will be providing the exchange with information on any dependents that are filing a tax return in that unit.

Mr. MARCHANT. If you have two people unmarried living under the same roof, each having a child, will that constitute a household, and which of the tax returns will be the main tax return that will constitute—that will apply to the exchange?

Mr. MILLER. I will come back in writing if they tell me I am wrong, Congressman, but it is going to depend on who is taking whom as a dependent. The household is that individual who has some people being taken—who is taking some people as a dependent on their return.

I do not know in a given situation whether the two unmarried folks have a dependency relationship in that respect or not or whether the children do or not. It really is going to depend—the definition of "household income" is your modified adjusted gross income subject to some foreign provisions in tax exempt interest, and the income from those who you have taken on your return as a dependent provided that dependent has filed a tax return.

Mr. MARCHANT. If you had two adults living in the same household that filed separate tax returns, would a married couple filing separate tax returns be constituted as a household?

Mr. MILLER. Well, I will answer the question in a different way, which is if you are married under ACA, to get the premium tax credit, you must file married, filing jointly. That is an eligibility requirement for the credit.

Mr. MARCHANT. The physical living together has no part of the definition of "household." It is defined by virtue of the IRS Code, purely?

Mr. MILLER. The physical proximity might have an impact on the dependency claim on the tax return. Again, it ties off to whether you are a dependent on that person's return.

Mr. MARCHANT. For the first time ever, it will be the IRS' job to compile this and go through a separate step and define "household income?"

Mr. MILLER. The only separate step, Congressman, is including the income from a dependent who is filing a tax return. To be quite frank, you should have a general feel for what that income is if you are taking that person as a dependent because that is part of the test of taking that person as a dependent.

Much of that if not all of that discussion should be occurring already.

Mr. MARCHANT. Heretofore, all of this information has been passed to the states and HHS basically on an individual basis, an individual tax return basis.

Mr. MILLER. Rather than as a household. I do not know the answer to that one, Congressman. I apologize.

Mr. MARCHANT. Will the states get more information about households and IRS returns and will there be more people at the state level able to view more information about a person's IRS income and IRS status than ever before?

Mr. MILLER. To the extent that the exchanges are using this for eligibility purposes, then those are new purposes, and probably new people that are taking a look at that data.

Mr. MARCHANT. Thank you.

Chairman BOUSTANY. Mr. Reed.

Mr. REED. Thank you, Mr. Chairman. Thank you, Mr. Miller, for being here today.

I just want to follow up quickly before I get to another point on Mr. Kind's comment. When he asked you about the 16,000 new employees for the IRS, you quickly and confidently said there was no basis for that number.

It is clear to me that you have taken a look at that situation in depth to be able to make such a quick response and confident response.

What I am going to ask you, Mr. Miller, is in 2012, I believe there were 1,278 additional employees to implement the Affordable Care Act that were requested and put forth in the IRS. In 2013, 859 new employees.

Do you agree with those numbers of employees that were increased in the staffing for IRS to implement the Affordable Care Act?

Mr. MILLER. No. It is a mis-reading. The total number of people working on ACA in 2012, and I will be wrong on the specific number, but something like 670.

Mr. REED. 670 for 2012. For 2013, how many new employees will be doing that work, or is it just 670 is all you are going to need?

Mr. MILLER. It is the 670 plus the increment to get to the 859 you were talking about. 859 is the total number of folks.

Mr. REED. 670 in 2012 and the difference between 859 and 670 would be the increase for 2013.

Mr. MILLER. Right.

Mr. REED. From 2012 to 2013, the testimony is 859 new employees?

Mr. MILLER. No, sir.

Mr. REED. I am confused. Please correct me.

Mr. MILLER. Again, the total number of employees will be 859 employees in 2013. They are not additive. We already have 670, whatever the math is. I cannot do the math off the top of my head.

Mr. REED. The total for the 2 years, 2012 and 2013, is 859? Is that what you are saying?

Mr. MILLER. No, I do not think I am saying that. I am saying in 2012, we had 670 people work on it. In 2013, our intention is to have 859 work on it. They are separate numbers.

Mr. REED. Let's go forward, 2014, the bulk of the law goes into further implementation, how many additional employees do you feel are going to be either hired or allocated to implement the Affordable Care Act thereafter?

Mr. MILLER. That number we are working on as we speak. We have a draft 2014 budget that is floating up into a discussion with Department of Treasury, OMB, and that will be part of the administration's budget.

Mr. REED. Okay. You are working on an estimate, you are working on a proposal. What does that estimate show you right now at this point in time?

Mr. MILLER. I do not have that number for you because again, it is an estimate and it has not been approved.

Mr. REED. You are working on it, I would hope.

Mr. MILLER. Yes, we are working on the 2014 budget, which is due in January.

Mr. REED. The employment needs for the IRS in 2015 and beyond, I hope you are doing some projections as to what you are going to need in order to implement the law.

Mr. MILLER. That becomes more difficult because again we operate on an annual basis. We are working on 2014 and we will see what we have in 2014, and that will inform along with where we are on various other business processes, what we desire in 2015. We do not have details.

Mr. REED. That concerns me, Mr. Miller. You are the agency that has been responsible or charged with responsibility for implementing this law. What you are telling me is you really do not have a clear indication as to what employment burdens are going to be put on the IRS as a result of this law. That is very concerning to me.

Would you agree that is concerning to a Member of an oversight Committee on your agency, that the agency should have some type of projection as to what those employment burdens are going to be and the costs associated?

Mr. MILLER. Mr. Reed, I understand your point, and if you were to give me a budget for multiple years, I might have a better sense of what I could do or not.

The budgetary process is an annual process. It is difficult for me given the scenario of budgets to have a precise number for you at this point for 2015. We are working on 2014, sir.

Mr. REED. How about anything past 2015? Nothing?

Mr. MILLER. We will be in steady state in 2016, sir.

Mr. REED. I have a few more minutes, I hope. I want to talk about the premium tax credits real quick. My understanding is the advance payment for that goes to the insurer.

Mr. MILLER. The insurance company.

Mr. REED. The insurance company, not the insured, but the insurer, which is the insurance company.

Mr. MILLER. Correct.

Mr. REED. If there is an over credit, and I know I am short on time, do you go back to the insurance carrier to get that over payment or do you go to the individual taxpayer?

Mr. MILLER. I would be glad to answer it. I am not sure I understand the question, sir. I apologize.

Mr. REED. Okay. I am out of time. I do want to follow up on that. I am concerned that the money goes to the carrier and yet the taxpayer ultimately, if it is an over payment situation, the money never gets from the carrier back to the individual. It comes from the IRS which then comes from the taxpayers.

Mr. MILLER. There will be a reconciliation process on both ends.

Mr. REED. I will submit written questions on that. I appreciate your input, Mr. Miller. I really do. Thank you. I yield back.

Chairman BOUSTANY. Thank you, Mr. Reed. If you could respond to that final piece in writing.

Mr. MILLER. We will do that.

Chairman BOUSTANY. Thanks, Mr. Miller.

Mr. Paulsen.

Mr. PAULSEN. Thank you, Mr. Chairman, for conducting the hearing. Mr. Miller, last week we heard from the IRS about plans to publish revisions to Form 637 very soon. 637, that is the application for registration dealing with excise taxes in particular.

In reviewing this form, I am looking at the form, I know there are a lot of items that are listed that are subject to the excise tax. Items like gas guzzler automobiles, sports fishing equipment, fishing tackle boxes, bows, quivers, broadheads, points, arrow shafts, also alcohol, tobacco and gasoline are subject to an excise tax.

The public policy rationale in the past for excise tax has historically been to deter certain activities. As you know, the medical device tax, which is a part of the new health care law, is an excise tax. In my mind, the last thing we want to do is deter creation or innovation of these life saving, life improving drugs.

Do you believe as a matter of public policy it is appropriate to apply an excise tax to medical devices in a similar category as these other items?

Mr. MILLER. Congressman, I only administer it. I cannot really speak to whether it is appropriate policy in terms of use or not.

Mr. PAULSEN. Do you think the line item we might see on a Form 637 is going to also include gas guzzling automobiles and life saving medical devices? Will there be a line item that will identify it for medical device companies in that manner?

Mr. MILLER. I do not know specifically. We are working hard. We have proposed regulations out on the medical device tax. We are working with the industry to make sure we try not to burden them and get them to know the rules and comply going forward.

I am not sure on the form itself. I am not familiar with it.

Mr. PAULSEN. According to the new law, the companies will have to begin paying this tax on January 1, which is just a few months from now. Am I correct in my understanding that no final rule has been released by the IRS yet on this?

Mr. MILLER. Right. That is close, sir.

Mr. PAULSEN. Without clarity of the rules, you said you were working with the industry, but I know they are expressing concern about having to comply with the new law, certainly. You say you are working with them?

Mr. MILLER. We are.

Mr. PAULSEN. There are about 7,000 of these companies across the country. They do a lot of medical devices. It could be diagnostic equipment. Many of these companies are not profitable. They are still going to be required to pay the tax. This fact does not take into account the administrative burdens of the tax that will come through the new IRS form, for instance.

Has the IRS done a Paperwork Reduction Act analysis to measure the administrative burdens of the device tax on companies?

Mr. MILLER. I do not know the answer to that. I can get back to you on that, sir.

Mr. PAULSEN. That would be good to know. I am just curious.

Mr. MILLER. If I could say one thing. The burden that has been placed on—it is a statutory provision. We did not create this out of whole cloth, sir.

Mr. PAULSEN. I know there is going to be additional paperwork, costs for companies to comply with the tax. It is also my understanding that the excise tax payments are traditionally collected semi-monthly or every 2 weeks.

Do you think that model would fit for many of these companies which have the experience essentially of making estimated income tax deposits on a quarterly basis, but they do not have any experience in the Federal excise tax component, and I do not think they have systems in place for calculations.

Is there consideration being taken into account for that?

Mr. MILLER. I do not know the answer to that question either, sir. Again, we are working with them. The proposed regulations are out. The number of issues, Congressman, are not a myriad. There are a few issues that remain unclear and we are working with them on. A lot of this has been put out and discussed.

Mr. PAULSEN. Okay. Mr. Chairman, I just raise some of these issues because I think we are clearly going in a precarious situation or dangerous situation for a lot of these companies that provide a lot of jobs, it is domestic manufacturing, and we have analyzed a little bit of what the effects of the tax would be.

We have tried to stop it. We have repealed it in the House in a very strong bipartisan vote.

Now that we are moving forward on January 1 and these companies are laying off employees already, I want to make sure we are also taking into account the paperwork connections and the IRS following up on the Paperwork Reduction Act analysis and process as well.

I yield back.

Chairman BOUSTANY. I thank the gentleman. I think the gentleman is correct in that we have a lot of uncertainty in the policy

of the law but also concerns about the implementation, too, and the timing.

This is creating uncertainty for business, and it is certainly not helping our economy.

Ms. Black, you are recognized for 5 minutes.

Mrs. BLACK. Thank you, Mr. Chairman. Mr. Miller, I want to go to the privacy issue. As we know, there are few things more sacrosanct to people than having their tax information known broadly and widely to other folks.

An entire section of the Tax Code, Section 6103, as you well know, is devoted to limited instances in which this information can be shared, but in the wrong hands, taxpayer information can be used to steal tens of thousands of dollars from the Treasury. We have already seen instances of that. We have had hearings here related to that matter.

It contains information of a personal nature, about personal finances, and family information.

Underneath of the President's health care law, the IRS will be sharing this information, this taxpayer information, more broadly with many more parties than you ever have before.

While the IRS already shares some of this data with places like child support, we have heard about that in testimony, Medicaid and some other revenue collection situations, this new sharing is going to be much broader, especially since the exchange employees will be taking place.

How do you plan to make sure this information is fully protected?

Mr. MILLER. Congresswoman, this is what we do. We do this quite a bit already. We have hundreds of agreements with various governmental agencies.

The process is quite restrictive actually, and I think if you would talk to other agencies, they would tell you how restrictive we are in terms of making sure that the information that is sent needs to go—once it arrives, it is stored properly, it is subject to appropriate controls in terms of who has access to it, and is subject to either destruction or return to the IRS when it is no longer needed.

These are rules, and I can outline these in writing, these are safeguard rules, that we have an entire part of the IRS working with folks on.

We will come to an agreement with a particular government entity or the exchange as to what is the expectation of what will happen with that data. We will then go on-site and inspect to ensure that document is correct.

We have quite detailed rules in the area because we take it incredibly seriously.

Mrs. BLACK. You already have memorandum's of understanding with agencies and exchanges?

Mr. MILLER. Not exchanges at this point, I do not believe.

Mrs. BLACK. Not exchanges. You say you already have rules in place?

Mr. MILLER. We have rules in place generally, Congresswoman, for this sort of situation.

Mrs. BLACK. Okay. Can you provide us with what you are doing with those agencies as that comes along? I think that will be im-

portant for this Committee, considering the fact, as I say, we have already had hearings about how taxpayer information is used by people to fraudulently get their return, get money back that does not belong to them.

I think it would be important for this Committee, this oversight Committee, to know that we are protecting even more information with even more people that are going to have access to this.

My next question is what will be the repercussions against exchange employees or contractors that mis-use taxpayer information? Do you already have something in place?

Mr. MILLER. I will come back to you on that, but I believe they are subject to the same restrictions as I am in terms of being subject to criminal prosecution and other penalties for disclosing that information.

Mrs. BLACK. I would appreciate you keeping this Committee in touch with what you are doing so we can be sure that absolutely is happening considering all the things that are happening with people's information right now.

Thank you. I yield back the balance of my time.

Chairman BOUSTANY. Thank you. Mr. Miller, I think that concludes our questioning. We appreciate you being here today and providing this information.

Of course, there is more work to be done as we look at the implementation of this. We look forward to hearing from you in the future. We appreciate your testimony and your forthright answers.

Mr. MILLER. Thank you.

Chairman BOUSTANY. We are going to ask the next panel to come forward, and we will start taking testimony. We will recess, as I mentioned earlier, to attend the commemoration, and then we will resume at 11:30.

We will ask the next panel to come up and we will try to get through some of the testimony.

I want to thank our next panel of witnesses for being with us today. We have four experts on this subject.

First, we will hear from the Honorable Fred Goldberg, a partner of SkaddenArps, a law firm here in Washington, DC. Mr. Goldberg is a former IRS Commissioner, former Assistant Secretary of Treasury for Tax Policy.

Next, we will welcome Kathy Pickering. Ms. Pickering is Executive Director of The Tax Institute and Vice President of governmental Relations at H&R Block.

Third on the panel is Scott Hodge. Mr. Hodge is President of The Tax Foundation here in Washington.

Finally, we will hear from Mr. Seth Perretta, a partner of the law firm Crowell and Moring.

We want to thank you all for being with us today. The Committee has received your written testimony and it will be made part of the formal hearing record. Each of you will be recognized for 5 minutes for your oral remarks.

Mr. Goldberg, we will start with you for 5 minutes. We will try to get through two statements. We will recess and come back promptly at 11:30.

Mr. Goldberg, you may proceed.

STATEMENT OF FRED GOLDBERG, JR., PARTNER; SKADDEN, ARPS, SLATE, MEAGHER & FLOM

Mr. GOLDBERG. Mr. Chairman, Ranking Member Lewis, Members of the Committee, it is an honor to appear before you today to discuss the impact of certain revenue provisions of the Affordable Care Act on taxpayers and the IRS.

I am appearing today solely in my individual capacity.

Many years ago, I had the pleasure of appearing before this Committee during my time as IRS Chief Counsel, as IRS Commissioner, and as Assistant Secretary for Tax Policy.

Your Committee has a long bipartisan history of concern for effective tax administration and your efforts have served the American people well.

Before starting, I would like to make a preliminary observation. The administrative, behavioral and tax compliance issues you are considering are inherent in any policy that provides phased out tax credits to subsidize the purchase of health insurance, including, for example, the Ryan-Wyden proposal. They are not unique to the Affordable Care Act.

Much of my written statement explains in some detail why my experience as IRS Commissioner convinces me that the revenue provisions of the Act in their current form will become a burdensome, costly, and frustrating quagmire for millions of Americans, and will cause significant non-compliance with our tax laws.

My oral statement does not address portions of my written statement dealing with adverse impact of the Act's financial incentives on employers and individuals, but I will be happy to answer any questions.

What I want to emphasize today is my experience as IRS Commissioner also convinces me that these failings are unnecessary and are easily minimized.

Chief Justice Roberts and four of his colleagues have decided that the revenue provisions of the Act are all about the government's taxing power.

I believe they got it right and the best way to avoid administrative, behavioral and tax compliance melt down is to embrace this reality.

First, now that we know the revenue provisions are all about the government's taxing authority, there is no longer any reason whatsoever why each of 51 different exchanges should have responsibility for determining the proper amount of health insurance tax credits on behalf of millions of individuals and families.

The exchanges will be starting from scratch with information that is 2 years out of date because personal and financial circumstances change. Change is the one constant in our real lives. The exchange's credit calculations will be too high or too low most of the time. Now, in hopes of getting it less wrong, each exchange will need to obtain sensitive personal and financial information from millions of individuals and families and it will need to do so throughout the year because life's changes do not follow the bookkeeper's calendar. These efforts will require direct interaction with millions of individuals and families in ways that meet their reasonable expectations and allow them to make timely decisions.

Decades of IRS experience make clear that as citizens, we want our questions answered and our issues resolved promptly, properly, and in ways we understand. We are sharing intimate details of our personal and financial lives and expect that our information will remain confidential, and because the stakes are so significant, our health and hard-earned money, we have high expectations and little tolerance for mess ups.

These responsibilities are not going to be core competency of the exchanges. There is no reason they should be and there is no chance the exchanges will get it anywhere near right. They are facing more than enough challenges without functioning as some weird hybrid of tax advisor and tax enforcer. Let folks figure out their expected credits with support from a long-established network of public and private intermediaries and let them make appropriate representations to their exchanges. They have been doing this kind of thing for decades in their dealings with the IRS. Taking the exchanges out of the picture will make things far less intrusive, burdensome, and costly and will save the exchanges a fortune.

Second, from the standpoint of tax compliance, the current sanctions for overstating the amount of health insurance tax credit, coupled with limits on IRS enforcement activities, effectively guarantee that there will be widespread noncompliance. To avoid these compliance issues, treat these taxes like all other taxes.

Thank you very much.

[The prepared statement of Mr. Goldberg follows:]

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 shear 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.

Chairman BOUSTANY. Thank you, Mr. Goldberg.
Ms. Pickering, you're recognized for 5 minutes.

STATEMENT OF KATHY PICKERING, EXECUTIVE DIRECTOR, THE TAX INSTITUTE AT H&R BLOCK; VICE PRESIDENT, GOVERNMENT RELATIONS

Ms. PICKERING. Good morning, Chairman Boustany, Ranking Member Lewis, and distinguished Members of the Oversight Subcommittee. Thank you for the opportunity to share H&R Block's views on the IRS' implementation of the Patient Protection and Affordable Care Act.

H&R Block is the country's leading provider of tax preparation services. In each of your districts, we have on average 37 offices, 12 franchisees, and 323 preparers. We are one of the largest employers of military spouses in the nation and we work alongside the IRS to help taxpayers annually file about 25 million returns.

Clearly, the implantation of ACA is a significant undertaking and we commend the IRS for the progress it has made; however, it will face numerous challenges and conflicting demands for resources.

First, the IRS and HHS have two very different missions and focuses with respect to the ACA. HHS will focus on ensuring that everyone has healthcare coverage. The focus of the IRS will be on enforcing tax law, reconciling advanced payments of the premium tax credit, and collecting revenues from the various tax provisions of the ACA.

For example, HHS has stated that an individual can enroll in an exchange, but using documentation from other sources to substantiate income levels; however, the IRS will require individuals to file a tax return to reconcile advanced payments of the premium tax credit. As a result, individuals may receive an unpleasant surprise when they find out that they have a tax liability because they improperly estimated their income. We recommend the IRS and HHS develop consistent processes for income verification and eligibility. Requiring individuals to provide tax return information is the most reliable, consistent way to provide this verification.

The second area I wish to highlight is the need for finalizing regulations and educating the greater tax community. There are many key provisions that still need to be finalized in order to implement by January 1, 2014. As a franchisor, H&R Block is concerned about the impact and timing of new regulations on small businessowners. For example, small businessowners will need at least 4 months to plan and to determine if they will participate in a small business health options program where enrollment begins in October 2013. We recommend that, given the time required to publish regulations, the IRS should ensure all ACA regulations are proposed by April 30, 2013.

To be successful, the IRS and HHS must also provide individuals with timely education and guidance. This may be one of the most challenging tasks the IRS will face in 2013. We recommend the IRS leverage the tax preparation community through the Return Preparer Initiative to amplify taxpayer outreach and education efforts. To do so, the IRS and its testing vendor need to ensure they have sufficient testing capacity across the country to meet the December 2013 deadline; however, the IRS has ongoing operational challenges which will be magnified by the difficulties of implementing of ACA. Therefore, a third and final area of importance is ensuring readiness for the 2013 tax season.

In the 2012 tax season, millions in refunds were delayed in the early season due to fraud system programming errors and transmission problems with the Modernized e-File System, coupled with a decrease in IRS toll-free phone services in 2012. Taxpayers dealt with increased hold times and a decreased level of service. The IRS must complete the full transition to the Modernized e-File System, continue to improve fraud controls, respond to late tax legislation,

and successfully implement the Return Preparer Initiative, all while handling the effects of a late start to the e-filing system currently set for January 22nd. This means that many early season, low-income filers will not receive their much needed refunds until well into February.

We recommend that the IRS begin accepting and processing e-filed returns no later than January 15, 2013. Additionally, the IRS should maintain legacy as a contingency and provide the framework they intend to use to determine if it will be deployed. More importantly, the IRS should promptly notify the tax preparation community and taxpayers of problems with processing returns.

In conclusion, the IRS and HHS together have a daunting task ahead and the IRS should use the upcoming tax season to improve several key areas of tax administration in order to be better positioned to fully implement ACA. H&R Block looks forward to continue to working with the IRS in these and many other areas.

Chairman Boustany, thank you once again for organizing today's hearing and for the opportunity to testify.

[The prepared statement of Ms. Pickering follows:]

H&R BLOCK®

WRITTEN TESTIMONY OF KATHY PICKERING
VICE PRESIDENT OF GOVERNMENT RELATIONS AND
EXECUTIVE DIRECTOR OF THE TAX INSTITUTE
H&R BLOCK
BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT
HEARING ON THE INTERNAL REVENUE SERVICE'S IMPLEMENTATION AND ADMINISTRATION OF THE AFFORDABLE CARE ACT
SEPTEMBER 11, 2012

Chairman Boustany, Ranking Member Lewis, and distinguished Members of the Oversight Subcommittee, thank you for the opportunity to share H&R Block's views on the Internal Revenue Service's ("IRS") implementation and administration of the Patient Protection and Affordable Care of 2010 ("ACA").

H&R Block is the leading provider of tax preparation services. Approximately 25 million returns are prepared each year by our more than 90,000 tax return preparers ("preparers") in 10,000 offices, online, or via our software solutions. Through our tax offices we are one of the larger employers of military spouses, and in each of your congressional districts we have, on average, 37 offices, 12 franchisees, and 323 preparers.

The ACA created new processes and interactions between the tax industry, the insurance industry, and government agencies that have not existed in the past. In addition to navigating these new processes and interactions, the ACA requires the IRS to promulgate regulations, create new forms, and provide extensive education to taxpayers and tax preparers, all while still performing its core functions of interpreting and enforcing tax law and collecting revenue.

The implementation and administration of the ACA is a significant undertaking and we commend the IRS for the progress it has made thus far. The IRS clearly will face numerous challenges and conflicting demands for resources. With regard to those challenges and demands for necessary resources, we would like to address the following concerns:

1. Disparate focuses of the IRS and the Department of Health and Human Services ("HHS")
2. Finalizing ACA regulations and education of the greater tax community
3. Resources and readiness for the 2013 tax season

1. Disparate focuses of the IRS and HHS

According to its mission statement, HHS is the United States government's principal agency for protecting the health of all Americans and providing essential human services, especially for those who are least able to help themselves. In contrast, the mission of the IRS is to provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Although the IRS and HHS have historically worked together, by way of the Social Security Administration, the ACA creates a new, more complex interaction between these two diverse agencies. The agencies have two very different focuses with respect to the ACA, albeit having a common end goal.

In general, HHS' focus for the implementation of ACA will likely include ensuring as many individuals and their families as possible, are enrolled in coverage through Affordable Insurance Exchanges ("Exchanges"), Medicaid, a Basic Health Program, or the Children's Health Insurance Program. The IRS' focus will include reconciling advance payments of the premium tax credit ("PTC") and collecting revenue from the various tax provisions of the ACA. These different focuses may lead to taxpayer confusion and unexpected tax debts as a result of overpayments of subsidies.

For example, the determination of eligibility for advance payments of the PTC by an Exchange will presumably be more flexible than the IRS' reconciliation process at the end of the year.

On one hand, Section 1411(c)(4)(B) of the ACA gives the Secretary of HHS authority to change the manner in which Exchanges determine eligibility for advance payments of the PTC. HHS has promulgated regulations stating an individual does not have to file a tax return to enroll in an Exchange but instead can use documentation from other sources to substantiate income levels. An individual without tax return data may make an attestation of projected income, and have advance payments of the PTC paid on their behalf for 90 days or longer while the Exchange is verifying their income. An Exchange may also accept an applicant's attestation on a case-by-case basis if the applicant's information cannot be verified.[1]

On the other hand, the IRS' standard tax collection requirements are much more stringent than HHS' requirements for enrollment and advance payments of the PTC. The IRS will require individuals to file a tax return to reconcile advance payments of the PTC and generally individuals must be able to substantiate income with tangible, verifiable evidence if the IRS so requests. If Exchanges are able to enroll individuals and use less strict income verification procedures than the IRS, individuals may receive an unpleasant surprise when they find out they are required to repay their subsidy tax credit because they estimated their income improperly, an error which may occur simply because they have not been required to file a tax return in prior years, if ever.

Our recommendation: The IRS and HHS should develop consistent processes for income verification and eligibility. Requiring individuals to provide tax return information is the most reliable, consistent way to provide this verification. In fact, the IRS should encourage all taxpayers to file tax returns in 2013 that can be used to enroll in Exchanges in the fall of 2013. Further, the IRS and HHS should more closely align to create a communications strategy to ensure uniform messaging of this requirement. The IRS has already started dialogue to more closely align these two agencies. H&R Block is certainly appreciative of this important first step, but recommends continuing with more formal discussions to achieve alignment.

[1] Public Welfare, 45 C.F.R. §155.315 (2012)

2. Finalizing Regulations and Educating the Greater Tax Community

Finalizing Regulations: While the IRS has already provided numerous regulations, revenue procedures and rulings, and other forms of guidance, they have not yet proposed or finalized all regulations necessary to implement the ACA. With a deadline of January 1, 2014 for the implementation of most key provisions of the ACA, it may appear that the IRS has more than a year to promulgate regulations; in actuality, the IRS must complete this process much sooner in order to provide adequate time for individuals and businesses to plan for the effects of the ACA.

While H&R Block does have concerns about the impact of the ACA on individuals, one of which we address later, what is more apparent to us is the impact and timing of new regulations on small business owners. As a franchisor, we are in contact with owners of small businesses daily. Our franchisees have communicated their concern over waiting for the IRS to propose and finalize regulations. The timing of the release of regulations could impact their ability to engage in strategic planning and effectively execute business plans.

For example, businesses generally perform strategic planning to determine their employee benefit offerings and negotiate with coverage carriers at least three to four months before the end of the calendar year. In addition, open enrollment in Exchanges, including enrollment for those participating in a Small Business Health Options Program ("SHOP"), begins October 1, 2013. This means small businesses will need, at a minimum, four months to plan for 2014 and to determine if they intend to participate in a SHOP.

Our recommendation: Given the time required to complete the process of publicizing regulations, the IRS should ensure all regulations and other authoritative guidance related to the ACA are proposed by April 30, 2013.

Educating the Greater Tax Community: As mentioned previously, individuals will need adequate time to prepare for the impacts of the ACA. The majority of taxpayers do not yet understand the ACA and how it will affect them. For the implementation of the ACA to be successful, the IRS and HHS must provide individuals with timely education and guidance. This may be one of the most challenging tasks the IRS will face in 2013.

The ACA is complex and there is no one universal communication method that will be effective for all audiences. The agencies will need to educate individuals through multiple channels including television, the Internet, and social media. H&R Block suggests the IRS also consider private-public partnerships to disseminate information to taxpayers. While the IRS has not communicated any intent to leverage the tax preparation community for this purpose, we believe it is logical for the IRS to use the more than 700,000 PTIN holders to help with outreach and education efforts.

Our recommendation: The IRS should leverage the tax preparation community, through the return preparer initiative, to amplify taxpayer outreach and education efforts.

3. Resources and Readiness for the 2013 Tax Season

As demonstrated above, the implementation and administration of the ACA will require considerable resources. These new duties may dilute the IRS' ability to maintain focus on key initiatives and improvements to the delivery of the core functions of the IRS. If the IRS is unable to continue to focus on its core functions, taxpayers will be adversely affected.

To ensure taxpayers are not adversely affected and instead are provided top quality service in 2013, the IRS must address and correct problems identified in the 2012 filing season, complete the transition to full implementation of the Modernized e-File system ("MeF"), continue to improve fraud controls, be prepared to respond to potential late tax legislation, and develop strategies to successfully implement the Return Preparer Initiative ("RPI"), all while preparing for and handling the effects of a delay to the traditional acceptance date of e-filed returns.

Tax Season Delays: The IRS has told the tax preparation industry it will begin accepting e-filed returns for tax season 2013 on January 22. This is five days later than the January 17th acceptance date in tax seasons 2011 and 2012, and seven days later than the January 15th acceptance date in tax season 2010.

Given the standard refund delivery time of 10-21 days, a later than traditional start date for e-file processing means many early season filers will not receive their refunds until well into February. This delay will most likely negatively impact low income taxpayers, who often file in January to receive their refunds as soon as possible. With an average refund of more than $3,500 for January filers (according to the IRS' Cumulative Individual Income Tax Return Report for January 27, 2012), this will be the largest lump sum of money most of those taxpayers will receive all year.

Our clients rely on this money every year to catch up on rent and utilities, pay for holiday expenses, and make much needed repairs to their homes and vehicles. The absence of this much needed funding will disrupt the lives of many taxpayers, adding late fees and interest to their existing debts, and causing many to resort to alternative loans. If the IRS does not provide taxpayers with advance notice of this delay, taxpayers will be completely unprepared to mitigate the effects.

A delay in the processing of returns and refunds will also increase the frequency, volume and urgency of phone calls to toll-free IRS customer service centers. A surge of this nature occurred in the 2012 filing season when fraud detection programming errors and transmission problems with the MeF system delayed the receipt of refunds for approximately 12.5 million early filers. Coupled with a decrease in funding for toll-free telephone services in 2012, taxpayers were met with increased hold times and a decreased level of service. The tax preparation community and the IRS drew heavy criticism as a result.

If the IRS does not move up the acceptance date for e-filed returns, and taxpayers are not given adequate advance notice of the impact of the delay, the IRS and tax preparation industry will again face criticism from taxpayers. Ultimately, the delay will hurt the taxpayers who need help the most.

Our recommendation: The IRS should begin accepting and processing e-filed returns no later than January 15, 2013.

Modernized E-file, Late Legislation, and Fraud: January 2013 also marks a change for the IRS as they will be undertaking the important transition to full-implementation of MeF. As mentioned previously, in tax season 2012 a number of returns were delayed due to programming errors and transmission problems with the MeF system. The IRS was able to remedy the delays by temporarily switching back to the legacy e-filing system ("Legacy").

Based on the lessons learned from the 2012 tax season, prudence dictates the IRS maintain Legacy as a contingency for one more filing season. While maintaining Legacy is necessary to maintain operational continuity, the requirement to program two separate systems is burdensome for the IRS, H&R Block, and all other e-file software developers. The IRS has provided no framework for determining what circumstances would cause it to deploy Legacy. As such, it is unclear what purpose the additional work serves if there's no definition of what severe conditions will be mitigated or avoided.

The challenge of maintaining and programming two systems is further compounded by the potential for late tax legislation and the need to create effective new processes and programs to detect and prevent fraud. With two separate systems on point, responding to late tax legislation and remaining nimble in an ever-changing fraud environment will presumably be twice as difficult.

Our recommendation: The IRS should maintain Legacy as a contingency while making the transition to full-implementation of MeF. The IRS should provide the framework they intend to use to determine if and when Legacy will be deployed, and how deployment will be communicated to the tax preparation community. The IRS should also promptly notify impacted taxpayers of problems with return processing systems.

Return Preparer Initiative: H&R Block is supportive of the RPI and believes it will help raise the professional and ethical standards of the tax preparation profession. We acknowledge it will take considerable time and effort to make sure all PTIN holders meet the requirements of the RPI by the December 31, 2013 deadline. In light of this, we strongly encourage the IRS to take additional steps to ensure they are able to hold fast to this deadline.

In order to adhere to the deadline, the IRS and its vendor, Prometric, must work with the tax preparation community to ensure the more than 300,000 preparers required to take the competency examination are able to do so by the deadline. The IRS should develop a strategy to ensure Prometric is able to service each preparer. As many preparers live in rural, remote areas without a nearby testing center, it is critical this strategy include making mobile testing sites available. This strategy should not include extending the testing deadline. An extension of the deadline would delay the intended benefits of the RPI and be a disservice to taxpayers.

Our Recommendation: The IRS and its testing vendor should develop strategies to ensure they have provided adequate access to testing facilities and sufficient testing capacity to meet the needs of the tax preparation community.

Once again, H&R Block recognizes the challenges of implementing and administering the ACA, and commends the IRS for the progress it has made thus far. We are concerned the added strain the ACA places on the IRS may lead to a deterioration of the IRS' focus on its core functions and its mission to provide taxpayers top quality service. We recommend the IRS create public-private working groups to address this concern. We encourage the Committee to ensure the IRS has the resources needed to maintain its core functions and mission while implementing and administering the ACA, and to ensure the IRS is using those resources efficiently. We thank the Chairman and the Committee for organizing this hearing.

Chairman BOUSTANY. Thank you, Ms. Pickering.

We are now—the Committee is now going to recess for the commemoration of 9/11. I appreciate the panel's patience with us. We will promptly reconvene at around—right about 11:30 at the conclusion of that commemoration and we will proceed from there.

So we thank you. Committee stands in recess.

[Recess.]

Chairman BOUSTANY. We would like to reconvene the hearing. I would ask the panelists to please take their seats.

The Subcommittee thanks you all for your patience with this delay we have had and—but, anyway, we will continue onward.

And Mr. Hodge, you are recognized for 5 minutes for your oral statement.

STATEMENT OF SCOTT A. HODGE, PRESIDENT; THE TAX FOUNDATION

Mr. HODGE. Thank you, Mr. Chairman and Mr. Lewis and Members of the Committee. I really do appreciate the opportunity to talk about this important topic.

I am sure you all agree that the ideal tax system should do only one thing and that is raise a sufficient amount of revenues to fund the government activities with the least amount of harm to the economy, but by all accounts, the U.S. Tax Code is far from that ideal. Our current tax system is a byzantine monstrosity that spans 70,000 pages, costs taxpayers more than $160 billion a year to comply with, and now dictates virtually every aspect of our lives, and even before the ACA grafted more than 40 new provisions to the Tax Code, the relentless growth of credits and deductions over the past 20 years has made the IRS a super agency, engaged in policies as unrelated as delivering welfare benefits to subsidizing energy-efficient refrigerators.

Although the IRS's annual budget may be relatively small, it is essentially controlling vastly more budgetary resources than any cabinet level agency. The more than 170 different tax expenditure programs in the Tax Code have a total budgetary cost of over $1 trillion and these myriad tax provisions were enacted to achieve all manner of social and economic objectives, but the most troubling development in recent years is that the expanded use of these tax credits to deliver social policy has knocked millions of people off the tax rolls and turned the IRS into an extension of the welfare state, a role that it has not managed very well, and today there are a record number of Americans, 56 million in all, 41 percent of all filers now pay no individual income taxes because of the generous credits and deductions, and worse yet, the IRS now gives out more than $100 billion in refundable credits to people who have no income tax liability.

In 2010, the budgetary costs of both refundable and nonrefundable tax credits exceeded $224 billion, and to put this in perspective, if tax credits were combined into a single program, they would be the fourth largest domestic program behind Social Security, Medicare, and Medicaid, and the ACA's generous tax credits and cost sharing programs will no doubt increase the number of nonpayers and increase the IRS's role as a deliverer of social benefits and the IRS has a dismal record of managing these tax credit programs. So we should expect the ACA to lead to billions of dollars in fraud, abuse, and erroneous payments.

The Treasury's own IG for tax administration has testified here that refundable credits are a magnet for unscrupulous individuals who file erroneous claims for these credits and the IRS' failure to rein in the sizable amount of fraud and improper payments in pro-

grams such as the EITC and the Hope Credit should give us great concern about the ability of the IRS to skillfully manage the ACA, and the IRS stumbled out of the gate in implementing some of the earliest and perhaps the simplest provisions of the ACA, such as the Small Business Healthcare Credit and the indoor tanning tax.

Many businessowners said that the benefits of the Small Business Health Insurance Credit was not worth the effort and you can't blame them considering that calculating the credit takes multiple steps and seven different worksheets, and the IRS also had difficulty simply identifying the number of businesses who are supposed to pay the tanning excise tax.

In many areas, the ACA makes the IRS an extension of the Department of Health and Human Services. The Premium Assistance Credit is a case in point where HHS has the authority to make the rules while the IRS and Treasury are responsible for doing the paperwork, policing the system, cutting the checks, and fixing any problems that may arise.

Now, imagine if the Supplemental Nutrition Assistance Program were run in the same fashion where eligibility for SNAP benefits was determined by USDA, but the IRS was responsible for verifying the incomes of recipients and either giving a food tax credit directly to taxpayers or sending checks to grocery stores on their behalf. Does anyone think that that would make for an efficient and user-friendly system?

The added compliance costs of the ACA will fall disproportionately on small businesses and the poor. Already about 73 percent of those people claiming their income tax credit pay a professional preparer to complete their tax return and no doubt that number will arise because of the ACA. The irony is that many taxpayers, low-income taxpayers, will have to ask themselves how much they can afford to pay a professional tax preparer in order to claim a tax credit that is intended to pay for health insurance that they currently cannot afford.

In conclusion, Mr. Chairman, it is hard to believe that anything can make the Tax Code look simple and understandable, but the Affordable Care Act does just that. The solution is not to give the IRS more money, resources or staff. The solution is to reform the Tax Code and eliminate the most burdensome and distortionary tax preferences and return the IRS to its core mission of simply collecting the necessary revenues to fund government programs.

Thank you very much for this opportunity. I welcome any questions that you may have.

[The prepared statement of Mr. Hodge follows:]

Written Testimony
Of
Scott A. Hodge
President
Tax Foundation

Before the House Ways and Means Committee
Subcommittee on Oversight
On the IRS's Implementation of the Affordable Care Act
September 11, 2012

Introduction

Mr. Chairman and members of the Committee, thank you for the opportunity to speak to you today on the challenges facing the IRS's implementation of the Affordable Care Act (ACA).

Founded in 1937, the Tax Foundation is the nation's oldest organization dedicated to promoting economically sound tax policy at the federal, state, and local levels of government. We are a non-partisan 501(c)(3) organization.

For 75 years, the Tax Foundation's research has been guided by the immutable principles of economically sound tax policy that were first outlined by Adam Smith – taxes should be neutral to economic decision making, they should be simple, transparent, stable, and they should promote economic growth.

In other words, the ideal tax system should do only one thing – raise a sufficient amount of revenues to fund government activities with the least amount of harm to the economy. By all accounts, the U.S. tax code is far from that ideal. Our current tax system is a Byzantine monstrosity that spans 70,000 pages, costs taxpayers more than $160 billion per year to comply with, and now dictates virtually every aspect of our lives.

Even before the ACA grafted more than 40 new tax provisions to the tax code and effectively paired the IRS with HHS to manage one-sixth of the nation's economy, the relentless growth of credits and deductions over the past 20 years has made the IRS a super-agency, engaged in policies as unrelated as delivering welfare benefits to subsidizing the manufacture of energy efficient refrigerators.

Although the IRS's annual budget may be relatively small, it is essentially controlling vastly more budgetary resources than any Cabinet-level agency. The more than 170 different tax expenditure programs in the tax code have a total budgetary cost exceeding $1 trillion. Some $900 billion of those tax expenditures are targeted to individuals, while another $100 billion are intended to benefit businesses.

These myriad tax provisions were enacted to achieve all manner of social and economic objectives, such as encouraging people to buy hybrid vehicles, turn corn into gasoline, buy a

home, replace the home's windows, adopt children, put them in daycare, then help them go to college, while saving for your own retirement, and the list goes on.

Managing vast social programs is not a function the IRS is designed to perform, nor is it a function that the IRS performs very well. But the ACA will not only expand the IRS's role in the welfare state, it will force more and more Americans it look to the IRS for their income and benefits.

If the tax code wasn't complicated enough, the ACA will make it unmanageable while increasing the compliance costs of millions of taxpayers. The result will be an increase in fraud, abuse, and erroneous payments.

Oddly, in many of its provisions, the ACA makes the IRS and extension of the Department of Health and Human Services. The bill gives HHS the authority to make the rules while giving the IRS the responsibility for doing the paperwork, policing the system, cutting the checks, and fixing any problems that arise.

While the temptation is to give the IRS more money and resources to meet these tasks, the real solution is to overhaul the tax code and allow the IRS to return to its core mission of collecting tax revenues.

The ACA Gives the IRS Three Big Tasks

The ACA gives the IRS three major roles to play in assuring universal health insurance.[1] First, the IRS is required to collect more than $800 billion in new tax revenue over the next ten years to fund the various components of the legislation. Second, the IRS is tasked with managing very generous refundable tax credits for individuals who cannot afford to purchase private health insurance as well as tax credits for small businesses that cannot afford to provide their employees insurance. Lastly, the ACA puts the IRS in the role of enforcer to extract special taxes – or "penalties" – from individuals who fail to purchase health insurance or from businesses that fail to provide "affordable" insurance.

These are anything but complementary missions. The IRS's own Inspector General fully admits that "the ACA presents a major challenge to the IRS as the ACA represents the largest set of tax law changes in more than 20 years and affects millions of taxpayers."[2]

In order to get a sense of how the IRS will manage these new tasks, it is fair to look at the results of current policies.

---

[1] http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions

[2] *Affordable Care Act: Planning Efforts for the Tax Provisions of the Patient Protection and Affordable Care Act Appear Adequate; However, the Resource Estimation Process Needs Improvement*, Treasury Inspector General for Tax Administration, June 14, 2012, Reference Number: 2012-43-064, p. 1.

The Growth in Nonpayers and the IRS's Role in the Welfare State

One of the most troubling development in recent years is that the expanded use of the tax code to deliver social policy has knocked millions of taxpayers off the tax rolls and turned the IRS into an extension of the welfare state – a role it has not managed well.

Today, a record number of Americans – 56 million, or 41 percent of all filers – now pay no income taxes after taking advantage of the generous credits and deductions in the tax code. At least half of these filers look to the IRS as a source of income thanks to the more than $100 billion in refundable tax credits paid out to people who have no income tax liability. As a result of removing millions of people off the tax rolls, we have dramatically reduced the number of people with "skin in the game" while increasing the amount of redistribution through the tax code.

In 2010, the budgetary cost of both the non-refundable and refundable tax credits totaled $224 billion. After adjusting for inflation, this is ten-times their cost in 1990. To put today's costs in perspective, if tax credits were combined into a single program, they would now be the fourth-largest domestic program behind Social Security, Medicare, and Medicaid. "The two largest refundable credits, the EITC and the ACTC, receive a much larger appropriation than the IRS's own budget."[3]

The ACA's generous tax credits and cost-sharing payments – with an average value of $4,000[4] – will no doubt increase the number of nonpayers while increasing the IRS's role as deliverer of social benefits. The cost of the Health Insurance Premium Tax Credit and exchange subsidies is now expected to total more than $800 billion during the ten years after it goes into effect in 2014.

The IRS is Ill-Equipped to Manage Social Programs

The IRS has a dismal record in managing the plethora of tax credit programs it is already responsible for, so we should expect the ACA to led to billions of dollars in fraud, abuse, and erroneous payments. For example, Treasury's IG for Tax Administration has testified here that "the unintended consequences of [refundable] credits is that they are often the targets of unscrupulous individuals who file erroneous claims for these credits."[5] The fact that the value of the Premium Tax Credits could approach $14,000 for a family of four, by some estimates[6], all but guarantees that the IRS will have to combat considerable fraud and abuse.

---

[3] "Improper Payments in the Administration of Refundable Tax Credits," Testimony of the Honorable J. Russell George, Treasury Inspector General for Tax Administration, Hearing Before the Committee on Ways and Means Subcommittee on Oversight, U.S. House of Representatives, May 25, 2011, p. 2.

[4] Stephen Ohlemacher, "Can the IRS Manage to Police Both Taxes and Health Care Law?", Associated Press, July 19, 2012. http://www.usatoday.com/money/industries/health/story/2012-07-09/IRS-to-tackle-health-care-and-taxes/56108848/1

[5] Ibid.

[6] Stephanie Rennane and Eugene Steurle, Health Reform: A Two-Subsidy System, Tax Policy Center S10-0001, Table 3, (2010). http://www.taxpolicycenter.org/numbers/Content/PDF/S10-0001.pdf

IG reports are replete with examples of how the IRS has failed to control fraud and erroneous payments in virtually all of the tax credit programs under its jurisdiction. Some recent examples include:

Earned Income Tax Credit: The largest tax credit program leads to the most abuse. The IRS reports that "23 to 28 percent of EITC payments are issued improperly each year," which translates into "$11 to $13 billion in improper EITC payments."[7] Remarkably, reports the IG, "the IRS does not require individuals to provide any supporting documentation to verify eligibility for claiming the EITC."[8] The EITC has the second highest amount of improper payments after Medicaid.[9]

The Additional Child Tax Credit: The IG reports a substantial increase in the number of filers who are not authorized to work in the U.S., but use an Individual Taxpayer Identification Number (ITIN) to improperly claim the credit. In 2010, the IRS paid $4.2 billion in refundable child credits to individuals who were not authorized to work in the United States.[10]

Plug-in Electric and Alternative Motor Vehicle Credit: The IG "identified 12,920 individuals who electronically filed their tax returns and erroneously claimed $33 million in Plug-in and Alternative Motor Vehicle Credits" because "IRS processes did not ensure the plug-in electric and alternative motor vehicles met the requirements for vehicle year, placed-in-service date, and make and model."[11]

Residential Energy Credits: The IG reported that because the IRS did not require any third-party documentation for the expenses related to home energy efficiency improvements, 362 prisoners or under-age tax filers erroneously claimed the Residential Energy Credits on their tax returns.[12]

Hope Credit: The IG found that, "Some taxpayers are claiming the Hope Credit for more years than allowed by law."[13] The limit is two years but some were found to claim the credit for three and even four years. In one investigation, the IG found that "the amounts of credits inappropriately claimed averaged close to $1,400 and totaled just over $232 million."[14]

---

[7] Ibid., p. 3.
[8] Ibid., p. 4.
[9] http://www.treasury.gov/tigta/semiannual/semiannual_sept2010.pdf. p.23.
[10] J. Russell George, Inspector General, Memorandum for Secretary Geithner, "Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2012," p. 12.
[11] "Energy Tax Policy and Tax Reform," Testimony of the Honorable J. Russell George, Treasury Inspector General for Tax Administration, Hearing Before the Committee on Ways and Means Subcommittees on Select Revenue Measures and Oversight, U.S. House of Representatives, September 22, 2011, p. 4.
[12] Ibid., p. 5.
[13] "Improvements and Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions," Treasury Inspector General for Tax Administration, September 30, 2009, Reference Number: 2009-30-141, p. 2.
[14] Ibid.

Despite the IG's recent report suggesting that the IRS's plans to implement the ACA appear "adequate," the vast number of problems the IRS is already having administering its current portfolio of tax programs should give us great concern over its ability to skillfully manage the ACA.

The IRS Has Stumbled Early in Administering the ACA

The IRS stumbled out of the gate in implementing some of the earliest – and, perhaps simplest – provisions of the ACA: the Small Business Health Care Tax Credit; the Indoor Tanning Excise Tax; and, the Expansion of the Adoption Credit.

The initial results from the Small Business Health Care Tax Credit do not bode well for lawmakers' broader goal of incentivizing businesses to provide affordable health insurance for their employees.[15] Despite the IRS's $1 million expense to mail 4.4 million postcards to potentially eligible small business owners, only 309,000 had claimed the credit as of October 2011. These taxpayers claimed $416 million in credits, a fraction of the $2 billion cost the Congressional Budget Office had estimated for that year.[16]

When the IRS surveyed business owners to find out why they did not take advantage of the program, many responded that the benefit was not worth the effort. This is not surprising considering that "there are multiple steps to calculate the Credit, and seven worksheets must be completed in association with claiming the credit."[17] If this small provision is any indication of the added compliance burden that the ACA will place on businesses, it is fair to say that the total compliance costs for the entire act will be staggering.

The IRS's experience with implementing the Tanning Excise Tax – the most joked about tax in the bill – should also give us pause. As the IG has reported, the number of businesses who first paid the tax was much lower than expected, in part because there were no good figures on how many businesses actually provide tanning services. The Indoor Tanning Association estimated that there were roughly 25,000 such businesses, but the actual number who filed excise tax returns last year averaged around 10,300.[18]

Lastly, the ACA increased the value of the Adoption Credit to $13,170 from $12,150 and made it refundable. [19] As it has with the other tax credit programs, the IRS has struggled to prevent erroneous payments. In the first quarter of 2011, the IG identified 736 taxpayers who had received more than $4 million in improper Adoption Credits.

While these may seem like a trivial issues, there are provisions within the ACA that likely will cause the IRS similar problems. For example, it is fair to wonder if small biotech firms will find the administrative cost of claiming the tax credits available through the Qualified Discovery

---

[15] TIGTA, Ref. No. 2011-40-103, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (September 2011).
[16] Ibid. p. 6.
[17] Ibid. p. 2.
[18] TIGTA Semiannual Report to Congress, April 1, 2011 – September 30, 2011, p. 29.
[19] IRS Management Challenges Memorandum, p. 9.

Project Program worth the effort. On the other hand, if the IRS could not determine how many tanning businesses were required to charge the Tanning Excise Tax, how can it successfully implement the Medical Device Excise Tax? This will require the IRS to coordinate its efforts with the FDA, which has classified some 1,700 generic classes of medical devices.

The IRS as an Extension of HHS

In key areas, the ACA gives HHS responsibility to determine eligibility and set the program's rules but gives the IRS the responsibility of verifying eligibility based on tax returns and a staggering amounts of data from employers and insurance companies. Then, the IRS is also responsible for delivering benefits and fixing any problems that arise. At best, this is a recipe for bureaucratic turf battles. At worst, it is a quagmire for both the IRS and taxpayers.

The Premium Assistance Credit is a case in point. The credit amount is determined by the Secretary of HHS, but it is up to the IRS to verify household income based on tax return data for past years. Recipients can either chose to have Treasury make direct payments to the insurance plan in which they are enrolled or they can chose to pay the premiums themselves and apply to the IRS for the credit at the end of the tax year.

However, if HHS and the exchanges miscalculate someone's credit amount, it is up to the IRS to fix the overpayment or underpayment on a taxpayer's 1040. The overpayment will be treated as a tax while an underpayment will be treated as a reduction in tax. Either way, taxpayers will be caught between any communications disputes between the IRS and HHS.

Imagine if the Food Stamp system were run in the same fashion, where the eligibility for Food Stamps was determined by USDA but the IRS was responsible for verifying the incomes of recipients and either giving "food" tax credits directly to taxpayers or sending checks to grocery stores on their behalf. Does anyone think that this would make for an efficient and user-friendly system?

Compliance Costs will Skyrocket Under ACA

The ACA is a full employment act for the tax preparation industry and will add billions of dollars in compliance costs to people who cannot afford health insurance. As it stands, complying with the current tax code costs taxpayers an estimate $163 billion each year according to the National Taxpayer Advocate.

About 80 percent of all taxpayers use professional tax return preparers and commercial software to complete and file their tax returns, and that figure is surely to rise as the result of the ACA. While some may think that this will make compliance easier, the burden of these costs fall disproportionately on small businesses[20] and the poor. For example, about 73 percent of those

[20] http://www.sba.gov/sites/default/files/files/rs382.pdf

claiming the EITC pay a professional preparer to complete their tax return.[21] No doubt, this number will rise for taxpayers attempting to claim the Health Insurance Premium Tax Credit. The irony is that many taxpayers will have to ask themselves how much they can afford to pay a professional tax preparer in order to claim a tax credit that is intended to pay for health insurance they currently cannot afford.

Furthermore, it may be impossible to calculate the added compliance burden on businesses who must calculate the costs of the innumerable scenarios facing them: pay for health insurance for employees, absorb the employer-mandate penalties, or do nothing.

The experience with the Hope Credit suggests that much of these new compliance costs will go to waste. The IG reported that educational institutions spent millions of dollars and staff hours to provide taxpayers and the IRS with copies of Tuition Statements (Form 1098-T). However, the IRS did not use this Form in its compliance programs, or accept the Form as documentation to support claims for education credits.[22]

Conclusion

Mr. Chairman, it is hard to believe that anything could make the tax code look simple and understandable, but the Affordable Care Act does just that.

Ironically, while most everyone agrees that the tax code is badly in need of simplification and that the IRS is already overburdened, the Affordable Care Act has saddled the agency with duties that are beyond its core competency and has set it up for failure.

While we can never anticipate every unintended consequence of legislation, it is fairly easy to predict that the ACA will lead to more Americans taken off the tax rolls and made more reliant on the IRS for much of their income. And, it will produce more fraud, abuse, and improper payments from programs that should not be delivered through the tax code in the first place.

The solution is not to give the IRS more money, resources or staff. The solution is to reform the tax code, eliminate the most burdensome and distortionary tax preferences, and return the IRS to its core mission of simply collecting the necessary amount of tax revenues to fund the government.

Thank you very much. I would welcome any questions you may have.

---

[21] National Taxpayer Advocate, Report to Congress: Fiscal 2010 Objectives, June 30, 2009, p. xxii. http://www.irs.gov/pub/irs-utl/fy2010_objectivesreport.pdf

[22] Ibid., p. 1.

Chairman BOUSTANY. Thank you, Mr. Hodge.
Mr. Perretta, you may proceed with 5 minutes.

STATEMENT OF SETH PERRETTA, PARTNER; CROWELL & MORING, LLP

Mr. PERRETTA. Thank you, Mr. Chairman and Members of the Subcommittee. I am Seth Perretta, a partner at Crowell and Moring, where I lead the firm's employee benefits practice. I am here today on behalf of the American Benefits Council for whom I serve as outside health tax counsel.

The Council's Members are principally major national employers, as well as health insurers and employee benefit advisors. Collectively, the Council's Members either sponsor directly or provide services to health and retirement plans covering more than 100 million Americans.

I would like to briefly address three points today. The first concerns the job that the Treasury Department and the IRS have done in helping employers and others comply with the Affordable Care Act, the second is to refer to a few examples of how the agencies have resolved the challenges faced by employer sponsors of health plans, and the third is to mention some of the important decisions yet to be made.

First, whether one believes the Affordable Care Act represents good policy or bad policy, everyone ought to agree on two points. Namely, the Act is a large and complex statute involving many new responsibilities for employers and other stakeholders, and given that reality, the Treasury Department and IRS have overall done a very commendable job helping employers and others understand and comply with the law's requirements.

As referenced in my written testimony, the Council and the employer community as a whole have not always agreed with the interpretations that the agencies have made regarding certain provisions of the Act. For example, the agencies' interpretation of what constitutes a grandfathered plan is an example, but it has been our experience that the agencies have generally sought to give employers flexibility in implementing the law and I can say without reservation that the agencies have been very accessible during this process to us, not only welcoming input from us, but also actively seeking out our views on how to make the law more administratable.

Since March of 2010, the American Benefits Council has hosted 14 webinars for our members on different aspects of the Affordable Care Act. Collectively, thousands of employee benefits professionals nationwide have participated. IRS or Treasury officials have directly presented at a great many of these programs and have been a very valuable technical resource for all of them.

In the same vein, I just completed my term as chairman of the Employee Benefits Committee of the DC Bar where we hosted seven programs ourselves related to the ACA for the benefit of legal practitioners across the city. Again, the agencies' officials actively participated in these programs upon request.

These sessions and other formal and informal communications have allowed the regulators to answer numerous questions from employers as well as benefit practitioners. Of equal importance, the agencies have used these opportunities to better understand the design and operation of employer sponsored health plans so they could address the true diversity of plan offerings that exist and develop rules regarding implementation.

Second, time does not permit a lengthy discussion of specific regulatory projects, but my written testimony addresses some in greater detail, and of course I will be pleased to answer any questions you may have about them.

The first concerns the requirement for employers to include the value of employer healthcare on an employee's form W-2 starting

for the 2011 tax year. Employers had many questions and concerns about this new requirement, including whether particular coverage was to be included on the form, and if so, how do actually value that coverage. In answering these questions, the IRS incorporated many employer suggestions and in fact gave employers a much needed one-year reprieve in complying with the new requirement.

Another example concern to the law is the so called pay-or-play provision and the challenge of defining what constitutes full-time employment and whether coverage is deemed affordable. This is relevant both from employer penalties as well as for purposes of the premium tax credit. The IRS has crafted safe harbors that will make these determinations simpler for plan sponsors.

A third example relates to the way in which IRS allows employers to treat multiple plan offerings for purposes of determining their financial obligation to pay one of the new fees prescribed by the law. I believe one of you mentioned the medical device tax. Well, this is—there is another fee called the PCORI fee and the IRS issues favorable guidance from the employer perspective that makes it easier to comply.

Again, with respect to all three examples, it goes without saying that many companies may not like the underlying requirements, but IRS action has made compliance with these provisions more straightforward and flexible to accommodate a variety of plan structures.

The third and final point I want to emphasize concerns the future. In the coming months, employers will need clear and easy to follow guidance in order to fulfill a number of reporting and disclosure obligations, including just 6 months from now a March 2013 notice related to state insurance exchanges. The IRS also needs to more fully explain how employers are to determine whether the plans they offer provide minimum value for purposes of the Act's pay-or-play provision. And likewise, employers who sponsor wellness programs to improve the health of their employees and control healthcare costs need to know how wellness incentives will be taken into account for determining whether an employer-sponsored plan is deemed affordable.

With respect to these and other regulatory projects yet to be developed, we urge the IRS to continue to be receptive to input from employers in the same fashion that it has sought to do so from day one of the Act.

Thank you for allowing me to testify this morning. I would be pleased to answer any questions.

[The prepared statement of Mr. Perretta follows:]

TESTIMONY OF

SETH T. PERRETTA

PARTNER,
CROWELL & MORING LLP

ON BEHALF OF THE

AMERICAN BENEFITS COUNCIL

BEFORE THE

COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

THE INTERNAL REVENUE SERVICE'S IMPLEMENTATION AND ADMINISTRATION OF THE PATIENT PROTECTION AND AFFORDABLE CARE ACT

SEPTEMBER 11, 2012

Chairman Boustany, Ranking Member Lewis, and Members of the Subcommittee, thank you for the opportunity to share our views with you today regarding the implementation and administration of the Patient Protection and Affordable Care Act (the "ACA") by the Internal Revenue Service (the "IRS"). My name is Seth T. Perretta, and I am here today representing the American Benefits Council (the "Council"). The Council is a public policy organization representing plan sponsors – principally Fortune 500 companies – and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

In my role as outside health tax counsel to the Council, I have been assisting the organization and its members in understanding how to comply with the many provisions of the ACA that have or will soon become effective. Additionally, as a partner at Crowell & Moring LLP here in Washington, DC, I work regularly with both employer and health insurance company clients in helping them understand their obligations with respect to the ACA. Since March 2010, my practice has been focused in very large part on the ACA and I have spent thousands of hours assisting my clients in complying with the ACA and have worked closely with the federal agencies, including the IRS, as part of my work.

As this testimony describes in greater detail, it is the Council's view that the IRS has worked diligently to adopt a thoughtful and generally collaborative implementation process. In addition to the opportunities for the employer community to provide input via the formal regulatory process, through the submission of extensive comment letters and meetings with the agencies, Treasury and IRS officials have made themselves available to help the employer community understand its compliance responsibilities through a number of informal means. For example, since the enactment of the ACA, the Council has hosted fourteen compliance webinars to date reaching, collectively, thousands of corporate employee benefits professionals nationwide. Treasury and IRS officials have participated directly in four of them and have been an available technical resource for the rest.

I would also note that I recently completed my tenure as Chairman of the Employee Benefits Committee of the Tax Section of the District of Columbia Bar Association. In that capacity, we hosted seven ACA compliance webinars for legal practitioners. Likewise, the agency officials either directly participated or provided valuable input to our education efforts. Notably, IRS and Treasury officials have not only been available to answer numerous questions, but have themselves used these webinars and other opportunities to learn more about employer and health plan compliance challenges as they have developed regulatory guidance.

Implementation Challenges of the ACA

The ACA is a very significant piece of legislation for employer plan sponsors. The law includes dozens of provisions that affect employers, and employers, in turn, take their compliance obligations very seriously. These include new requirements on employer plans to provide specific substantive benefits such as first dollar coverage for preventive care services, expanded eligibility for coverage for children up to age 26, broader claims and appeals rights, new requirements to value and report the aggregate cost of certain employer-provided coverage on an employee's Form W-2, and new responsibilities for employers with an average of at least 50 employees to offer coverage to full-time employees and to meet new affordability and minimum value standards for the health coverage they offer. Additionally, the law imposes many new notice and disclosure requirements on employers, including a requirement that is effective just six months from now in March 2013 that requires employers to notify employees of the availability of health insurance through state insurance exchanges beginning in 2014. Additionally, unlike some statutes which contain a single effective date for their substantive provisions and which provide substantial lead time to allow the regulating agencies and the regulated public to prepare for those provisions, the ACA contains a range of effective dates, from as soon as six months after enactment of the ACA through 2018.

As a result, employers have had to work quickly and continuously since the ACA's enactment to comply with its provisions. In the same vein, the IRS has had to work diligently on a near-constant

basis to provide timely guidance on a range of issues. The implementation challenges, for employers and the IRS alike, have been very substantial.

IRS Implementation and Administration Efforts

From the beginning of this process and continuing to the present, the IRS has worked hard to establish a deliberative implementation process that allows for comment and participation by stakeholders, including the employer community. Naturally, employers and health plans have not always agreed with the guidance issued by the IRS. For example, employers were particularly disappointed that the regulatory agencies took an overly narrow interpretation of what constitutes a "grandfathered" plan that permits employers to avoid the need to comply with several ACA requirements. But, overall, the Council commends the agency's regulatory process and its efforts to provide flexibility to plan sponsors in implementing the law.

The IRS has not followed one specific method for promulgating ACA-related guidance. Instead, the IRS has adopted different approaches to providing guidance and conducting rulemaking over the past two-and-a-half years based, in part, on the effective dates prescribed by the law.

In the first six months following enactment of the ACA, the IRS, along with the U.S. Department of Labor ("DOL") and U.S. Department of Health and Human Services ("HHS"), relied to a great extent on the use of interim final rules in providing guidance. This is in contrast to issuing proposed rules, which typically allow for more meaningful notice and comment by stakeholders. The IRS's use of interim final rules, however, was due in large part to the fact that many of the ACA's market reforms had an initial effective date of just six months following enactment. The Council and its members found this process frustrating at times as the resulting guidance was sometimes unclear or resulted in unnecessary administrative burdens. Nonetheless, the IRS was regularly available to the Council and its members to address employer concerns and worked diligently with the Council to address many pressing implementation issues facing employers. On several occasions, the IRS

provided additional clarifying guidance following the issuance of an interim final rule in response to concerns expressed by the Council and its members.

As we have moved further from the initial effective date of the ACA, the IRS has generally adopted a more measured approach to rulemaking that relies more heavily on proposed rulemaking rather than interim final rules. Additionally, before proceeding with the issuance of proposed or final rules, the IRS often issues a notice as the initial step of its rulemaking process to first ask stakeholders for input on discrete issues or concerns related to a specific guidance project or to set forth in writing for public comment a concept or framework under consideration by the agency. The IRS then follows up this notice by issuing proposed regulations that again provide for notice and public comment. The IRS has also generally been willing to address concerns of broad applicability quickly through the issuance of various forms of sub-regulatory guidance, such as answers to Frequently Asked Questions ("FAQs"), Notices and the like.

The use of sub-regulatory guidance can in some respects be a mixed blessing. It facilitates the issuance of important guidance in a timely fashion, but may not allow for meaningful public comment. Significantly, unlike in the months that initially followed enactment of the ACA, where the use of sub-regulatory guidance by the agencies was fairly common, the IRS appears to be using sub-regulatory guidance at this time more to frame issues for future rulemaking or to clarify more formal guidance that has already been the subject of significant public comment.

Specific Examples of IRS Implementation Efforts

1. New Form W-2 Reporting Requirements for Employer-Sponsored Group Health Coverage: Under the ACA, employers are required to report the cost of certain employer-provided health coverage on the Form W-2. This requires employers to make complex determinations of whether particular coverage is subject to reporting and how to value the coverage if it is. This new reporting requirement was scheduled to become effective for the 2011 tax year, meaning that many employers

would have been required to make substantial changes to their payroll and accounting processes with very little lead time. Fortunately, after receiving feedback from the Council and the employer community generally about the near-impossible task this would entail, the IRS, in Notice 2010-69 (issued on October 12, 2010), provided employers with a one-year reprieve by making the new requirement optional for 2011.

Subsequently, on March 29, 2011, the IRS issued Notice 2011-28, which provided interim guidance to employers on this new reporting requirement. The Notice provided that, unless and until the IRS issues further guidance, employers filing fewer than 250 Forms W-2 for the preceding calendar year are not subject to the reporting requirement. The Notice also invited additional comments, and, in response to the comments it received, the IRS, on January 3, 2012, issued Notice 2012-9, which amended and restated the interim guidance provided in the earlier Notice. In addition, the IRS stated in Notice 2012-9 that it would continue to consider additional comments as it works toward issuing additional guidance, including regulations. Employer plan sponsors are currently working to implement this requirement in time for issuing Forms W-2 for tax year 2012, which generally are issued to employees in January 2013.

As should be apparent by this point, employers as well as various other stakeholders voiced their concerns regarding the implementation of this new reporting requirement, and the IRS listened. The series of Notices on this topic not only incorporated many employer suggestions and responded to numerous employer concerns, but also provided employers with additional time to better understand how the new rule works and to update their administrative systems and practices to facilitate eventual compliance with the rule. Although certain questions remain to be answered, as a result of the IRS outreach to the employer community on this issue, employers are in a much better position to comply with this reporting requirement.

2. The ACA's Pay-or-Play Provision: Under the ACA, beginning in 2014, large employers are required to offer their employees the opportunity to enroll in group health plan coverage that provides "minimum essential coverage," that is both affordable and provides "minimum value." If a large employer does not offer "minimum essential coverage," or if such coverage is either unaffordable or does not provide minimum value, the employer will be subject to a significant excise tax. This has come to be known as the ACA's "Pay-or-Play" provision, with large employers choosing between the "Pay" option (i.e., do not provide such coverage and pay the excise tax) or the "Play" option (i.e., provide the requisite coverage and avoid the excise tax).

As noted, employers subject to the ACA's Pay-or-Play provision are only required to provide qualifying and affordable coverage to full-time employees. Hence, employers have been keenly interested and invested in a rational, coherent administrative scheme for determining which employees will be considered to be "full-time employees" for this purpose. The IRS responded by issuing a series of Notices that are intended to provide employers with helpful rules for purposes of determining who is a full-time employee.

First, the IRS issued Notice 2011-36 on May 3, 2011. This Notice described and requested comments on a potential optional safe harbor (the "look-back/stability period safe harbor") to determine whether existing (versus new) employees are full-time employees for purposes of Pay-or-Play. Under this safe harbor approach, an employer will be permitted to determine each employee's full-time status by first choosing a "look-back" period of three to twelve months. The employer can then determine during this "look-back" period whether the employee averaged at least 30 hours of service per week or 130 hours per month. If the employee averages the necessary hours during this "look-back" period, the employee will be treated as a full-time employee during the subsequent "stability" period, regardless of the employee's actual number of hours worked.

This guidance generally was well-received by employers because the safe harbor would help eliminate administrative burdens associated with complying with Pay-or-Play on a monthly basis

with respect to a variable hour employee who could work full-time hours one month but perhaps not the next month. Additionally, employers appreciate the flexibility that would be provided in determining the length of any look-back and stability periods. Such flexibility will ensure that employers can adopt look-back and stability periods that best reflect the unique realities of their employee population and business.

On September 13, 2011, the IRS issued Notice 2011-73, which provided additional relief for employers with regard to the Pay-or-Play provision. Specifically, this Notice described a safe harbor under which employers could rely on the employee's Form W-2 wages, instead of household income, to determine whether the coverage they offer is "affordable." Under this safe harbor, no excise tax would apply if the required group health plan contribution by the employee was no more than 9.5% of the employee's Form W-2 wages. This guidance was also generally well-received by our members. The statute provides that "affordability" is based on an individual's modified adjusted gross *household* income. However, since employers generally do not have knowledge of an employee's sources of income beyond the Form W-2 wages paid by the employer to the employee (in part because of privacy concerns), employers need a way to measure whether the coverage provided to an employee is affordable in order to determine whether they could be subject to an excise tax under the Pay-or-Play provision for failing to provide affordable coverage. The contemplated rule is helpful because it will allow employers to determine affordability based solely on an employee's Form W-2 wages.

The IRS has since issued several additional notices that have been intended to both clarify prior guidance set forth in the earlier notices as well as make certain modifications based on comments received by the IRS to date. The consistent theme in this series of Notices is the IRS' willingness to solicit feedback from employers and other stakeholders, and to continue to move toward a more flexible and predictable regulatory scheme for employers.

3. Fees for the Patient-Centered Outcomes Research Trust Fund: The ACA created several new sections of the Internal Revenue Code to impose a fee (the "PCORI Fee") on health insurance plans with respect to "specified health insurance policies" and on employers with respect to "applicable self-insured health plans" to partially fund new comparative clinical effectiveness research relating to patient-centered outcomes through the Patient-Centered Outcomes Research Trust Fund. The PCORI Fee is a per capita fee based on the average number of lives covered under a policy (for insured coverage) or plan (for self-funded plans).

The PCORI Fee, which applies for plan or policy years ending after September 30, 2012 but on or before September 30, 2019, raises the cost to employers of providing group health coverage and, as such, is an issue of great importance to employers. Hence, the Council believes the IRS took the correct step when it began the implementation process for the PCORI Fee by releasing, on June 8, 2011, Notice 2011-35, which requested comments on how the fees imposed by these new provisions of the Internal Revenue Code should be calculated and paid, including possible rules and safe harbors. The IRS followed this up, on April 17, 2012, by issuing proposed regulations pertaining to the PCORI Fee under which, among other things, employers may treat multiple self-insured arrangements as a single applicable "plan," so long as these arrangements are established and maintained by the same plan sponsor and have the same plan year. Because many employers already treat multiple arrangements as a single "plan" for business or accounting purposes, this approach would allow employers to continue with current business practices without fear of incurring additional liability under the PCORI Fee. In this case, again, the IRS addressed an employer concern in providing additional guidance.

Additional Guidance Needed

The ACA is, of course, a large and complex law, and much of the implementation and administration responsibilities are still on the horizon. Thus, just as the IRS has generally been very

receptive to employer input so far, the agency must continue to understand that ensuring employer flexibility is essential to successful implementation of the law.

Among the areas the Council sees an urgent need for additional guidance are:

- *Reporting and Disclosure Obligations*: The ACA will impose additional reporting and disclosure obligations on employers, including disclosures to employees, as well as various agencies including the IRS. Of special concern to employers is a requirement, effective for March 2013, that employers provide a notice to employees regarding the availability of insurance coverage through the state exchanges. Employers urgently need guidance regarding their new reporting and disclosure obligations, including this March 2013 notice requirement.

- *Minimum Value*: As noted above, an employer must pay certain excise taxes under the Pay-or-Play provision if it fails to provide coverage that provides "minimum value." Although the IRS has issued some recent guidance setting forth a conceptual framework for determining "minimum value" (and requesting comments with respect to such guidance), many questions remain regarding how "minimum value" will be determined. Many employers are unable to plan for the future – specifically plan years beginning in 2014 – without further clarifying guidance regarding minimum value.

- *Wellness Programs*: Employers continue to utilize wellness programs to improve the health of their employees and to control the rising cost of providing employer-sponsored health coverage. Under rules put in place in the mid-to-late 1990s, employers have been able to offer incentives of up to 20% of the total premium cost to encourage employees to participate in wellness programs. The ACA effectively codified this guidance by allowing for an increase to 30%. Employers are concerned that any guidance issued to implement the increase not impose new burdens on employers. Additionally, employers need clarification that such incentives will be taken into account in determining whether an individual's

employer-provided coverage is "affordable" for purposes of Pay-or-Play. If a wellness incentive is not considered for purposes of Pay-or-Play, this would most assuredly have the result of making wellness programs less attractive to employers and discouraging their use overall. The Council urges the IRS to issue guidance making clear that wellness programs will be taken into account for purposes of Pay-or-Play, and to ensure that employers continue to have the necessary flexibility to create wellness programs that improve the health of their employees while strengthening employers' ability to continue to provide quality group health coverage to their employees.

Conclusion

The Council appreciates the ongoing efforts of the IRS to take into consideration as part of its rulemaking the issues and concerns of the employer community during the lengthy and complex implementation process of the ACA. We also recognize that much more work remains to be done by the agency and all affected stakeholders, including employers. Therefore, we urge that the agency continue to reach out to the employer community and provide timely guidance on the many issues that remain on the implementation agenda.

Thank you for the opportunity to share the Council's perspectives on these important issues. We look forward to continuing to work with the IRS and Treasury on employer concerns with respect to implementation of the ACA, and would be happy to share our views regarding the progress of this implementation with the Subcommittee at any point in the future.

Chairman BOUSTANY. Thank you, Mr. Perretta. We will begin questioning.

Our tax laws provide financial and behavioral incentives to actors across our entire economy, some intended, others not.

Mr. Goldberg, in your experience both as a government official in multiple capacities and a tax practitioner, I think you probably have a deeper understanding than most of us about how that all plays out. Can you describe in greater detail some of the unintended consequences the new law might provide?

For example, might it provide incentives for employers to dump low-income employees into an insurance exchange or shift workers to part-time employment?

On the individual's side, does it incentive healthy individuals to forgo buying health insurance until they are sick or injured?

Could you comment on some of the unintended consequences that might ensure?

Mr. GOLDBERG. Sure, Mr. Chairman.

My experience tells me that the American people are extraordinarily responsive to incentives created by the Tax Code. They are aided in this process by a massive infrastructure of advisors. For the most part, I think this is healthy. This is part of who we are.

The way the Affordable Care Act is currently structured, I believe that employers will have significant incentives to discontinue group coverage and split their savings with employees. I believe that is going to happen. I believe that the current tax penalty structure for failure to purchase insurance on an exchange clearly provides a young, healthy individual to not purchase the policy until he or she is in need of insurance. So this is going to happen and it is going to happen for sure.

You can change it. You have decades of collective experience in structuring incentives. If you structure the incentives properly, you will change the behavior.

Chairman BOUSTANY. Others want to comment on this, on unintended consequences?

Mr. HODGE. Yes, Mr. Chairman.

If you are looking to reduce the cost of healthcare, this is not the way to do it, and for instance, two taxes in particular, one is the medical device tax, which the ultimate payer of that tax will be insurance companies of the first order, ultimately consumers, but that will cascade down to consumers eventually. In addition to that, there is the fee that is being placed on insurance companies. That will also cascade down to the payers, the companies, businesses, and individuals.

Chairman BOUSTANY. In higher premiums then?

Mr. HODGE. In higher premiums. So these will actually jack up the cost of premiums in insurance. So if the intended goal is to reduce that, this is going to have a contrary effect.

Chairman BOUSTANY. Thank you.

Others want to comment on this?

Mr. Hodge, you made a comment in your statement and it is also in your written statement about the tax credits that we have thrown throughout our entire Tax Code and the sheer complexity of this and you made a statement and I want to make sure I have this correct. It constitutes the—it would constitute the fourth largest social welfare program.

Mr. HODGE. That's correct, Mr. Chairman.

If you add up to the total cost in both the refundable and nonrefundable costs of all of the tax credits that are currently administered, it would be the fourth largest domestic program in the budget. They currently total $224 billion and that would make them fourth only to Social Security, Medicare, and Medicaid.

Chairman BOUSTANY. And so now we are going in a direction—with ACA we are going in a direction of more complexity in the Tax

Code rather than the stated goals of trying to get to a simplified Tax Code with lower rates?

Mr. HODGE. Well, we have certainly turned the IRS now into a full-blown governmental agency managing vast numbers of programs in a way that it was simply not intended to do.

Chairman BOUSTANY. Thank you.

And I would like to hear from the panel on how the new responsibilities from the healthcare law might affect the tax gap. I think when I read through testimony, this was raised, and Mr. Goldberg, I know you mentioned a threat of an increased tax gap in your written testimony. Could you expand on that?

Mr. GOLDBERG. Yes, Mr. Chairman.

Again, I have a simple story. This is a tax. Treat it like a tax. The current penalties for noncompliance, and I am talking principally about on the credit side, there is no interest, there are no penalties. The IRS is not going to engage in its customary enforcement efforts. This is an ugly story. It is not happy, but it is true, and if you give—if you simply let the IRS do its job the way it does elsewhere, you will mitigate significantly these compliance problems.

It is not a perfect marriage, but it has been around a long time and despite what others say, I believe the IRS and taxpayers pretty much have worked it out pretty well and if you are going to go down this road, let taxpayers do their job, let the IRS do its job, and I believe it will significantly minimize noncompliance, but as currently structured, it is going to be a mess.

Chairman BOUSTANY. So we will see a widening of the tax gap?

Mr. GOLDBERG. Yes, sir.

Chairman BOUSTANY. And the revenue generated from these taxes in ACA are basically a significant part of the funding of the new program, the coverage expansion; is that correct?

So we are going to see a widening tax gap, but also significant underfunding of the proposed program; is that a fair statement?

Mr. GOLDBERG. I believe it is, Mr. Chairman. I think your Committee historically has done an admirable job bipartisan supporting adequate funding for the IRS. They are charged with immense responsibility and they should be funded properly to discharge it.

Chairman BOUSTANY. Thank you.

Others want to comment on the tax gap issue? No.

Thank you. That's all I have.

Mr. Lewis?

Mr. LEWIS. Thank you, Mr. Chairman.

I want to thank each one of you for being here today, taking the time and being so patient.

Mr. Perretta has reached out to the IRS on issues related to health reform, to the health reform law, and what have been your experience in term of the IRS responding?

Mr. PERRETTA. I speak with folks at the IRS and Treasury on issues both on behalf of the American Benefits Council and on behalf of my issuer and employer clients on a very frequent basis. I would say I speak with them probably on a biweekly or certainly once a month on issues of emerging importance in terms of figuring

out how to comply with these rules and I can say that the response has always been fantastic.

The IRS and Treasury, I really think, in many respects as a Federal agency are a model for making themselves available to help comply with their rules. They always make themselves available to provide both explanations on an informal basis to individual practitioners, but also to larger groups.

As I mentioned, as chairman of the DC Bar Employee Benefits Committee, we hosted several programs and several—seven or eight programs since 2010 on the ACA and you call around town and you try to get people from the agencies to come speak to practitioners who are trying to understand these rules and help employers understand these rules, and I can say without a doubt, the IRS and Treasury have always been the most responsive of the agencies I have dealt with in making available people to help have those conversations.

Mr. LEWIS. What type of help/assistance do employers need from the IRS that hasn't been issued yet?

Mr. PERRETTA. There are sort of, I think, three really, really big issues. One is minimum value in order to determine whether or not an employer is providing coverage that will qualify as minimum essential coverage under the pay-or-play, so essentially how an employer decides whether or not they are complying with the obligation to provide qualifying coverage. The coverage must provide minimum value, and right now, we have a proposed sort of concept as to how minimum value will be determined, which we are very thankful for and very happy with, but I think further contours on that rule would be helpful so employers can understand their obligation.

Wellness incentives, employers are using wellness programs to a greater extent to help both reduce the healthcare trends and also to make sure their employees are healthy and wellness incentives were codified—sorry, were addressed in regulation by HIPAA almost 20 years ago and it was codified by Congress in the ACA, and employers just want to make sure that as we move forward with wellness programs, that they are supported as a way for employers to continue to encourage their employees to become healthier.

I think those would be two of the more significant.

Mr. LEWIS. Thank you very much.

Mr. Hodge, I am somewhat curious and maybe I just want to know. You seem to be saying by the IRS helping to carry out the mandate of the Affordable Care Act, that it is helping to expand the welfare state and I want to be sure that we are reading from the same page.

Could you just tell me what is the welfare state?

Mr. HODGE. I would include all of the means-tested type safety net programs in addition to all—many entitlement programs that are generally administered through HHS and so forth, and the IRS has now become an integral part of many of those welfare type programs, broadly stated, and so, yes, it is an integral part of the welfare state in providing basic assistance to people through things like the Earned Income Tax Credit and other sorts of refundable credits.

Mr. LEWIS. And do you think that is a good thing or——

Mr. HODGE. I think it is a very bad thing actually. I do not think it is a role for the IRS to play in that. I think for the IRS to be handing out now over $100 billion worth of refundable credits is a very bad trend.

Mr. LEWIS. Well, who should play that role? What agency of the government should play that role? It is a necessary role for someone to play. Who should play that role?

Mr. HODGE. Well, it is already being played in other areas of the government. For instance, HHS is providing that role through its assistance programs and now we have it duplicated through the Tax Code and I think that we ought to have agencies that specialize in it keep to their core missions.

Mr. LEWIS. Would other Members of the panel like to respond? Mr. Goldberg.

Mr. GOLDBERG. Mr. Lewis, I—my first presidential appointment was from Ronald Reagan. My second presidential appointment and third were from the first President George Bush. Each of those presidents supported increases in the Earned Income Tax Credit. The intellectual birth of the Earned Income Tax Credit is Milton Friedman.

The IRS is the most efficient delivery of these kinds of incentives in the world. It doesn't regulate. It doesn't dictate behavior. It simply administers a pricing system. One would think that conservatives are particularly enamored, as am I, of pricing systems. The code is about our values. It is about homeownership. It is about education. It is about thrift. It is about education. It is about health. And abstract notions to get rid of all of that, I believe, are stillborn.

So I think the IRS is doing a terrific job. It is a job that was charged with by each of my bosses, President Reagan and President Bush, and I think they do it very well.

Thank you very much.

Mr. LEWIS. Thank you, Mr. Goldberg.

Madam Chair, I yield back.

Mrs. BLACK. Thank you, Mr. Lewis.

And now, Ms. Jenkins, you are recognized for 5 minutes.

Ms. JENKINS. Thank you, Madam Chair. Thank you all for being here.

Ms. Pickering, in your testimony you noted that the vastly different missions of the Department of Health and Human Services and the Internal Revenue Service has the potential to create taxpayer confusion and unexpected debt, tax debts, as a result of overpayments of subsidies. For example, according to HHS regs, a taxpayer does not have to file a tax return to substantiate their income level; however, the IRS will require a tax return to reconcile the advanced premium tax credit.

Can you just elaborate on the consequences of having two different standards and what recommendations would you have to ensure that taxpayers do not receive an unpleasant surprise because they improperly estimated their income?

Ms. PICKERING. Thanks for that question.

We certainly, on the frontline as we are serving our clients, see from a very real and practical experience the challenges that individuals have in navigating the complex tax laws. What we are par-

ticularly concerned about with regards to, you know, the HHS having much looser documentation requirements for establishing income and eligibility, the HHS in their mission is motivated and incented to help everyone gain health coverage and the IRS is incented to collect taxes and reconcile that premium, and so for that, we are afraid that with different standards and different confusing information, and certainly as this is a new regulation being rolled out, we will see that there are many taxpayers that have not recently or ever been required to file their taxes will now have to enter into the tax system to file their taxes to reconcile that premium and that is going to cause some frustration, some surprises, and put people into a situation where they have a tax liability through no fault of their own, certainly not through, you know, bad intentions. They just didn't understand the regulations, estimated things incorrectly, and now find themselves owing money.

Ms. JENKINS. Okay. Thank you. That helps.

From my understanding, current law requires that if a taxpayer's circumstances change during the year, whether it is due to good news, like a new job or a raise, or because they lost their job, the taxpayer's responsible for updating their information with the exchange, potentially resulting in a large overpayment or underpayment if not timely reported. The taxpayer advocate has warned taxpayers who do not update their household information during the year may find that they owe a significant amount of money at the end of the year, money they likely do not have.

Maybe, Mr. Goldberg, each of you could comment and describe how this requirement to provide notice and the IRS reconciliation process works from this perspective of just everyday taxpayers.

Mr. GOLDBERG. Sure, Ms. Jenkins.

Let me comment very briefly on your prior question.

Ms. JENKINS. Sure.

Mr. GOLDBERG. I believe that the issue of forcing people to file tax returns may be less than is generally estimated. Because of the way the Affordable Care Act is structured, I believe virtually all of—a very, very large percentage of those folks will receive health coverage through Medicaid rather than on the exchanges. There will be some exceptions and it is going to be a problem.

Stepping back, I think that we have decided to run this through the exchanges. I believe, frankly, that was a political decision because people didn't want to call it a tax. That creates a wholly unnecessary intermediary dealing with all of the information you are talking about. They don't know how to do it. Mrs. Black, as you alluded to, it raises serious confidentiality and privacy—and it is just not necessary. The H&R Blocks of the world, the advisors of the world, the churches, the nonexempt or tax-exempt organizations, the IRS, I believe will do a credible job of educating employees and purchasers on the exchanges generally how the rules work.

If you simply let the family go in and say, "Gee, I got a raise, I want to change my premium," which families are perfectly capable of doing, it will work fine. If you say, "You have to fill out three forms and talk with four different government employees, getting passed from phone to phone before you can make the change," they are just not going to do it.

So my recommendation is you trust the individuals and families to make that decision working with advisors, working with providers, and you will significantly reduce that problem and I believe the IRS, properly instructed by this Committee, will be reasonable in dealing with the transition, but as it is structured, it is just a bureaucratic mess.

Ms. JENKINS. Okay. Fair enough.

Madam Chair, I yield back.

Mrs. BLACK. Thank you, Ms. Jenkins.

And Mr. Becerra, you are recognized for 5 minutes.

Mr. BECERRA. Thank you, Madam Chair, and thank you all for your testimony. By the way, thanks for being patient with us as we went out to commemorate 9/11.

You know, I would agree with anyone who is willing to say that any time you do something big, especially in a big place like America, it is going to take a little time to adjust.

And, Mr. Goldberg, can I just say to you thank you for your constructive comments. We could be critical or critique, but at the same time, what we are hoping to do is have a functional government, and I appreciate where you point out where IRS can do better and where it is doing the best it can and I agree with you. There aren't too many governments in the world that can say they have as efficient a system as we do. We still have to figure out how we collect on that tax gap that we got, but I got to believe that men and women who work in the IRS, who oftentimes get a lot of heartburn for what they do, are trying to do the best job they can, especially the folks that are out there trying to do the enforcement, you know, trying to find the folks who are trying to evade paying their fair share of taxes.

So I am going to be the last one that is going to sound like Scrooge and say that as we try to expand healthcare to 33 million Americans who had a heck of a time trying to afford it, that we should try to go backward because the reality is it is not just about trying to help 33 million Americans and their families to get health insurance, quality, affordable health insurance for the first time. Actually, a lot more is at stake. There are over 100 million Americans who, beginning 2014, will never have to worry about a preexisting condition again. They all have the security of knowing that they are going to keep their insurance, and as we try to administer this program, whether through the IRS or HHS, who cares, we are trying to do something to help folks.

At the end of the day, as Mr. Goldberg, I think you said, it is trying to make sure that government works for people, whether it is the IRS or any other agency, and my sense is that if we all work together, we can make this happen.

Mr. Hodge, I am concerned when I hear people say that the IRS is taking on way too many things. It should go back to its—I think you said something to the effect of it should go back to its core responsibilities. I don't disagree with that except that the IRS helps people save money. Should the IRS stop providing assistance through these provisions that help people save money by encouraging them to do so and getting a tax break by doing so? Should the IRS not do that?

Mr. HODGE. There are certain elements of the Tax Code that should be in place. We should not be taxing savings. So I don't consider that a "tax break." It should——

Mr. BECERRA. But we do tax it. We do tax benefits/gains that are made, people's income, and what we do is we give people a chance to not have all their income taxed if they save some of it.

So should we not provide folks with that type of a tax credit or a tax deduction through the code?

Mr. HODGE. We have gone way beyond that into——

Mr. BECERRA. No, I know we have. I agree with that, but——

Mr. HODGE.—now giving credits for replacing the windows of their home and buying an electric car and putting their kids in daycare and so forth, and so——

Mr. BECERRA. Right. So should we return to, as you say, the core mission of simply collecting the necessary amount of tax revenues the government?

Mr. HODGE. That is right.

Mr. BECERRA. Okay. So then we shouldn't provide—encourage people, through a tax credit or a tax deduction, encourage them to save more money? We shouldn't encourage them through the homeowner's mortgage interest deduction, an incentive to purchase a home. We shouldn't provide them with a tax credit to save money to prepare to send their kids to college.

Those are not core missions of the IRS, and from what I gather from your testimony, we are simply pure and have the IRS collect the revenues that the government needs. There are a whole bunch of Americans who would have a tougher time buying a home, saving for their kids' college education or even saving for their own retirement, and I understand what you are saying. The further away you get from your core responsibility, the more chance that there is mischief or a mistake, but I got to believe that only Scrooge would say don't try to package that present for that little child on Christmas Day.

There are things that we try to do to make life better. Don't always get them right, but, as I think Mr. Goldberg was just saying, if we try to focus on doing it right, then there is a good chance that we are going to be helping a lot of Americans and in a bill that has become law, historic legislation, that now will extend protections against discrimination on preexisting condition in healthcare to 150 million Americans or so, to extend coverage to 33 million American families now. I hope that what we do is just work together, figure out how we can help the IRS make sure it doesn't make mistakes and does it right so that when Christmas comes, everyone gets what they deserve.

With that, Madam Chair, I will yield back the balance of my time.

Mrs. BLACK. Thank you, Mr. Becerra.

And Mr. Marchant, you are recognized for 5 minutes.

Mr. MARCHANT. Thank you, Madam Chair.

When I held my town hall meetings this last break, Bedford, Texas comes to mind, the crowds pretty consistently stood and delivered one message. Please simplify the Tax Code. Please make it to where the IRS does not have as much involvement in our lives. Pretty simple message from my constituents.

When I got the briefing paper for this hearing today, which was a very good briefing paper, I was taken aback by the exact opposite. When the Affordable Healthcare Act comes into effect, the IRS is going to be even more involved in our lives. The IRS is going to be a bigger part of everybody's tax return, and in fact, in my opinion, people that have been doing their own taxes may now have to consult with someone and pay someone to help, and in my mind, we are going exactly the opposite direction.

Yes, 33 million people theoretically will become—have access to healthcare, but 300 million people are possibly impacted by the process that we have put in place to bring about that change.

Mr. Hodge, Deputy Commissioner Miller suggested that the process of taxpayers updating government officials about the details, the intimate details, of their personal and family lives had really nothing to do with the IRS. It was just going to be a simple calculation, a simple you fill out your return and based on what you put on the return, that was going to be the extent of the IRS's involvement. Do you have anything to say about that?

Mr. HODGE. Well, it looks very clear, as I understand the legislation, and especially from what Mr. Goldberg and Ms. Pickering has said, the IRS will be immediately and very—and intimately involved in that, and if I read the briefing from the Joint Committee on Taxation summary of the ACA, it says very clearly that any adjustment to tax resulting from the difference between the advanced premium assistance and the allowable refundable tax credit would be assessed as an additional tax or a reduction in tax on the tax return. In many aspects, this will be like the Alternative Minimum Tax where it is sort of an accidental thing that people fall into when they actually fill out their tax return. It is very difficult for them to adjust their withholding in such a manner as to anticipate this situation. So they are going to be caught in this bureaucratic quagmire between HHS and the exchanges, which could make a mistake, and their own changes and their own situation, and then the IRS that has to rectify these.

It is—I feel sorry for folks that are going to get caught up in this and they will end up on April 15th realizing a tax burden that they may not have seen coming and that is pretty frightening.

Mr. MARCHANT. Mr. Goldberg, do you see—you made the comment earlier that business and individuals are very responsive to the Tax Code and they will sit down, they will figure it out. Do you see the opportunities for additional tax avoidance in the way these forms are filled out or do you see people's behavior being altered? Do you see them sitting down with their accountant saying, "Okay, we may have filed this way before, but because of the new rules, we are going to decide to file this way?" And, in fact, the Alternative Minimum Tax is an excellent example from my district because that's the number one thing in the Tax Code that catches my constituents.

Will it alter the behavior of taxpayers?

Mr. GOLDBERG. Yes, sir, I believe that it is a certainty. For example, if you have a young kid off on his or her own who is healthy, someone, I guarantee you, will tell her, "You can either pay $400 to the IRS or you can pay $3,000 to the exchange or you can wait and when you get sick, you can buy an insurance policy

because there is no preexisting conditions. So you can save 2,600 bucks a year till you get sick." That is going to happen for sure.

So, yes, of course, and I think that is just human nature. That is—I mean you see nothing but human nature if you are running the IRS, better and worse.

The important point I think that Congress needs to keep in mind is if you say you want to maintain private markets for health insurance and if you say I want to subsidize the cost of insurance for those who have difficulty paying, you have just said I want some form of phased-out credit. That is what you have just said, otherwise you can give everybody $25,000 and tell everybody to go buy insurance and tax it at the back end. That would actually work, but otherwise, you are stuck with this question.

I personally think the structure of the Ryan proposal, setting aside the numbers, in many ways is a terrific structure. It was first supported by President Clinton, but it has the same question. How are you going to get progressive, subsidized subsidies from the government to buy health insurance? See, you got the same question any way you go. You got the same issues, and I believe the choice is very simple. For all of its problems, you either let the IRS administer those kinds of progressive credits or you get somebody else to do it, and I think it is a more prudent choice to let the IRS do it, but you can't avoid the choice. You go to single-payer, you avoid the choice, but otherwise, I think you are stuck with it.

You are absolutely right about the behavior. The Tax Code today is grotesque. It is repulsive. It is so unneedlessly complex (sic). In terms of issues, your colleague across the capitol, Senator Coburn, is a profile in courage for calling out some of the needless subsidies provided by the Tax Code. You guys could do a terrific job to strip it down. Healthcare, progressive subsidies, phased-out credit, you are stuck where you are, whether it is Congressman Ryan or whether it is the Affordable Care Act. That's what I——

Mrs. BLACK. And thank you, Mr. Goldberg. The time is expired. Thank you, Mr. Marchant.

And I think, barring anyone else walking in the door, it looks like we are at the end, and I just want to go back to a question that I asked to the previous panel, Mr. Miller, related to the amount of information that is going to be in so many different places having to do with the taxpayer's personal information so much more than we have ever known before and that is a real concern for me.

I mean obviously right now the IRS does share some of this data with Child Support, some with Medicaid, and maybe some other cases of revenue collection, but now we are going to see it much broader. We are going to see it where the exchange employees with vast amounts of information that they haven't previously been privy to, and I want to know from your perspective, each of you, if you have the same concern that I have, especially given the fact, as I said in the previous panel, that what we have seen in this Committee, as we have had the IRS hearings, that we know that there is fraud out there. There are people who have gotten refunds that didn't belong to them, and are—do you have a concern about where we are going with this?

Mr. Goldberg, I want to start out with you and if we can just go down the panel, that would be great.

Mr. GOLDBERG. Yes, I share the concern. It is one of the greatest concerns about the Affordable Care Act. The easiest solution is to take the exchanges out of that business.

Mrs. BLACK. Thank you.

Ms. PICKERING. Yes, I share that concern as well. We know that the IRS works very hard to protect taxpayer information. In working with HHS and the exchanges now, there is going to be a broader exchange of information, and while I believe everyone works to the—you know, to the best of their ability with the best intentions, there is just so much more opportunity and the fraudsters and the criminals are getting so much more clever in their ability to propagate these fraud schemes. So I think there is exposure and vulnerability.

Mrs. BLACK. Thank you.

Mr. Hodge.

Mr. HODGE. Yeah, I too share that and I am sure every taxpayer fears their information getting out. They do so when they fill out a credit card application, a health plan. Everything is now accessible to these hackers and I would think everyone would worry that the more you disseminate this kind of information, personal information, the more vulnerable it is to that kind of mischief.

Mr. PERRETTA. Thank you. I certainly support the comments of my fellow panelists here.

I can't help but say a couple things from the perspective of the Council, which is employers are obviously very focused on employee privacy and, you know, one of the issues that employers were concerned about was the issue of having to figure out whether their health coverage was affordable because that is relevant to figuring out whether the employer has to pay a penalty, and most employers don't know what their employees' household income is and most employees don't want to tell their employers what the household income is, and thankfully the IRS listened to the Council and the employer community and they came up with the Safe Harbor Rule, which lets employers base affordability on the employee's W-2 wage, which is something that the employer will know, and so it does go a little bit to your point, Chairwoman, about the issue of privacy.

Another issue I do want to touch on while I have your attention is the issue of notice and disclosure and this goes a little bit to the issue of flowing of information from parties, and I think employers, both small and large, are obviously concerned about the burdens that are going to fall upon them in terms of having to transmit, collect, store information as part of their obligations under the ACA and I think as the IRS moves forward, they have been very thoughtful in reaching out to us to understand sort of what our concerns are, but that is obviously an area where working closely with the employer community would be helpful since the employers will bear a significant piece of that burden in making sure that information flows in the right way.

Mrs. BLACK. Thank you.

Ms. Pickering, I have one additional question, one final question for you, and this goes back to the comment that you made both

here and also in your written testimony about the concerns as preparers and getting your—the folks that work for you educated on what they are going to have to be doing as far as the rules go and I would like for you just to expound a little bit about how if we don't get those final rules in a timely manner, how this is really going to affect those who will be preparing those taxes for folks/the clients that you will be seeing?

Ms. PICKERING. We have got a number of factors going on there. The Registered Tax Return Preparer Initiative is a very important initiative for getting all professional tax preparers registered with the IRS and up to—you know, up to standard competency levels. This is something that we have always supported. We think it is important for the professionalism of the industry, and in there, there is a continuing education requirement as well which says that preparers need to stay current on tax law.

Now, as the ACA is rolling out as well, our clients will be coming to us looking forward to some additional understanding at least a minimum what are the tax implications to them with regards to the healthcare implementation and it is very important to have timely regulations so that all of that can be incorporated into the training plans and getting people prepared.

So the timing of these things is critical and it is, you know, certainly a daunting task, but one that we look forward to partnering with the IRS on.

Mrs. BLACK. Well, thank you.

Mr. PERRETTA. Could I just add a follow-up comment?

Mrs. BLACK. Yes.

Mr. PERRETTA. Just to the idea that—going on that point, employers are often pricing their health insurance coverage 12 to 14 months in advance.

Mrs. BLACK. That is right.

Mr. PERRETTA. And so when you think about having coverage in effect for 2014, many employers are beginning to fashion that coverage and make decisions about what that is going to look like, what their subsidies are going to be, and obviously playing on that point about the timely information, really the sooner the regulations can come out, obviously with opportunity for notice and comment, the better.

Mrs. BLACK. Absolutely, and I know I am also hearing this from the insurance industry as well. Everybody's waiting for those final rules and regulations, almost that they need them yesterday in order to be able to give advice to their clients or those that are buying the product.

Once again, I want to say thank you to the panel for your patience today and thank you for all of the good information that you provided to us.

This hearing is completed.

[Whereupon, at 12:20 p.m., the Subcommittee was adjourned.]

[Submissions for the Record follow:]

Timothy Stoltzfus Jost

House Committee on Ways and Means

The Internal Revenue Service's Implementation and Administration of the Democrat's Health Care Law

Testimony of Timothy Stoltzfus Jost
Professor, Washington and Lee University School of Law

Submitted for myself and not for any organization

1370 Lincolnshire Drive
Harrisonburg, Va. 28802
540 564 2524
jostt@wlu.edu

House Committee on Ways and Means

The Internal Revenue Service's Implementation and Administration of the Democrat's Health Care Law

Testimony of Timothy Stoltzfus Jost

In a little more than a year, millions of uninsured Americans will begin enrolling in health insurance plans through the American Health Benefits Exchanges. These Americans—your constituents—will be able to purchase health insurance because of the availability of premium tax credits. At this point, it appears that many states are choosing not to create their own exchanges in 2014, but rather to have their citizens purchase health insurance through federally facilitated exchanges. It is essential that these uninsured Americans be able to receive premium tax credits through these federal exchanges. My testimony addresses the provisions of the Affordable Care Act that will make it possible for this to happen.

My name is Timothy Stoltzfus Jost and I am a law professor at Washington and Lee University. I am also a consumer representative to the National Association of Insurance Commissioners and an elected member of the Institute of Medicine. I have written extensively about the Affordable Care Act, and blog regularly about Affordable Care Act implementation at www.healthaffairs.org/blog.

My remarks today address assertions by Michael Cannon of the CATO institute that the Department of the Treasury's rule providing for the federal exchange to issue tax credits is not authorized by the Affordable Care Act. This assertion has been widely publicized and seems to be causing confusion among state lawmakers. Mr. Cannon's position, however, is based on a misunderstanding of the law, its structure, and history, as I will explain.

The Affordable Care Act Exchanges and Premium Tax Credits

To understand this issue it is necessary to understand the role of the exchange in the Affordable Care Act. The American Health Benefits Exchange is fundamentally a market in which health insurance is bought and sold. The exchange is also responsible for ensuring that insurers who sell their products through the exchange meet certain minimum standards to ensure that individuals and small employers who purchase in the exchange are getting value for their dollar. Finally, the exchange is the gateway to federal premium tax credits, Medicaid, and other assistance programs for those unable to afford health insurance. The exchange concept has until very recently enjoyed broad bipartisan support as a tool for making private sector health insurance widely available and affordable to Americans. Indeed, Congressman and Vice President nominee Paul Ryan's Roadmap for America includes health insurance exchanges.

Section 1311 of the Affordable Care Act asks the states to establish American Health Benefits Exchanges. The federal government cannot order a state to operate a federal regulatory program, so section 1321 of the ACA authorizes the Secretary of Health and Human Services to establish a federally facilitated exchange in states that choose not to establish their own exchange.

Mr. Cannon takes the position that federal exchanges cannot offer premium tax credits. He bases this opinion on two subsections of section 36B of the Internal Revenue Code (created by section 1401 of the ACA), which provides for tax credits to help middle-income Americans afford health insurance. In defining the premium tax credit amount and the coverage months for which it is available, sections 36B(b)(2) and 36B(c)(2)(A) refer to persons "enrolled in [a qualified health plan] through an Exchange established by the State under section 1311." Mr. Cannon argues that this language precludes premium tax credits being issued through the exchanges operated in the states by the federal government. If this is true, it is likely that many—perhaps most--Americans will be denied access to an important middle-class tax benefit in 2014, as it now appears that many states will, at least initially, have federally facilitated exchanges.

In a recent article, Mr. Cannon, together with Professor Jonathan Adler of Case Western University, claims that this language is not only unambiguous but also intentional, that Congress intended to punish states that refused to establish exchanges by refusing premium tax credits to their residents.[1] Cannon and Adler further claim that final rules promulgated by the IRS making premium tax credits available through federal as well as state exchanges are unauthorized by law, and thus illegal.

If this claim is true, uninsured constituents of members of this committee stand to lose billions of dollars in federal tax relief that would have assisted them in purchasing health insurance.

The Affordable Care Act Explicitly Authorizes Federal Exchanges to Provide Premium Tax Credits

Fortunately for your constituents, Mr. Cannon's claims are simply not true. If the sections that he cites were the only relevant sections of the Affordable Care Act, and if the legislative history and structure of the ACA could be simply ignored, his statutory construction claim would be plausible. But the availability of tax credits through federally facilitated exchanges is recognized through the language of the ACA itself. Moreover, the legislative history of the ACA also establishes that Congress understood that premium tax credits would be available through both federal and state exchanges. The IRS is explicitly authorized by Congress to interpret the statute and its interpretation of the law will be given deference by the courts. The existence of exchanges in every state was assumed both by the Congressional Budget Office and by both proponents and opponents of the ACA as it was being debated. Finally, the structure and purpose of the ACA requires that state or federal exchanges offer premium tax credits in every state.

I begin with the language of the ACA itself. The term "exchange" is a defined term under the ACA, a point that Mr. Cannon does not mention in his article but that would surely be paid great attention by the courts. Section 1563(b) of the ACA states: "The term 'Exchange' means an American Health Benefit Exchange established under section 1311 of the Patient Protection and Affordable Care Act." Section 1311 literally requires that the states "shall" establish an American Health Benefits Exchange by January 1, 2014. Because the Constitution prohibits the federal government from literally requiring states to establish exchanges, however, section 1321(c), provides that "the [HHS] Secretary shall (directly or through agreement with a not-for-profit entity) establish and operate *such* Exchange within the State." Under the ACA's definition of exchange, the term "Exchange" in section 1321 means a section 1311 exchange. This is reinforced by section 1321 itself, in which the term "such Exchange," refers to the "required exchange" mentioned in section 1321(c)(1)(B)(i), which is to say the 1311 exchange. When section 1321 directs HHS to establish an "Exchange," therefore, it means to establish a section 1311 exchange, which section 36B authorizes to provide premium tax credits. Moreover, section 1311(d)(1) defines an exchange as an exchange established by the state, therefore by definition a section 1321 federally facilitated exchange is an exchange established by a state under section 1311.

Section 36B is not the only section of the ACA that imposes duties on the state and federal exchanges relevant to premium tax credits. Section 1311(d)(4)(G) requires exchanges to provide their enrollees with premium calculators that include a deduction for premium tax credits. Section 1311(d)(4)(I), requires exchanges to forward to the IRS information about enrollees who are eligible for premium subsidies. Section 1311(d)(4)(J), requires an exchange to notify employers if their employees are receiving premium tax credits. Finally, section 1413 requires state and federal exchanges to use streamlined applications and eligibility assessments to help people qualify for "health subsidy programs," which programs specifically include premium tax credits, see section 1413(e)(1). All of these sections apply to federal as well as state exchanges.

Most importantly, a third subsection of section 36B itself clarifies that premium tax credits are available through both state and federal exchanges. The ACA is composed of the Senate version of the Patient Protection and Affordable Care Act, Public Law 111-148, and the Health Care and Education Reconciliation Act, Public Law 111-152. The Senate adopted the bill that became Public Law 111-148 in December of 2009, but the House adopted it only in March of 2010. Shortly thereafter, the House and Senate adopted HCERA, through which the House made certain changes in the Senate bill. As a later-adopted statute, HCERA takes precedence over that of the PPACA, if there is a contradiction. Moreover, since the adoption of HCERA was necessary to secure House adoption of the Senate bill, it is doubly important that the provisions of HCERA be taken seriously. The House bill contained only a federal exchange. Section 1004 of HCERA adds to IRC section 36B, subsection 36B(f)(3) which requires both 1311 and 1321 exchanges to provide certain information regarding premium tax credits to the IRS and to taxpayers. Cannon and Adler admit the existence of this provision but simply say it is meaningless, as 1321 exchanges cannot authorize premium tax credits. This position,

however, violates another canon of statutory construction—that every provision of a congressional enactment should be given effect.

It should be noted that several other sections of the ACA use the language on which Mr. Cannon relies--"an Exchange established by the State under section 1311." One of them is section 2001, which prohibits states from reducing Medicaid eligibility until an exchange "Established by the State under section 1311" is operational." If Mr. Cannon's interpretation of the ACA is correct, states that decide not to establish a state exchange will be barred indefinitely from changing their Medicaid eligibility requirements. But this is not what the law means.

The Affordable Care Act's Legislative History also establishes that Federal Exchanges can offer Premium Tax Credits

Mr. Cannon's interpretation of the ACA is also refuted by the legislative history of the ACA. The Senate bill which became the ACA was derived from the S 1679,[2] the Senate Health, Education, Labor and Pensions Committee bill and S 1796[3] which emerged later from the Senate Finance Committee. Each of these bills included state and federal exchanges, which were called Gateways in the HELP bill.

The HELP bill (section 142, adding section 3104 of the Public Health Services Act) created an elaborate structure under which states could either establish exchanges themselves ("establishing states"), request the federal government to establish an exchange in the states ("participating states"), or fail to do either, in which case four years after the enactment of the statue the federal government would create a fallback exchange in the state. Premium tax credits were available in establishing and participating states, but would only be available through the federal fallback exchanges in states that complied with the employer responsibility provisions for state and local employees. In other words, the states were threatened with loss of premium tax credits, not for failing to establish exchanges but for not complying with the employer responsibility provisions for their employees.

The Finance Committee bill did not use this elaborate structure. In fact, the rules it creates are very similar to the final ACA. It creates section 2235 of the Social Security Act, which provides that states "shall" establish an exchange, and sets out the duties of the exchange. Section 2225(b) provides, in language very similar to current ACA section 1321, that HHS shall contract with a nongovernmental entity to operate an exchange in states that fail to "establish and operate" an exchange in states that fail to create one within 24 months. The Finance Committee Report[4] refers to these federally established exchanges as "state exchanges." In a number of places, including the precursor of the current premium tax credit provision, the bill refers to exchanges "established by the state," but nowhere does it provide, as did the HELP bill, that premium tax credits would not be available in the any of the exchanges created by the federal government.

The provisions of the current ACA addressing this issue are taken largely from the Finance Committee bill, which makes sense because the Finance Committee has jurisdiction over tax matters. The punitive provisions of the HELP bill were abandoned.

The Senate debated the ACA extensively during November and December 2009. The version of the Act they were considering included both state and federal Exchanges. Throughout the debate, Senators assumed that tax credits would be available in all 50 states. Thus Senator Bingaman stated on December 4, 2009, that the ACA "includes creation of a new health insurance exchange in each State which will provide Americans a centralized source of meaningful private insurance as well as refundable premium tax credits to ensure that coverage is affordable."[5] Senator Johnson stated on December 17, "the legislation will also form health insurance exchanges in every State," which will "provide tax credits to significantly reduce the cost of purchasing that [insurance] coverage."[6]

If Congress had meant to limit premium subsidies to state-established exchanges, as an incentive to States, one would have expected the Finance Committee report on S. 1796 to have mentioned this, and for at least one Senator to have pointed this out during the debate in November and December 2009.

Most importantly, the Congressional Budget Office (together with the Joint Committee on Taxation) provided Congress on November 30, 2009, with an analysis of the impact of the legislation on premiums that assumed that premium tax credits would be available in all states, making no distinction between federal and state exchanges.[7] Over the next few days this analysis was discussed by Republican Senators Grassley,[8] Enzi,[9] and Coburn.[10] None raised what Cannon and Adler see as an obvious point—that the CBO analysis was flawed because it failed to recognize that premium tax credits would not be available though federally facilitated (sec. 1321) exchanges. In fact, the CBO repeatedly provided cost estimates of the ACA and HCERA in late 2009 and early 2010, but never suggested that premium tax credits might be reduced if states failed to establish exchanges. In their most recent report from two weeks ago updating ACA coverage estimates in the wake of the Supreme Court decision, the CBO and JCT reiterates again that premium tax credits will be available though state, federal, and partnership exchanges.[11] As Yale Professor Abbe Gluck notes in a recent blogpost[12] (and forthcoming article), Senators often don't listen to each other, but they all listen to the CBO, which assumed that premium tax credits would be available to all Americans in all states.

Mr. Cannon claims, however, to have found a smoking gun, a colloquy between Senators Baucus and Ensign during the Finance Committee debate on the bill, in which, they claim, Senator Baucus admits that premium tax credits could not be made available through federal exchanges. In fact, the colloquy had nothing to do with federally facilitated exchanges, but rather with whether the Finance Committee or the Judiciary Committee had jurisdiction over malpractice reform legislation that Ensign wanted to attach to the bill. In fact, there is nothing in the legislative history of the ACA that

supports the notion that premium tax credits will not be available through federal exchanges.

Mr. Cannon argues that Congress prohibited the federal exchanges from offering premium tax credits as a way of encouraging the states to adopt exchanges. It is in fact clear that Congress favored state exchanges, and offered generous grants to the states—which to date have totaled nearly $850 million dollars with more on the way.[13] States that fail to establish exchanges will also lose some control of their insurance markets. But Congress did not try to "coerce" states to create state exchanges by threatening their citizens with loss of billions of dollars of premium tax credits. Indeed, under the Supreme Court's recent Medicaid decision, such coercion might have been suspect.

The Structure of the Affordable Care Act Makes it Clear that Federal Exchanges may offer Premium Tax Credits

Moreover, not only do a number of provisions of the ACA, already described, refer explicitly to federal and state exchanges performing functions relating to premium tax credits, but the entire structure of the ACA's insurance reforms are based on the availability of premium tax credits in all states, The ACA's guaranteed issue and community rating requirements apply to insurers in all states, regardless of whether they have federal or state exchanges. So do the ACA's risk mitigation programs. So does the ACA's individual mandate. The premium tax credits are intended to bring millions of new participants into insurance markets, and if they are not available in many states, the nature of insurance markets will change dramatically, increasing the risk of insurers and decreasing availability to middle-income Americans. If this was the intent of Congress, it surely would have made it far more evident.

The ACA is admittedly not a model of clear drafting. It contains three sections with the same number (1563) and amends an existing provision of the Public Health Services Act inconsistently twice within the scope of a few pages. The Senate bill was not supposed to be the final law. Only Senate the election in Massachusetts in early 2010 made a conference committee bill that would have reconciled the House and Senate versions and cleaned up the current bill impossible. The courts are unlikely to find the "established by the state" language a "scrivener's error." But the courts will interpret the ambiguous language in the context of the ACA's structure and purpose, in light of the ACA's legislative history, and putting great weight on the HCERA amendment, and find that federally facilitated exchanges can in fact issue premium tax credits.

The Department of the Treasury is Authorized to Interpret Section 36B and the Courts will Defer to its Interpretation

Finally, the courts are likely to grant great deference to the IRS premium tax credit regulation. Section 36B explicitly grants authority to the IRS to interpret the section. A recent CRS Legal Analysis of this issue states clearly that under the ruling "Chevron doctrine," derived from the case of Chevron v. NRDC,[14] courts will defer to the

interpretation of the IRS of section 36B unless they conclude that "Congress has spoken to the precise question at issue." As should by now be amply clear, Congress has not clearly said that federal exchanges cannot grant premium tax credits. If a court finds the issue ambiguous, however, "the question for the court is whether the agency's answer is based on a permissible construction of the statute." In this situation, "legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." As noted above, the interpretation of the ACA by the IRS is completely consistent with rather than "manifestly contrary" to the statute, and thus will be granted judicial deference.

Conclusion

In 2014, millions of your constituents will gain access to private health insurance coverage with assistance with premium tax credits. It was the hope of Congress and remains the hope of the federal agencies implementing the ACA that they will receive these premium tax credits through state exchanges. But the ACA also created fallback federal exchanges, which will be available in states represented by other members of this Committee to ensure that all Americans get access to affordable health insurance. The Department of the Treasury has correctly determined based on the language and history of the ACA that premium tax credits will be available through all exchanges, state and federally facilitated. None of your constituents will be denied the tax credits made available through the ACA to ensure them access to affordable health insurance. I thank you for the opportunity to address this important issue.

References

[1] Jonathan Adler and Michael Cannon, Taxation without Representation: The Illegal IRS Rule to Expand Tax Credits Under the PPACA (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2106789
[2] S 1679, http://www.govtrack.us/congress/bills/111/s1679/text
[3] S 1796, http://thomas.loc.gov/cgi-bin/query/z?c111:S.1796:/
[4] Senate Report 111-89
[5] 155 Cong. Rec. S12358.
[6] 155 Cong. Rec. S13375.
[7] CBO, An Analysis of Health Insurance Premiums Under the Affordable Care Act, http://www.cbo.gov/publication/41792
[8] 155 Cong. Rec. S12107, 12/2/09
[9] 155 Cong. Rec. S12378, 12/4/09
[10] 155 Cong. Rec. S13687
[11] http://www.cbo.gov/sites/default/files/cbofiles/attachments/43472-07-24-2012-CoverageEstimates.pdf at n. 14.
[12] http://balkin.blogspot.com/2012/07/cbo-canon-and-debate-over-tax-credits.html,
[13] http://statehealthfacts.kff.org/comparetable.jsp?ind=954&cat=17
[14] 467 U.S. 837 (1984).

William G. Schiffbauer

BNA, INC.

HEALTH PLAN & PROVIDER

BNA Employee-Owned Since 1947

REPORT

No Good Deed Goes Unpunished: Enforcing an Individual Health Insurance Mandate

BY WILLIAM G. SCHIFFBAUER, ESQ.

Pending federal health insurance reform legislation appears set on a course to adopt an individual mandate requiring the purchase of health insurance that would be enforced through the federal income tax system. Similar proposals were considered in the mid-1990's during the 103rd Congress in connection with health care reform legislation.

At that time, it was considered "an unprecedented form of federal action" to transform a voluntary private transaction into a requirement for people to buy any good or service as a condition of lawful residence in the United States. See CBO Memorandum, *The Budgetary Treatment of An Individual Mandate to Buy Health Insurance* (August 1994).

In 2007, Massachusetts began phasing in a mandate that all adult residents have "affordable" health insurance. Beginning in 2008, a financial penalty is assessed for each month that a Massachusetts resident is not covered. In its report entitled *Key Issues in Analyzing Major Health Insurance Proposals* (December 2008), the CBO notes that "it is still too soon to evaluate the full effect of the mandate in Massachusetts."

CBO also notes that a recent study did not attempt to isolate the effects of the mandate on the rate of the uninsured from other aspects of the state's health reform initiative including insurance market reforms and new premium subsidies for lower-income individuals and families.

Schiffbauer is a health care attorney in private practice in Washington. He is a member of the Advisory Board for BNA's Health Plan & Provider Report. *He can be contacted at wgslaw@erols.com.*

Enforcing an Individual Mandate

A mandate is only as good and effective as is its enforcement mechanism. There is limited experience or guidance with an individual health insurance mandate that is enforced through the federal individual income tax system. A federal mandate would impact everyone, not just the uninsured.

Much of the administrative burden of compliance would fall upon individuals who already have health insurance and who will be required to prove that they are in compliance with the mandate. It would also be complicated and poses significant challenges because: the income tax compliance system operates retrospectively and not all of the uninsured are participants in the income tax filing system. These challenges are discussed below.

The Insured Must Prove Compliance

Individuals who currently have health insurance may not be fully aware that the individual mandate would require them to prove that they have coverage in compliance with the requirement. Everyone will be required to prove that they are in compliance with a federal health insurance mandate.

The administrative burdens of compliance would not be invisible to those who have done the "good deed" and voluntarily purchased health insurance. This compliance burden may come as a surprise. Taxpayers will experience additional filing burdens and increased complexity of an income tax based enforcement mecha-

 ISSN 1528-2953

nism for a health insurance mandate which will be borne by individuals who already have health insurance and those ''compelled'' to have coverage.

Enforcement Model. The Commonwealth of Massachusetts is the only jurisdiction in the United States to require the individual purchase of health insurance and to enforce this mandate through its income tax system. Accordingly, the state's income tax-based enforcement mechanism is a likely ''model'' for implementation of the federal health insurance mandate.

In 2007, individuals in Massachusetts faced losing their entire personal income tax exemption for failure to purchase health insurance (or were uncovered for more than 63 days). Beginning in 2008, individuals were subject to a monthly income-based penalty for failure to comply with the mandate.

In order to prove compliance, a new three-page schedule had to be completed and filed with other schedules required to be filed for the state income tax return. In addition, a 10-page booklet with instructions and worksheets accompanies the other income tax instructions and worksheets for the state income tax return. A similar schedule, instructions, and worksheets would likely be required for use in any federal income tax-based enforcement mechanism.

The Massachuetts ''Schedule HC'' must be completed and enclosed with the individual income tax return. The form requires all tax filers to ''declare'' their coverage status and to report general information regarding: name; Social Security number; date of birth for the filer and spouse; family size; and federal adjusted gross income.

Next, the schedule requires the filer to indicate whether they and their spouse had health insurance (including Medicare, Veterans Administration health care, Tri-Care, or ''other'' government health coverage) at any point during the year, or whether they were enrolled in the MassHealth (Medicaid) program or Commonwealth Care program.

If the filer was enrolled in a private health insurance policy, the schedule requires information regarding health insurance coverages of the filer and spouse from the new 1099-HC form required to be filed by the health insurer (name of company, federal identification number of the insurance company, and subscriber name).

The 1099-HC form requires: the name of the insurance company or health benefit plan administrator; the federal identification number of the insurance company or plan administrator; the subscriber's name, date of birth, and subscriber number, and address. The form requires information regarding whether the subscriber had full-year coverage, or to indicate month-by-month the subscriber's coverage history for the year.

The ''Schedule HC'' also requires the filer and spouse to indicate on a month-by-month basis if they were uninsured for any part of the year; whether any religious exemption or a certificate of exemption issued by the Health Insurance Connector applies; and whether the affordability requirements were met by the filer's employer.

The form also requires filers to indicate whether they were eligible for government-subsidized health insurance and whether they were able to afford private health insurance coverage. Finally, the schedule includes instructions for the filing of an appeal if the filer was unable to obtain affordable health insurance due to ''hardship'' or other circumstances.

Numerous Penalty Exemptions Provided

Poverty Level Exemption. Any applicable penalties for noncompliance with the requirement to purchase health insurance *would not apply* to persons whose income was at or below 150 percent of the federal poverty level. In Table 2 of the instructions for 2008, for example, this federal poverty level exemption from the enforcement penalty would apply for a family of one at an income level of $15,612; and for a family of four at an income level of $31,812.

Health insurance coverage is ''deemed'' to be unaffordable for persons in these income categories. Interestingly, of the estimated 154 million federal ''income tax units'' in the United States, 62 million have adjusted gross incomes of less than $20,000. Nearly 15 million of the 45 million uninsured have incomes of less than $20,000.

Using a similar ''poverty level'' exemption might significantly dilute the effect of this enforcement mechanism and would leave its efficacy to the incentive eligibility for a subsidy that is provided to purchase health insurance.

Hardship Exemption. Taxpayers may also appeal the imposition of an income-based penalty by claiming that a ''hardship'' prevented them from purchasing health insurance. A special Schedule HC-A must be filed with the state income tax return to request an appeal on the basis of a ''hardship.''

The determination of whether to allow a ''hardship'' appeal is made in accord with procedures established by the Health Insurance Connector Authority and not the Massachusetts Department of Revenue. The Connector Authority is empowered to determine the appeal, and the Department of Revenue would not assess a penalty amount until a final determination is conveyed to the Department by the Connector Authority if the appeal is denied.

Pending federal health reform legislation would also incorporate a ''hardship'' exemption into the health insurance mandate structure.

In Massachusetts, to establish a ''hardship'' the instruction for Schedule HC provides that the taxpayer: (1) must have been homeless, more than 30 days in arrears in rent or mortgage payments, or received an eviction or foreclosure notice; (2) received a ''shut off'' notice, were shut off, or were refused the delivery of essential utilities (gas, electric, oil, water, or telephone); (3) had non-cosmetic medical and/or dental out-of-pocket expenses (exclusive of premium payments, and not covered by a third party) totaling more than 7.5 percent of adjusted gross income; (4) had incurred significant, unexpected increase in essential expenses (due to domestic violence, death, extended illness, aged parent, fire, flood, other natural or human-caused event); (5) experienced financial circumstances that would deprive them of food, shelter, clothing or other necessities; (6) had a family size such that affordability is inequitable; or (7) experienced other circumstances that made the taxpayer unable to purchase insurance.

Lapse in Coverage. No penalty is assessed if there is only a lapse in coverage of 63 days or less. This is borrowed from the federal ''creditable coverage'' rules

HPPR ISSN 1528-2953

wherein a period of ''creditable coverage'' is not counted when there is a lapse of more than 63-days during which an individual is not covered under any ''creditable coverage.

Deemed Affordability. Table 3 of the Schedule HC instructions includes various ranges of Federal adjusted gross income levels with corresponding monthly premiums to annually determine whether employer-offered health insurance is ''affordable.''

This will depend upon the filing status (individual, married filing jointly, married filing jointly with dependents, etc.) and income of the taxpayer. For example, for an individual with a federal adjusted gross income between $42,501 and $52,500, the ''affordable'' monthly premium is $330.

The filer must then compare this amount to the lowest cost of coverage offered by an employer and if that amount for the offered coverage is less than the amount from Table 3, then the filer is ''deemed'' to be able to afford employer-sponsored coverage.

For purposes of a federal ''affordability'' measure, it would seem that the amount designated as the measure of employer-provided coverage affordability would have to differ by geographic region. This would greatly complicate the burden on the IRS and in the tax instruction forms for federal taxpayers.

Table 4 of the instructions includes premium information by each county of the state, by age, and family status (individual, married with no dependents, or family) to annually determine if the taxpayer was able to afford private health insurance. This will depend upon the filing status (individual, married with no dependents, or family), and a person's age.

For example, an individual between the ages of 18-26 would be able to afford private health insurance of: $120 per month in Berkshire, Franklin, and Hampshire Counties; or $140 per month in Bristol, Essex, Hampden, Middlesex, Norfolk, Suffolk, and Worcester Counties; or $130 per month in Barnstable, Dukes, Nantucket, and Plymouth Counties.

Again, for purposes of a federal ''affordability'' measure, it would seem that the amount designated as the measure of coverage affordability would have to differ by geographic region. This would greatly complicate the tax instruction forms for federal taxpayers.

Table 5 of the instructions includes annual income standards by family size to determine the income-based penalty that is assessed for noncompliance with the health insurance mandate. For example, a family of four, with annual income above $63,612, would be placed in Column ''D'' for purposes of determining penalties.

Table 6 of the instructions includes the schedule of penalties. As an example, for 2008, the penalty for a filer in the Column ''D'' classification would be subject to a penalty of $76 per each month of being uninsured. If the taxpayer was uninsured for 12 months, the penalty assessed would be $912.

Some pending federal health care reform proposals would impose a surtax equal to 2 percent of the taxpayer's adjusted gross income as a penalty amount.

Tax Filing Retrospective, Not Contemporaneous

In addition, the federal income tax mechanism is not contemporaneous but is retrospective and would permit a person to go months without insurance. By the time a person has gone months without insurance, or has incurred uninsured medical bills, the prospect of recovering back premiums and charges, let alone penalties, is likely to be remote.

In Massachusetts, for example, monthly compliance is determined by matching tax returns with the 1099-HC information returns required to be filed with the Commonwealth's Department of Revenue on an annual basis by health insurance companies to confirm that a taxpayer was covered by health insurance for each month of the previous year.

Contemporaneous enforcement is likely to be more effective than retrospective enforcement. For example, relying upon a year-end tax filing poses income tax collection problems where liabilities may be large compared to the taxpayer's income and savings. Penalties for failure to purchase health insurance would likely be based upon last year's income using the current federal income tax filing system. See, Steuerle, Eugene. *Implementing Employer and Individual Mandates*, Health Affairs (Spring 1994). See also, Steuerle, Eugene, and Van de Water, Paul N., *Administering Health Insurance Mandates* (National Academy of Social Insurance) (January 2009).

Retroactive enforcement is less effective as a deterrent because tax authorities would not detect noncompliance with the mandate until months after the failure to obtain coverage and penalties are assessed months or even a year after the violation has occurred.

Each April, if a tax filer has to find the money to pay a tax penalty for being without health insurance coverage the previous year, there is little or no incentive or funds to start buying health insurance at that time. See, Connecticut Health Policy Project Issue Paper, *An Individual Health Insurance Mandate: Could It Work for Connecticut?* (December 2008).

Few federal income tax returns are routinely identified for an audit—currently about 1%—and it may take far longer to identify those who may have provided incorrect information on their filed returns regarding the required levels of health insurance coverage. After the IRS would identify a person with inadequate or no coverage, the agency could not impose health insurance coverage on noncompliant filers but would assess penalties. See, Hevener, Mary B. H., and Kerby III, Charles K., Administrative Issues: Challenges of the Current System in *Using Taxes to Reform Health Insurance: Pitfalls and Promises* (Brookings, 2008).

The processing of tax returns would typically take a year or more before the IRS could identify and take steps to impose ''penalties'' on noncompliant tax payers. Unfortunately, in the context of health care reform, the IRS cannot correct failures by retroactively providing health insurance coverage or compelling noncompliant taxpayers to obtain health insurance coverage in order to reduce the number of ''uninsured'' Americans.

Many Uninsured Are Non-Filers

Although a principle goal of health insurance reform is to extend health insurance coverage to the 47 million Americans who are uninsured, a significant number of the uninsured have incomes at or below the federal poverty level and would not be tax filers under current law.

As a result, they would not be subject to this income tax-based enforcement mechanism. This was identified

as an issue in studies leading up to the recent Massachusetts reforms. See Blumberg, Linda J; Bovbjerg, Randall; and Holahan, John. *Roadmap to Coverage: Enforcing Health Insurance Mandates* (Blue Cross Blue Shield of Massachusetts Foundation) (October 7, 2005).

For example, for 2009, the federal poverty guidelines establish an amount of $10,830 for a family of one at 100 percent of poverty; $14,570 for a family of two; $18,310 for a family of three; and $22,050 for a family of four. See, Annual Update of the HHS Poverty Guidelines (Jan. 23, 2009). In 2007, one-third of the uninsured were in families with annual incomes of less than $20,000, and 35% of individuals in families with incomes of less than $10,000 were uninsured. See EBRI, *Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2008 Current Population Survey* (September 2008).

The Joint Committee on Taxation has estimated that 136.3 million individual income tax returns were filed in 2008. However, nearly 29 million tax units, headed by nondependents, did not have any reason under current law to file income tax returns. This is because their incomes were not above the filing thresholds, nor did they file to receive refunds of overwithheld income taxes or refundable tax credits. See Joint Committee on Taxation, *Overview of Past Tax Legislation Providing Fiscal Stimulus and Issues in Designing and Delivering a Cash Rebate to Individuals* (JCX-4-08R) (Feb. 13, 2008).

It is possible, therefore, that many of these individuals would be some of the ''uninsured'' who would be compelled to purchase health insurance and who would likely be eligible for a subsidy to make the purchase ''affordable.''

If they have no other reason to file income tax returns, then the ''enforcement'' mechanism is not effective for this segment of the uninsured. However, the IRS does boast of an overall voluntary compliance rate of about 84 percent. See U.S. Department of the Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009).

Notes on Auto Liability Comparison

The most commonly discussed example of an insurance purchasing mandate is the requirement for drivers to purchase liability insurance. Interestingly, compulsory auto insurance was first introduced in Massachusetts in 1927 for bodily injury and property damage protection.

Some 47 states and the District of Columbia have enacted auto liability coverage mandates. However, studies show that states with compulsory auto insurance have no lower rates of uninsurance than states without the requirement. See California Research Bureau, *Individual Mandate: A Background Report* (April 2009).

One study in 2006 by the Insurance Research Council noted that, nationwide, some 15 percent of motorists did not have auto liability insurance coverage. The highest rates of uninsured drivers were found in Mississippi (26 percent), Alabama (25 percent), California (25 percent), New Mexico (24 percent), and Arizona (22 percent).

States have been required to engage in more extensive data matching and information technology-based efforts to enforce the auto liability insurance mandate. However, automobile insurance data bases have been costly, controversial, and error-prone. See Steuerle, Eugene; and Van de Water, Paul N., *Administering Health Insurance Mandates* (National Academy of Social Insurance) (January 2009).

The point here with the auto liability insurance mandate is that despite the mandate, there remain significant instances of uninsured motorists. In many states, the primary enforcement mechanism must be supplemented by other methods that make the implementation of the mandate more costly.

Conclusion

An individual health insurance mandate that is enforced through the individual income tax system would be complicated and its efficacy questionable. This is because the income tax compliance system operates retrospectively and not all of the uninsured are participants in the income tax filing system.

Individuals who have health insurance may be surprised at the level of administrative burden required for individuals who already have health insurance to prove that they are in compliance with the mandate.

There will be increased costs and burdens placed on the IRS to process and verify the additional ''health insurance information returns'' and to match that information between individuals, employers, and insurers for compliance purposes.

Most surely, there will also be an increased and more intrusive role for the IRS in the daily lives of both insured and uninsured Americans.

HPPR ISSN 1528-2953