Potentially Improper Health Care Credit Claims by Tax-Exempt Organizations Are Generally Being Identified for Review, but Improvements Are Needed

January 17, 2014

Reference Number: 2014-13-005

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POTENTIALLY IMPROPER HEALTH CARE CREDIT CLAIMS BY TAX-EXEMPT ORGANIZATIONS ARE GENERALLY BEING IDENTIFIED FOR REVIEW, BUT IMPROVEMENTS ARE NEEDED

Highlights

Final Report issued on January 17, 2014

Highlights of Reference Number: 2014-13-005 to the Internal Revenue Service Commissioner for the Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

During Tax Year 2012, tax-exempt organizations claimed more than $73 million in Small Business Health Care Tax Credits provided for under the Patient Protection and Affordable Care Act. The Tax Exempt and Government Entities Division designed controls that systemically identify questionable credits for potential examination; however, additional controls would provide further assurance that potentially improper claims for the credit are identified and addressed effectively and efficiently.

WHY TIGTA DID THE AUDIT

The overall objective of this review was to assess whether the IRS has controls in place to provide reasonable assurance that tax-exempt organizations are accurately claiming the credit.

WHAT TIGTA FOUND

The Tax Exempt and Government Entities Division designed computer routines that identify potentially improper credits claimed by tax-exempt organizations for possible examination prior to processing the tax returns (prerefund). Since implementing these processes, the Internal Revenue Service reports that it has denied more than $1.5 million in credits that it had determined were improper.

From January 1 through July 23, 2012, the Tax Exempt and Government Entities Division reported that it had initiated prerefund examinations for 43 percent of the potentially improper credits identified by its computer routines. Because the IRS does not conduct prerefund examinations on all potentially improper credits, it is important that the IRS focus its limited resources on the most productive prerefund examinations.

However, TIGTA found that the Tax Exempt and Government Entities Division's compliance plan for the credit did not include plans for periodically reviewing computer routines to determine if any changes are needed based on prerefund examinations. In addition, the IRS does not have a post-refund compliance strategy for the credit. Based on our concerns, IRS officials indicated that they have begun to analyze the outcomes of prerefund examinations and initiated post-refund examinations. Lastly, TIGTA determined that amended returns are not always subjected to the same level of review as original returns.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Tax Exempt and Government Entities Division, complete work to analyze and document the outcomes of prerefund examinations, complete post-refund examinations, periodically update the compliance plan for the credit, and ensure that amended returns are subjected to the same reviews as original returns.

In their response to the report, IRS officials stated that they generally agreed with the recommendations and plan to or have taken corrective actions.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

January 17, 2014

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Potentially Improper Health Care Credit Claims by Tax-Exempt Organizations Are Generally Being Identified for Review, but Improvements Are Needed (Audit # 201210323)

This report presents the results of our review to assess whether the Internal Revenue Service (IRS) has controls in place to provide reasonable assurance that tax-exempt organizations are accurately claiming the Small Business Health Care Tax Credit. This review is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Implementing Tax Law Changes.

Management's complete response to the draft report is included as Appendix VII.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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Abbreviations

IRS	Internal Revenue Service
TE/GE	Tax Exempt and Government Entities

Background

On March 23, 2010, the Patient Protection and Affordable Care Act[1] was signed into law. Along with amendments in the Health Care and Education Reconciliation Act of 2010,[2] which was signed on March 30, 2010, this legislation contains $438 billion[3] worth of revenue provisions in the form of new taxes, fees, and penalties. It also contains a number of tax credits.[4] One of these credits, the Small Business Health Care Tax Credit, is provided as an incentive for small businesses and tax-exempt organizations to provide health care coverage for their employees. To be eligible for the credit, employers must have less than 25 full-time equivalent employees, have average annual wages that do not exceed $50,000, and cover at least 50 percent of the cost of health care coverage for each employee.

The Patient Protection and Affordable Care Act provides for a Small Business Health Care Tax Credit as an incentive for small businesses and tax-exempt organizations to provide health care coverage for their employees.

While the eligibility requirements are the same, the percentage of health care coverage that can be claimed as a credit and whether the credit can result in a refund differs between businesses and tax-exempt organizations. Through Tax Year 2013, the maximum credit that can be claimed is 35 percent for small businesses and 25 percent for small tax-exempt organizations.[5] In addition, when claimed on business returns, the credit is nonrefundable, *i.e.*, only available to offset actual tax liabilities. The credit is refundable to tax-exempt organizations.[6]

To claim the credit, eligible tax-exempt organizations must complete Form 8941, *Credit for Small Employer Health Insurance Premiums*,[7] and report the credit on Form 990-T, *Exempt Organization Business Income Tax Return*.

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[1] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.
[2] Pub. L. No. 111-152, 124 Stat. 1029.
[3] Joint Committee on Taxation estimated revenue effects, JCX-17-10, Mar. 20, 2010.
[4] See Appendix VI for a glossary of terms.
[5] Beginning in Tax Year 2014, some of the rules change and the credit will be available only for two consecutive years, but the amount allowed will increase.
[6] The refund cannot exceed the total amount of income tax and Medicare tax withholding from employees' wages and the employer's share of Medicare tax. In addition, the Balanced Budget and Emergency Deficit Control Act of 1985 (Pub. L. No. 99-177, Stat. 1038, 2 U.S.C. § 900) as amended by the Budget Control Act of 2011 (Pub. L. No. 112-25, Stat. 240) reduced the refundable portion of the credit for tax-exempt organizations by 8.7 percent.
[7] See Appendix V for a copy of Form 8941.

This audit report focuses solely on the Tax Exempt and Government Entities (TE/GE) Division's oversight of the credit claimed by tax-exempt organizations.

Figure 1 provides the amount of the credit claimed by processing year.

Figure 1: Tax-Exempt Organization Small Business Health Care Tax Credit Claims by Processing Year

Processing Year	Total Number of Returns Claiming the Credit	Credit Amount Claimed
2011	12,868	$47,485,409
2012	19,472	$73,099,167
2013*	16,739	$66,471,602

*Source: Small Business Health Care Tax Credit reports provided by the Internal Revenue Service (IRS). * Through September 26, 2013.*

This review was performed at the Ogden Submission Processing Center in Ogden, Utah, and information was obtained from the TE/GE Division Headquarters in Washington, D.C., during the period August 2012 through June 2013. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Potentially Improper Credits Are Being Identified, but Additional Compliance Issues Should Be Addressed

The TE/GE Division designed computer routines that identify, as tax-exempt organization returns are being processed, organizations that have potentially claimed the credit improperly.[8] Potentially improper credits may then be subject to a prerefund examination to determine whether the credit was accurate and should be allowed and whether any associated refund should be issued. Since implementing these processes, the IRS reports that it has denied more than $1.5 million in Small Business Health Care Tax Credits, which would have resulted in improper payments[9] if allowed.

From January 1 through July 23, 2012, the TE/GE Division reported that it initiated prerefund examinations on 681 (43 percent) of 1,578 returns that were identified as containing a potentially improper credit. However, more than half of the returns identified as containing potentially improper credits were not examined because, according to the IRS, it does not have the resources to conduct prerefund examinations on all questionable claims when returns are filed. Therefore, it is important that the IRS focus its limited resources on the most productive prerefund examinations and develop plans to address potentially improper credits that are not subjected to a prerefund examination (post-refund).

Additional controls would provide further assurance that potentially improper claims for the credit are identified and addressed effectively and efficiently. Without effective IRS oversight, improper or fraudulent credits may be claimed, thereby reducing Federal Government revenue. Actions can be taken to 1) update and improve the TE/GE Division's compliance plan for the credit, 2) subject amended returns to the same level of review as original returns, and 3) provide more accurate information for IRS employees researching credit claims.

The TE/GE Division's compliance plan could be more thorough

The TE/GE Division developed a compliance plan for the credit that included developing more than 10 computer routines to identify potentially improper claims for the credit for possible prerefund examinations. However, the TE/GE Division had not analyzed and documented the

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[8] We concluded this based on a review of a statistical sample of 97 tax-exempt returns. See Appendix I for further details on our sampling methodology.

[9] The Improper Payments Elimination and Recovery Act of 2010 (Pub. L. No. 111-204, 124 Stat. 2224) increased agency accountability for reducing improper payments in Federal programs.

outcome of these examinations to potentially increase the productivity of prerefund examinations by determining whether:

- Any of these computer routines should be given priority over other routines.
- Existing computer routines should be amended.
- Additional computer routines are needed.

The *Standards for Internal Control in the Federal Government* states that managers "…need to compare actual performance to planned or expected results … and analyze significant differences." If this type of evaluation is not conducted periodically and documented, the IRS may not be conducting prerefund examinations on the returns most likely to include improper credits. Without this evaluation, compliant organizations may be unnecessarily examined.

In addition, the TE/GE Division has not developed a post-refund compliance strategy. As previously mentioned, the TE/GE Division is enforcing the law by identifying potentially improper claims for the credit during processing of original returns. However, due to limited resources, the IRS cannot conduct prerefund examinations on all potentially improper credits prior to accepting the returns as filed; therefore, it is allowing the credits and is issuing potentially improper refunds. Based on concerns we raised during the audit, TE/GE Division officials indicated that they have begun to analyze the outcomes of examinations and initiated post-refund examinations, but have not yet completed this work or updated the compliance plan based on the results.

Potential improper credits are being allowed when amended returns are filed

The TE/GE Division does not subject amended returns to the same level of review as it does to original tax-exempt organization returns. The IRS analyzes amended returns manually. However, it does not consistently evaluate these returns using all the criteria in the computer routines that were designed to systemically review original returns. During the period January 1 through July 23, 2012, the IRS processed 253 amended returns[10] filed by tax-exempt organizations claiming the credit. We selected a statistical sample of these returns and determined that five (7 percent) of 71 returns included claims the IRS should have identified as potentially improper.[11] For example, four of the amended returns should have been identified as potentially improper because the number of employees reported by the organizations exceeded the maximum full-time equivalent employees allowable by law to qualify for the credit.

[10] The IRS could not differentiate between amended or duplicate returns on its systems because the IRS transaction code is the same for both types of returns. Therefore, the 253 returns include both amended and duplicate returns.
[11] All five returns were amended returns. During processing, IRS officials explained that duplicate and amended returns are flagged for appropriate resolution. For those returns that we identified as duplicates of an originally filed return, we determined that the IRS did not issue any duplicate refunds.

Although the number of amended returns filed by tax-exempt organizations claiming the credit is small (averaging nine returns per week), the IRS could reduce improper payments in compliance with the Improper Payments Elimination and Recovery Act of 2010 by following the same routines used when original returns are filed. We project that the IRS could potentially realize more than $116,000 in funds put to better use over three years.[12]

Information from tax-exempt organization returns was not displayed accurately

We reviewed a statistical sample of tax-exempt organization returns that were identified as including potentially improper credits and determined that the information transcribed from Form 8941 was not always displayed correctly for individuals conducting research on IRS computer systems. The *Standards for Internal Control in the Federal Government* states that controls should ensure that transactions are completely and accurately recorded.

Due to a programming error, information from line 16 of Form 8941 was displayed as line 15. As a result, any IRS employee who subsequently researched the filing would be viewing inaccurate credit information and could draw inaccurate conclusions.

Based on our concerns, the TE/GE Division and Information Technology organization took action to correct the programming error. However, this action only corrected information displayed from Forms 8941 that were transcribed after the date the programming error was corrected. Further, although this resulted in correctly displaying information from line 16, it did not remove the incorrect line identification (line 15) and in fact displayed the data from another line on the return instead.

Because this inaccurate programming could be used to display any Form 8941 filed by a tax-exempt organization that claimed the credit in Tax Year 2011, we determined that information about the credit from Form 8941 could be displayed incorrectly on IRS computer systems for more than 9,000 tax-exempt organizations.[13]

Recommendations

The Commissioner, TE/GE Division, should:

Recommendation 1: Complete work to analyze and document the outcomes of prerefund examinations, complete post-refund examinations, and periodically update the compliance plan for the credit.

> **Management's Response:** IRS management agreed with this recommendation and stated that they would complete an analysis of prerefund and completed post-refund

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[12] See Appendix IV.
[13] See Appendix IV.

examinations. Based on the results of this analysis, a determination will be made as to whether the compliance plan for the credit needs to be updated.

Recommendation 2: Ensure that amended tax-exempt organization returns are subjected to the same level of review as original returns to identify and address potentially improper claims for the credit.

Management's Response: IRS management agreed with this recommendation and stated that they have expanded documentation required to specifically reflect manual application of the electronic filters to amended returns. The TE/GE Division will issue internal guidance providing instructions on documenting the review of amended returns.

The IRS did not agree with the full estimate of funds that could be put to better use over five years if amended returns were subjected to the same level of review as original returns for the following reasons: (1) the amended returns may not have been selected for examination, (2) future changes to the statutory requirements to claim the credit, notably the limitation that allows eligible small employers to claim the credit for only two consecutive tax years beginning in Tax Year 2014, will affect the amounts claimed, and (3) for the examined returns to date, approximately 30 percent of the credit amounts claimed on examined returns have been disallowed.

Office of Audit Comments: Our estimate is based on the IRS examining questionable claims for the credit on amended returns. We have reduced the outcome measure to account for changes in statutory requirements that allow for the credit to be claimed for only two consecutive tax years beginning in Tax Year 2014. In addition, after the IRS provided calculations which show that 30.2 percent of the credit amount claimed has been historically disallowed during examinations, we revised our outcome measure to reflect the percentage disallowed.

Recommendation 3: Submit a request to correct programming errors regarding the display of credit information from Form 8941.

Management's Response: IRS management agreed with the recommendation and stated that they have requested programming be corrected regarding the display of credit information as it relates to Form 8941 for Form 990-T.

Recommendation 4: Alert employees to incorrect information that may be displayed when they research Forms 8941 that were transcribed prior to the correction of the programming error.

Management's Response: IRS management agreed with the recommendation and stated that an alert has been prepared and posted on the Servicewide Electronic Research Program that informs employees of the issues relating to Form 8941 for Form 990-T.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to assess whether the IRS has controls in place to provide reasonable assurance that tax-exempt organizations are accurately claiming the Small Business Health Care Tax Credit.[1] To accomplish our objective, we:

I. Determined what controls the IRS has in place to process and examine claims for the credit.

  A. Conducted a walkthrough and obtained documentation to identify controls designed for processing Forms 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*, and Forms 8941, *Credit for Small Employer Health Insurance Premiums*.

  B. Obtained and reviewed documentation on prerefund and post-refund examinations.

  C. Obtained reports the IRS used to monitor tax-exempt organizations' claims for the credit.

II. Reviewed the IRS's plans to identify and address potentially improper claims for the credit.

  A. Identified and reviewed documentation of new or revised computer routines to determine whether they would identify potentially improper claims for the credit.

  B. Determined whether the criterion to prioritize returns for prerefund examinations was supported by data on how well prior examinations had identified improper claims for the credit.

  C. Determined whether the TE/GE Division had developed a post-refund compliance strategy.

III. Determined whether the IRS effectively identified potentially improper claims for the credit.

  A. Determined whether computer routines designed to identify improper credits were working as intended.

    1. Identified the population and amount of claims for Tax Year 2011 by querying the Business Return Transaction File.

[1] See Appendix VI for a glossary of terms.

2. Validated the results of Step III.A.1. by comparing the results with the population and amount of claims on the TE/GE Division's credit report. We determined that the data were sufficiently reliable for the purpose of our audit.
3. Consulted with our contracted statistician to select a statistical sample of 97 (1 percent) out of 9,057 Tax Year 2011 Forms 8941. We selected our statistical sample using the following criteria: 90 percent confidence level, 10 percent expected error rate, and ± 5 percent precision rate. We used a random sample to ensure that each Form 8941 had an equal chance of being selected, which enabled us to obtain sufficient evidence to support our results.
4. Obtained and reviewed Forms 8941 and associated Forms 990-T to determine whether the credit was being calculated correctly.
5. Determined whether selected information from the Forms 8941 was being displayed accurately on the Integrated Data Retrieval System.
6. Determined whether the claim was also identified by the computer routines designed to identify potentially improper claims for the credit by manually applying the routines included in the compliance plan and comparing the results to the IRS's results.

B. Determined whether controls over amended returns were sufficient to identify improper credits.

1. Requested a data extract to determine the number of amended returns claiming a credit for Calendar Year 2012 (thru cycle 30) on the Business Master File.
2. Validated the results of Step III.B.1. by reviewing the tax-exempt organization accounts on the Integrated Data Retrieval System to ensure that an amended or duplicate return was filed as denoted by the presence of a Transaction Code 976.
3. Consulted with our contracted statistician to select a statistical sample of 71 (28 percent) out of 253 Calendar Year 2012 amended or duplicate returns (thru cycle 30). We selected our statistical sample using the following criteria: 90 percent confidence level, 10 percent expected error rate, and ± 5 percent precision rate. We used a random sample to ensure that each Form 8941 had an equal chance of being selected, which enabled us to obtain sufficient evidence to support our results.
4. Obtained and reviewed amended or duplicate Forms 8941 and associated Forms 990-T to determine whether any amended returns contained potentially improper credits based on the computer routines developed for original returns.
5. For any potentially improper credits identified, determined whether the TE/GE Division also identified the credits as potentially improper.

6. Calculated a Funds Put to Better Use outcome by projecting the number of potentially improper credits on amended returns that were not being identified by the TE/GE Division.

IV. Determined whether examination results were being used to improve the process to identify potentially improper claims for the credit.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: TE/GE Division policies, procedures, and practices for identifying potentially improper claims for the credit. We evaluated these controls by interviewing personnel, reviewing documentation, and reviewing statistical samples of tax-exempt organization returns.

Appendix II

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Russell P. Martin, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Troy D. Paterson, Director
Thomas F. Seidell, Audit Manager
William Simmons, Lead Auditor
Margaret A. Anketell, Senior Auditor
Jeffrey R. Stieritz, Senior Auditor
Brian W. Hattery, Information Technology Specialist

Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities Division SE:T:CL

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Funds Put to Better Use – Potential, $38,865 for Tax Year 2013, projected to $116,595 over three years (through 2015), representing the amount of potential funds put to better use that could be realized if amended returns were subjected to the same level of review as original returns (see page 3).

Methodology Used to Measure the Reported Benefit:

Based on a review of a statistical sample of amended or duplicate returns filed by tax-exempt organizations from January 1 through July 23, 2012, we determined that five (7 percent) of 71 returns included credits the IRS should have identified as potentially improper. The IRS reviews amended returns manually. However, it does not always evaluate these returns using all the criteria in its computer routines designed to systemically review original returns. If the IRS had followed the same criteria used when original returns are systemically reviewed, the IRS could have examined and potentially denied $38,865 in improper credits in compliance with the Improper Payments Elimination and Recovery Act of 2010[1] and could potentially realize more than $100,000 over three years.[2]

Type and Value of Outcome Measure:

- Reliability of Information – Potential, 9,057 tax-exempt organization accounts, representing the number of tax-exempt organizations whose information about the credit from Form 8941 could be displayed inaccurately on IRS computer systems (see page 3).

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[1] Pub. L. No. 111-204, 124 Stat. 2224.

[2] The IRS provided calculations showing that 30.2 percent of the credit amount claimed has been historically disallowed during examinations. This percentage was used in calculating the outcome measure. In addition, our calculations take into account statutory requirement changes that allow for the credit to be claimed for only two consecutive tax years beginning in Tax Year 2014.

Methodology Used to Measure the Reported Benefit:

We reviewed a statistical sample of tax-exempt organization returns that were identified as including potentially improper credits and determined that the information transcribed from Form 8941, *Credit for Small Employer Health Insurance Premiums*,[3] was not always displayed correctly for individuals conducting research on IRS computer systems.

Due to a programming error, information from line 16 of Form 8941 was displayed as line 15. As a result, any IRS employee who subsequently researched the filing would be viewing inaccurate credit information and could draw inaccurate conclusions.

Because this inaccurate programming could be used to display any Form 8941 filed by a tax-exempt organization that claimed the credit in Tax Year 2011, we determined that information about the credit from Form 8941 could be displayed incorrectly on IRS computer systems for all 9,057 tax-exempt organizations that claimed the credit in Tax Year 2011.

[3] See Appendix V for a copy of Form 8941.

Appendix V

Form 8941, Credit for Small Employer Health Insurance Premiums

Form **8941**

Department of the Treasury
Internal Revenue Service

Credit for Small Employer Health Insurance Premiums

► Information about Form 8941 and its instructions is available at *www.irs.gov/form8941*.
► Attach to your tax return.

OMB No. 1545-2198
2011
Attachment Sequence No. **63**

Name(s) shown on return | **Identifying number**

1	Enter the number of individuals you employed during the tax year who are considered employees for purposes of this credit (see instructions)	**1**	
2	Enter the number of full-time equivalent employees you had for the tax year (see instructions). If you entered 25 or more, skip lines 3 through 11 and enter -0- on line 12	**2**	
3	Average annual wages you paid for the tax year (see instructions). If you entered $50,000 or more, skip lines 4 through 11 and enter -0- on line 12	**3**	
4	Premiums you paid during the tax year for employees included on line 1 for health insurance coverage under a qualifying arrangement (see instructions)	**4**	
5	Premiums you would have entered on line 4 if the total premium for each employee equaled the average premium for the small group market in which you offered health insurance coverage (see instructions)	**5**	
6	Enter the **smaller** of line 4 or line 5	**6**	
7	Multiply line 6 by the applicable percentage: • Tax-exempt small employers, multiply line 6 by 25% (.25) • All other small employers, multiply line 6 by 35% (.35)	**7**	
8	If line 2 is 10 or less, enter the amount from line 7. Otherwise, see instructions	**8**	
9	If line 3 is $25,000 or less, enter the amount from line 8. Otherwise, see instructions	**9**	
10	Enter the total amount of any state premium subsidies paid and any state tax credits available to you for premiums included on line 4 (see instructions)	**10**	
11	Subtract line 10 from line 4. If zero or less, enter -0-	**11**	
12	Enter the **smaller** of line 9 or line 11	**12**	
13	If line 12 is zero, skip lines 13 and 14 and go to line 15. Otherwise, enter the number of employees included on line 1 for whom you paid premiums during the tax year for health insurance coverage under a qualifying arrangement (see instructions)	**13**	
14	Enter the number of full-time equivalent employees you would have entered on line 2 if you only included employees included on line 13	**14**	
15	Credit for small employer health insurance premiums from partnerships, S corporations, cooperatives, estates, and trusts (see instructions)	**15**	
16	Add lines 12 and 15. Cooperatives, estates, and trusts, go to line 17. Tax-exempt small employers, skip lines 17 and 18 and go to line 19. Partnerships and S corporations, stop here and report this amount on Schedule K. All others, stop here and report this amount on Form 3800, line 4h	**16**	
17	Amount allocated to patrons of the cooperative or beneficiaries of the estate or trust (see instructions)	**17**	
18	Cooperatives, estates, and trusts, subtract line 17 from line 16. Stop here and report this amount on Form 3800, line 4h	**18**	
19	Enter the amount you paid in 2011 for taxes considered payroll taxes for purposes of this credit (see instructions)	**19**	
20	Tax-exempt small employers, enter the **smaller** of line 16 or line 19 here and on Form 990-T, line 44f	**20**	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 37757S Form **8941** (2011)

Source: www.IRS.gov

Appendix VI

Glossary of Terms

Term	Definition
Business Master File	The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
Business Return Transaction File	A computer file of transcribed line items on all business returns and their accompanying forms and schedules.
Calendar Year	The 12-consecutive-month period ending on December 31.
Computer Routine	A procedure, or part of a computer program, that performs a particular task.
Credit	A credit is normally preferred over a deduction because it reduces the tax due dollar-for-dollar, as opposed to a deduction, which decreases taxable income.
Full-Time Equivalent	A measure of labor hours in which one full-time equivalent is equal to eight hours multiplied by the number of compensable days in a particular year. For the purpose of determining the credit, one full-time equivalent is equal to 2,080 hours.
Improper Payment	Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other requirements.
Integrated Data Retrieval System	The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

Appendix VII

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

December 11, 2013

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Michael D. Julianelle
Acting Commissioner, Tax Exempt and Government Entities

SUBJECT: Draft Audit Report – Potentially Improper Health Care Credit Claims by Tax-Exempt Organizations Are Generally Being Identified for Review, but Improvements Are Needed
(Audit # 201210323)

Thank you for the opportunity to review your draft report titled: *Potentially Improper Health Care Credit Claims by Tax-Exempt Organizations Are Generally Being Identified for Review, but Improvements Are Needed.*

We generally agree with your recommendations and appreciate your acknowledgement of the efforts we have taken to create a program that identifies potentially improper claims for the Small Business Healthcare Tax Credit by tax-exempt organizations.

Attached you will find a detailed response outlining our corrective actions, including how we plan to handle amended returns.

As explained during the course of the audit, all returns, both original and amended, are subject to examination selection criteria and either accepted as filed or selected for examination. We agree that documenting how we applied the criteria to amended returns should be improved and we have already initiated corrective action as noted in the attached response. Had the documentation occurred as stated in your recommendation, the five amended returns selected as samples which you identified as a potentially improper claim for the Credit, would have indicated these were reviewed, considered for examination, and would not have been selected based on the results of the review.

We do not agree with your outcome measure related to amended returns. Your methodology implies that if the five identified returns had been systemically reviewed using the same process as original returns, the five returns would have been selected for examination. However there is no certainty that any of the five would have been selected. In addition, the outcome measure appears to be based on an assumption that if the five returns had been selected for examination, the result would be a one hundred percent denial of the credit amount claimed. However to date, approximately thirty percent of the credit amounts claimed on examined returns are disallowed. Finally, your extrapolation of savings over five years does not take into account future changes to the statutory requirements to claim the Credit, notably the limitation that allows eligible small employers to claim the Credit for only two consecutive tax years beginning in TY14.

If you have any questions, please contact me, or a member of your staff may contact Christie Jacobs, Acting Director, Government Entities, at (720) 956-4504.

Attachment

Attachment

RECOMMENDATION 1: Complete work to analyze and document the outcomes of prerefund examinations, complete post-refund examinations, and periodically update the compliance plan for the Credit.

CORRECTIVE ACTION: We will complete an analysis of prerefund and completed post-refund examinations. Based on the results of this analysis, a determination will be made as to whether the compliance plan for the Credit needs to be updated.

IMPLEMENTATION DATE: September 15, 2014

RESPONSIBLE OFFICIAL(S):
Christie Jacobs, Acting Director, Government Entities

RECOMMENDATION 2: Ensure that amended tax-exempt organization returns are subjected to the same level of review as original returns to identify and address potentially improper claims for the Credit.

CORRECTIVE ACTION: TE/GE has expanded documentation required to specifically reflect manual application of the electronic filters to amended returns. TE/GE will issue internal guidance providing instructions on documenting the review of amended returns.

IMPLEMENTATION DATE: February 15, 2014

RESPONSIBLE OFFICIAL(S):
Christie Jacobs, Acting Director, Government Entities

RECOMMENDATION 3: Submit a request to correct programming errors regarding the display of Credit information from Form 8941.

CORRECTIVE ACTION: TE/GE has requested programming be corrected regarding the display of Credit information on BRTVU as it relates to Form 8941 for MFT34.

IMPLEMENTATION DATE: Completed

RESPONSIBLE OFFICIAL(S):
Christie Jacobs, Acting Director, Government Entities

RECOMMENDATION 4: Alert employees to incorrect information that may be displayed when they research Forms 8941 that were transcribed prior to the correction of the programming error.

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CORRECTIVE ACTION: A SERP Alert has been prepared and posted on SERP that informs employees of the BRTVU issue relating to MFT34 Forms 8941 during a certain period.

IMPLEMENTATION DATE: Completed (SERP Alert Posted December 5, 2013)

RESPONSIBLE OFFICIAL(S):
Christie Jacobs, Acting Director, Government Entities