



*The Affordable Care Act:  
Improvements Are Needed to  
Ensure the Accuracy of the Allocation of  
the Health Insurance Provider Fee*

**June 22, 2015**

**Reference Number: 2015-43-049**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

2 = Risk Circumvention of Agency Regulation or Statute

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# HIGHLIGHTS

## THE AFFORDABLE CARE ACT: IMPROVEMENTS ARE NEEDED TO ENSURE THE ACCURACY OF THE ALLOCATION OF THE HEALTH INSURANCE PROVIDER FEE

### Highlights

Final Report issued on June 22, 2015

Highlights of Reference Number: 2015-43-049 to the Internal Revenue Service Commissioner for the Large Business and International Division.

#### IMPACT ON TAXPAYERS

Section 9010 of the Patient Protection and Affordable Care Act imposes an annual fee on health insurance providers (referred to as covered entities). The IRS calculates the fee amount for each covered entity based on the covered entity's portion of market share premiums. For Fee Year 2014, the amount of the fee was \$8 billion.

#### WHY TIGTA DID THE AUDIT

This audit was initiated as part of our continued coverage of the IRS's implementation of key Affordable Care Act tax provisions. The overall objective of this review was to determine whether the IRS has developed processes to identify providers required to file premium reports, assess penalties on those that did not, and accurately determine health insurance providers' market shares and applicable annual fees.

#### WHAT TIGTA FOUND

The IRS used third-party data to the extent that the data were available to identify the covered entities required to file Form 8963, *Report of Health Insurance Provider Information*. However, third-party data were not available for all covered entities that are required to file. For example, our analysis of third-party data showed that 665 (53.9 percent) of the 1,233 providers that were listed on Forms 8963 were not included in premium information from third-party sources.

Our review also identified that regulations do not provide a process for the IRS to correct the health insurance provider fee for all covered entities once the final fee letters are distributed. As of October 22, 2014, TIGTA identified covered entities that filed Forms 8963 after the IRS made the final fee calculation for Fee Year 2014. The covered entities reported more than \*\*\*\*\*2\*\*\*\*\* in net premiums but were not assessed their portion of the fee totaling almost\*\*\*\*\*2\*\*\*\*\*.

In addition, TIGTA identified that 143 of the 477 covered entities filed a Form 8963 late. However, as of February 13, 2015, the IRS has not assessed the failure to report penalty against any of the 143 covered entities. \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
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\*\*\*\*\*2\*\*\*\*\*.

#### WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Large Business and International Division, work with the Department of the Treasury to amend the regulations to provide for a reconciliation process to ensure that the fee is accurately allocated among covered entities.

The IRS disagreed with this recommendation, stating that providing a reconciliation process would result in adjustments to the fee for the entire population of covered entities subject to the fee and would lead to a lack of certainty and finality as to their fee liability. However, the IRS indicated that it plans to continue to review the effectiveness of the current administrative process over the next three years and evaluate with the Department of the Treasury the potential costs and benefits to the Government and covered entities to determine whether to amend the regulations to provide for a reconciliation process.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

June 22, 2015

**MEMORANDUM FOR** COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL  
DIVISION

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

**SUBJECT:** Final Audit Report - The Affordable Care Act: Improvements Are  
Needed to Ensure the Accuracy of the Allocation of the Health  
Insurance Provider Fee (Audit # 201440303)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has developed processes to identify health insurance providers required to file premium reports, assess penalties on those that do not, and accurately determine health insurance providers' market shares and applicable annual fees. This audit addresses the major management challenge of Implementing the Affordable Care Act and Other Tax Law Changes and is part of our Fiscal Year 2015 Annual Audit Plan.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendation. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



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## *Abbreviations*

ACA	Affordable Care Act
CCIIO	Center for Consumer Information and Insurance Oversight
IRS	Internal Revenue Service
MLR	Medical Loss Ratio
NAIC	National Association of Insurance Commissioners
SHCE	Supplemental Health Care Exhibit



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## *Background*

The Patient Protection and Affordable Care Act of 2010<sup>1</sup> and the Health Care and Education Reconciliation Act of 2010<sup>2</sup> that made amendments to it (collectively referred to as the Affordable Care Act (ACA)) were both signed into law in March 2010. Section 9010 of the ACA became effective in Calendar Year 2014. This section imposes an annual fee on health insurance providers (referred to as covered entities)<sup>3</sup> that provide health insurance for any U.S. health risk.<sup>4</sup> The health insurance provider fee (hereafter referred to as fee) applies to those covered entities with net insurance premiums written during the calendar year that exceed \$25 million. The amount to be allocated for Fee Year<sup>5</sup> 2014 is \$8 billion, and the total amount for Fee Years 2014 through 2018 is \$58.8 billion. After Fee Year 2018, the total amount is increased by the rate of insurance premium growth. Figure 1 shows a breakdown of the fee for Fee Years 2014 through 2018.

**Figure 1: Health Insurance Provider Fee**

Fee Year	Health Insurance Provider Fee
2014	\$8 billion
2015	\$11.3 billion
2016	\$11.3 billion
2017	\$13.9 billion
2018	\$14.3 billion

*Source: Section 9010 of the ACA.*

In general, health insurance benefits consist of medical care (provided directly, through insurance or reimbursement, or otherwise) under any hospital or medical service policy or certificate, hospital or medical service plan contract, health maintenance organization contract, stand-alone dental and vision benefits, and retiree-only health insurance coverage offered by a covered entity. The fee is based on the net premiums written for health insurance, which

<sup>1</sup> 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.

<sup>2</sup> Pub. L. No. 111-152, 124 Stat. 1029. (See Affordable Care Act, *infra*).

<sup>3</sup> The term covered entity generally does not include self-insured employers, government entities, certain nonprofit corporations, or certain voluntary employees' beneficiary associations.

<sup>4</sup> The health risk of any individual who is a U.S. citizen, a resident of the United States, or located in the United States, with respect to the period such individual is so located.

<sup>5</sup> The calendar year in which the fee must be paid to the Government.



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includes the direct premiums written,<sup>6</sup> stand-alone dental and vision direct premiums written, and a reduction for Medical Loss Ratio (MLR) rebates.<sup>7</sup>

All covered entities are required to file Form 8963, *Report of Health Insurance Provider Information*,<sup>8</sup> by April 15 to report net premiums written for the preceding calendar year. Instructions to Form 8963 suggest that covered entities refer to information from third-party source data, or equivalent forms when available, to complete the Form 8963. When reviewing Form 8963, the Internal Revenue Service (IRS) uses information from various sources, including the following:

- *National Association of Insurance Commissioners (NAIC)*: The NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. State laws dictate which insurance providers are required to file premium information with the NAIC. The NAIC designed the Supplemental Health Care Exhibit (SHCE) to aid with reporting requirements imposed by the ACA. The IRS obtains premium information from the NAIC SHCE for comparison to net premium information reported on Form 8963.
- *Center for Consumer Information and Insurance Oversight (CCIIO)*: The CCIIO is part of the Department of Health and Human Services. Section 2718 of the ACA establishes minimum MLR standards and requires issuers to submit data on issuers' use of premium dollars to the Department of Health and Human Services. Insurance providers subject to and required by State law to be licensed to engage in the business of insurance must file with the CCIIO an MLR Annual Reporting Form by June 1 for the preceding calendar year.<sup>9</sup> The CCIIO makes the net premium information available to the public,<sup>10</sup> and the IRS uses the net premium information for comparison to net premium information reported on Form 8963.

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<sup>6</sup> Direct premiums written are the total premiums received by a health insurance company. Direct premiums written do not include indemnity reinsurance written and is not reduced by indemnity reinsurance ceded (transferred). Indemnity reinsurance is an agreement between one or more reinsuring companies and a covered entity under which A) the reinsuring company agrees to accept, and to indemnify the issuing company for, all or part of the risk of loss under policies specified in the agreement and B) the covered entity retains its liability to, and its contractual relationship with, the individuals whose health risks are insured under the policies specified in the agreement.

<sup>7</sup> Mandated under the ACA, MLR rebates are paid by insurers to employers whenever insurers do not spend at least a certain percentage, generally 80 to 85 percent, of the prior year's health insurance premiums on health care services.

<sup>8</sup> See Appendix V for a copy of Form 8963.

<sup>9</sup> During Fee Year 2014, the CCIIO required health insurance providers to provide Calendar Year 2013 net premium information by June 1. However, beginning in Fee Year 2015, the CCIIO requires this information to be filed by July 31 for the preceding calendar year.

<sup>10</sup> CCIIO data are available at <http://www.cms.gov/CCIIO/Resources/Data-Resources/mlr.html> and contain the raw data submitted by insurance companies subject to MLR reporting requirements.



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In addition, the ACA requires members of a controlled group<sup>11</sup> (controlled group members) to be treated as one covered entity for purposes of the filing requirement and fee calculation. The Forms 8963 submitted by covered entities are not subject to confidentiality and disclosure provisions, and the IRS makes the Form 8963 data available for public inspection on the IRS webpage.<sup>12</sup>

The IRS is responsible for calculating the amount of the annual fee for each covered entity. A covered entity's portion of the total fee, *e.g.*, \$8 billion for Fee Year 2014, is determined using its percentage of net premiums written (market share) which is calculated by dividing the covered entity's net premiums written subject to the fee (net premiums written less exclusions as shown below) by the total of net premiums written subject to the fee for all covered entities.

**Exclusions of net premiums subject to the fee**

Section 9010 excludes portions of the net premiums from the fee calculation for *all* covered entities. The IRS will:

- Exclude the first \$25 million of net premiums written.
- Exclude 50 percent of the net premiums written for amounts greater than \$25 million and up to \$50 million, *i.e.*, up to \$12.5 million of net premiums written are excluded.
- Include 100 percent of the net premiums written that are more than \$50 million.

For example, for a covered entity with net premiums written of \$150 million, the IRS will consider \$112.5 million to be the covered entity's net premiums written subject to the fee, and this amount will be used to determine the covered entity's market share as previously described. Figure 2 details the calculation of premiums subject to the fee.

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<sup>11</sup> A combination of two or more corporations that are under common control.

<sup>12</sup> Section 9010(g)(4) provides that Section 6103 of the Internal Revenue Code (relating to the confidentiality and disclosure of returns) does not apply to any information reported by covered entities under Section 9010(g). Form 8963 data obtained for the calculation of the preliminary fee are available for inspection at <http://www.irs.gov/Businesses/Corporations/Affordable-Care-Act-Provision-9010> (see Disclosure).



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**Figure 2: Hypothetical Example Calculation of Net Premiums Subject to the Fee**

Description	Amount Subject to Fee
0 percent of the first \$25,000,000 in net premiums.	\$0
50 percent of the next \$25,000,000 in net premiums (\$25,000,001 – \$50,000,000).	\$12,500,000
100 percent of the remaining \$100,000,000 in net premiums (\$50,000,001 – \$150,000,000).	\$100,000,000
<b>Total premiums subject to the fee</b>	<b>\$112,500,000</b>

Source: Treasury Inspector General for Tax Administration analysis of Section 9010.

Additionally, there are two exclusions available for certain covered entities:

- Covered entities exempt from tax, *i.e.*, exempt entities under Section 501(c)(3), 501(c)(4), 501(c)(26), or 501(c)(29), can exclude 50 percent of remaining net premiums attributable to its exempt activities after applying exclusions available to all covered entities.
- Covered entities reporting direct premiums written for expatriate plans<sup>13</sup> may rely on a temporary safe harbor<sup>14</sup> to exclude 50 percent of those premiums written for Fee Years 2014 and 2015 by attaching a statement to Form 8963 certifying the information.

Although a covered entity's net premiums may be excluded from the fee calculation, Form 8963 is still required to be filed. Figure 3 shows the number of covered entities that filed Forms 8963 for Fee Year 2014 and the number of controlled group members associated with those entities.

<sup>13</sup> Expatriate plans are group health insurance policies that provide coverage to employees who, substantially all of whom are working outside their country of citizenship, are working outside their country of citizenship and outside the employer's country of domicile, or are non-U.S. citizens working in their home country.

<sup>14</sup> A provision granting protection from liability or penalty if certain conditions are met.



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**Figure 3: Covered Entities Filing Form 8963 for Fee Year 2014**

<b>Amount of Net Premiums Written</b>	<b>Covered Entities</b>	<b>Controlled Group Members Associated With Covered Entities</b>
Over \$25 million – Assessed the Fee	292	981
\$25 million or less – Not Assessed the Fee	178	252
Total	470	1,233

Source: Treasury Inspector General for Tax Administration analysis of Forms 8963 from the Insurance Provider Fee system<sup>15</sup> for Fee Year 2014.

**IRS due diligence processes validate data prior to calculating the fee in an effort to ensure accuracy**

The IRS performs data validation tasks and works with the covered entities as necessary during processing of the Forms 8963, calculation of the fees, and assessment of penalties to ensure the accuracy of these processes. The IRS refers to these tasks as due diligence. The IRS indicated that these processes include:

- Comparing NAIC and CCIIO data with Form 8963 data to identify and contact, through correspondence or telephone calls, covered entities that have not filed Forms 8963.
- Comparing NAIC and CCIIO data with Form 8963 data to identify and contact, through correspondence or telephone calls, covered entities that have misreported (overstated or understated) insurance premiums.
- Ensuring that covered entities claiming the 50 percent exclusion for covered entities' tax-exempt activities are valid. The IRS validates tax-exempt eligibility by reviewing Master File<sup>16</sup> information and confirming tax-exempt status with its Tax Exempt and Government Entities Division.
- Ensuring that covered entities claiming the 50 percent expatriate exclusion comply with safe harbor requirements. The IRS verifies that covered entities include the required temporary safe harbor certified statement and that the 50 percent exclusion is correctly calculated.

<sup>15</sup> The Insurance Provider Fee system collects, stores, manages, and validates the data from the covered entities and identified external sources.

<sup>16</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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The IRS calculates the preliminary fee amount and final fee amount for each covered entity based on Form 8963 net premium information and the resulting information obtained through its due diligence. Figure 4 summarizes the timeline for filing, processing, and calculating the fee.

**Figure 4: Timeline for Administration of Fee Year 2014**

Date	Description of Action
January 1, 2014	Effective date of fee.
April 15, 2014	Covered entity due date for filing Form 8963 with the IRS to report net premiums written in Data Year 2013. <sup>17</sup>
June 13, 2014	The IRS mails each covered entity (including nonfilers) a notice of its preliminary fee calculation. This calculation includes premium information from Form 8963 and information from third parties, e.g., NAIC and CCIIO. If applicable, the preliminary fee letter will also include a notice of underreporting of net premiums written as well as a preliminary fee calculation for nonfilers identified by the IRS.
July 15, 2014	Each covered entity has an opportunity to dispute the preliminary fee calculation by submitting a corrected Form 8963.
August 28, 2014	The IRS recalculates the fee based on corrected premium information from Forms 8963 and information from third parties, e.g., the NAIC and the CCIIO, then notifies each provider of its final fee calculation.
September 30, 2014	Due date for payment of the fee via the Electronic Federal Tax Payment System. <sup>18</sup>

Source: Treasury Inspector General for Tax Administration analysis of IRS guidance for the fee.

**Fee penalty provisions**

Section 9010 states that a covered entity that fails to timely file Form 8963 (by April 15) can be assessed a failure to report penalty of \$10,000 plus the lesser of \$1,000 multiplied by the number of days the report is not timely filed or the amount of the fee. However, Section 9010 provides that this penalty will not be assessed if the failure to file is due to reasonable cause.

In addition, Section 9010 states that covered entities that understate net premiums written may be subject to an accuracy-related penalty. The penalty is equal to the excess of the amount of the fee that should have been paid over the amount of the fee determined based on the understatement of net premiums written reported on Form 8963. The regulations clarify that covered entities that understate net premiums on the initial Form 8963 but subsequently file a corrected Form 8963 will not be assessed the accuracy-related penalty.

<sup>17</sup> The calendar year immediately before the fee year.

<sup>18</sup> The Electronic Federal Tax Payment System is a free service from the U.S. Department of the Treasury that allows businesses, individuals, and tax professionals to pay Federal taxes electronically.



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This review was performed with information obtained from the Large Business and International Division's Pre-Filing and Technical Guidance function in Washington, D.C.; Planning, Analysis, Inventory, and Research organization in Ogden, Utah; and the ACA Project Management Office in Washington, D.C., during the period April 2014 through February 2015. 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 findings 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.



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## *Results of Review*

### ***Significant Efforts Were Taken to Educate Covered Entities on Fee Requirements; However, Data Sources to Identify Covered Entities Required to Report Net Premiums Continue to Be a Challenge***

As of November 28, 2014, the IRS collected almost \$7.99 billion of the \$8 billion fee for Fee Year 2014. The IRS took actions to both educate covered entities and ensure their compliance with fee filing and payment requirements. These actions include:

- Conducted outreach sessions for insurance providers hosted by America's Health Insurance Plans (the insurance industry's largest trade organization).
- Established a webpage dedicated to the fee on IRS.gov.
- Made available net premium information reported by covered entities on Form 8963 for Fee Year 2014 on IRS.gov.

To ensure compliance, the IRS used various data sources to the extent information was available to identify potential nonfilers and potential net premium reporting errors. This includes NAIC SHCE and CCIIO MLR data that are the IRS's only third-party sources of comparable premium information. However, these sources do not contain information regarding all covered entities. For example, the IRS received premium information on Forms 8963 for 1,233 providers in Fee Year 2014. However, our analysis of NAIC SHCE and CCIIO MLR data showed that 665 (53.9 percent) of the 1,233 providers were not included in premium information from either the NAIC SHCE or CCIIO MLR reports.

IRS management indicated that the filing requirements of Form 8963 differ from the filing requirements for NAIC SHCE and CCIIO MLR reporting. As a result, provider premium information may not always be included in NAIC or CCIIO data for all providers. For example, Health Maintenance Organizations are not required to file with the NAIC in the State of California but may be required to file Form 8963.<sup>19</sup>

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<sup>19</sup> Although Health Maintenance Organizations do not have to file with the NAIC, they have other State of California filing requirements.



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The IRS indicated that it used other third-party sources, such as the Health Insurance Oversight System,<sup>20</sup> the National Committee for Quality Assurance,<sup>21</sup> and the Centers for Medicare and Medicaid Services,<sup>22</sup> to identify potential nonfilers. However, these other sources do not contain comparable premium information for identifying covered entities that underreport net premiums.

The IRS knows that it cannot be assured that it identified all covered entities, ensured that they met their filing requirements, and accurately allocated the fee if health insurance providers are not required to file the NAIC SHCE or CCIIO MLR. However, in order to enhance transparency in administration of the fee, the IRS publishes Form 8963 premium information on IRS.gov. As a consequence, covered entities can review the information and notify the IRS of potential noncompliance with filing requirements. During Fee Year 2014, \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*.

***Covered Entities That File After Issuance of the Final Fee Letters Are Not Assessed the Fee Because the Regulations Do Not Include a Reconciliation Process***

Our review determined that the regulations do not provide a process for the IRS to correct the health insurance provider fee for all covered entities once the final fee letters are distributed. As a result, covered entities that file after the final fee calculation and distribution of the fee letters are not subject to their required portion of the fee. As of October 22, 2014, we identified seven covered entities that filed Forms 8963 after the IRS made the final fee calculation for Fee Year 2014. Three of these seven covered entities reported net premiums in excess of \$25 million and had a total of more than \*\*\*\*\*2\*\*\*\*\*. Our recalculation of the fee showed that these covered entities' portion of the fee would have been almost \*\*\*2\*\*\*\*\*. However, the net premiums for these three covered entities were not included in the IRS's final fee calculation.

In addition, although the IRS allocated the \$8 billion fee amount for the Fee Year 2014 final fee letters, fee amounts were not redistributed to all covered entities when changes were made to a covered entity's fee due to an IRS error discovered after the final fee letters were sent. For example, two covered entities alerted the IRS that in the calculation of their fee, the IRS did not use figures from their corrected Forms 8963. In response, the IRS reduced these covered entities' fee by more than \*\*\*2\*\*\*. However, these errors were not identified until after

<sup>20</sup> The Health Insurance Oversight System was created to facilitate several types of data collection from the Department of Insurance for States as well as insurance issuers that sell health insurance coverage.

<sup>21</sup> The National Committee for Quality Assurance is a private 501(c)(3) not-for-profit organization dedicated to improving health care quality.

<sup>22</sup> The Centers for Medicare and Medicaid Services was created to administer oversight for the Medicare Program and the Federal portion of the Medicaid Program.



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calculation of the final fee and mailing the final fee letters. The IRS did not redistribute the \*\*\*2\*\*\* to other covered entities. As a result, the IRS did not assess more than \*\*\*\*\*2\*\*\*\*\* of the \$8 billion fee amount for Fee Year 2014.

The fee is imposed upon the covered entities as a whole, with each covered entity being allocated a portion of the total fee based on the covered entity's ratio of premiums written subject to the fee to total premiums written subject to the fee for all covered entities. However, the regulations<sup>23</sup> provide that:

*In the interest of providing finality to the fee calculation process, the IRS will not accept a corrected Form 8963 after the end of the error correction period or alter final fee calculations on the basis of information provided after the end of the error correction period.*<sup>24</sup>

As a result, the IRS does not make adjustments to the fee calculation when covered entities either file or have adjustments after the final fee calculation. This consequently affects the fee amount for all covered entities. During the comment period for the regulations, stakeholders suggested to the IRS and the Department of the Treasury that the final regulations create a "true-up" (reconciliation) process by which the fee will be continually adjusted from year to year. However, in the interest of providing finality and certainty as to the fee liability, this suggestion was not adopted into the final regulations. Because the fee is an allocated fee, allowing a reconciliation process for one covered entity would result in adjustments to the fee for all covered entities.

It should be noted that the ACA does not prohibit the creation of a reconciliation process to ensure that the fee is accurately calculated and assessed to the covered entities. A reconciliation process is important because the IRS's availability and receipt of data from the CCIIO may not provide the IRS with the time needed to use the information in its due diligence process. For example, the CCIIO changed due dates of the MLR Annual Reporting Form from June 1 to July 31. In comparison, the regulations require the IRS to provide final fee letters to the covered entities by August 31. However when we discussed this with IRS management, they indicated that the change in reporting date of CCIIO data will not affect the IRS's ability to use CCIIO data in its due diligence process. We believe a reconciliation process would allow the IRS additional time to consider CCIIO data and ensure that the fee is accurately calculated for Fee Year 2015 and beyond.

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<sup>23</sup> The IRS, under the supervision of the Treasury Department, issues Treasury Regulations to provide guidance for new Internal Revenue Code provisions or other tax law provisions or to address issues that arise with respect to existing Internal Revenue Code sections.

<sup>24</sup> 26 C.F.R. Part 57.6(c) (Nov. 29, 2013).



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## **Recommendation**

**Recommendation 1:** The Commissioner, Large Business and International Division, should work with the Department of the Treasury to amend the regulations to provide for a reconciliation process to ensure that the fee is accurately allocated among covered entities.

**Management's Response:** The IRS disagreed with this recommendation. Provision 9010 is an allocated fee across all covered entities subject to the fee. Providing for a reconciliation process would result in adjustments to the fee for the entire population of covered entities and would lead to a lack of certainty and finality for the covered entities as to their fee liability. In addition, based on Fee Year 2014, the IRS cannot currently justify the cost versus benefit of a reconciliation process. The IRS will continue to review the effectiveness of the current administrative process over the next three years and evaluate with the Department of the Treasury the potential costs and benefits to the Government and covered entities to determine whether to amend the regulations to provide for a reconciliation process.

**Office of Audit Comment:** The lack of a reconciliation process results in the disparate treatment of covered entities and incorrect assessments of their portion of the annual health insurance provider fee. As we reported, the IRS's process allows covered entities that do not timely file required Forms 8963 to be exempt from paying their portion of the annual fee. This in turn results in covered entities that comply with the timely filing requirement paying more than their share in fees.

## ***Covered Entities That Did Not Timely File Forms 8963 Were Not Assessed Failure to Report Penalties***

Our review identified that 143 of the 477 covered entities (including the seven covered entities that filed after the final fee calculation) filed their original Form 8963 late.<sup>25</sup> However, as of February 13, 2015, the IRS has not assessed any of the 143 covered entities the failure to report penalty. Covered entities are required to file Form 8963 with the IRS by April 15. Figure 5 provides a breakdown of the late-filed Fee Year 2014 Forms 8963.

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<sup>25</sup> Forms 8963 were due April 15, 2014; however, we considered those filed after May 15, 2014, to be late.



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**Figure 5: Analysis of Late-Filed Fee Year 2014 Forms 8963**

Number of Days Form 8963 Was Filed After the Due Date	Number of Forms 8963
31 to 60	67
61 to 90	26
91 to 120	34
More Than 120	16
Total	143

*Source: Treasury Inspector General for Tax Administration analysis of Form 8963 received dates.*

Covered entities that do not timely file Forms 8963 can be assessed a failure to report penalty of \$10,000 plus the lesser of \$1,000 multiplied by the number of days the form is not filed timely or the amount of the fee. Specifically, Section 9010 states:

*A) IN GENERAL.—In the case of any failure to make a report containing the information required by paragraph (1) on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid by the covered entity failing to file such report, an amount equal to—*

*(i) \$10,000, plus*

*(ii) the lesser of—*

*(I) an amount equal to \$1,000, multiplied by the number of days during which such failure continues, or*

*(II) the amount of the fee imposed by this section for which such report was required.*

Each of the 143 covered entities provided the IRS with an explanation for why it was unable to submit the Form 8963 timely. Our review of the explanations from the 143 covered entities found that 123 (86 percent) of the explanations in general indicated that the covered entity was unaware of or unsure of the Form 8963 filing requirements. Figure 6 summarizes the reasons cited by the covered entities and the potential penalty amounts.





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## Appendix I

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether the IRS has developed processes to identify providers required to file premium reports, assess penalties on those that did not, and accurately determine health insurance providers' market shares and applicable annual fees. To accomplish our objective, we:

- I. Determined whether the IRS's procedures effectively identified covered entities that did not file required premium reports (nonfilers).
  - A. Reviewed the Internal Revenue Manual, Insurance Provider Fee system<sup>1</sup> SharePoint site, policy, memorandums, and other guidance and documentation related to the fee.
  - B. Evaluated communications and outreach performed by the IRS to the health insurance provider industry.
  - C. Interviewed fee program personnel to obtain an understanding of the policies, procedures, and practices taken to identify the population of covered entities that are required to file insurance premium reports with the IRS.
  - D. Determined whether the IRS properly identified covered entities that failed to file premium reports.
    1. Obtained 624 accepted original and corrected Forms 8963, *Report of Health Insurance Provider Information*, from the Insurance Provider Fee system as of August 22, 2014, for 470<sup>2</sup> covered entities, a list of 646 health insurance providers from the NAIC SHCE for Calendar Year 2013 as of July 15, 2014, and a list of 528 health insurance providers from the CCIIO MLR webpage for Calendar Year 2013 as of June 30, 2014.
    2. Identified 73 potential nonfilers using the information from Step I.D.1. and compared them with the IRS's list of potential nonfilers to determine whether the IRS properly identified the potential nonfilers. Our review identified no additional nonfilers that the IRS had not already identified.

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<sup>1</sup> The Insurance Provider Fee system collects, stores, manages, and validates the data from the covered entities and identified external sources.

<sup>2</sup> This does not include seven covered entities that filed Forms 8963 after the IRS made the final fee calculation for Fee Year 2014. These seven covered entities filed Forms 8963 after August 22, 2014 (the date we obtained data from the Insurance Provider Fee system).



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3. Identified and evaluated the IRS's process for including or excluding nonfilers identified by the IRS in Step I.D.2. in the preliminary and final fee calculation.
  4. Determined if other information could be used to identify additional nonfilers that were not identified by the IRS. Our review identified no additional data sources that the IRS had not already considered.
- II. Assessed the effectiveness of the IRS's processes to verify the amount of net premiums reported by health insurance providers on Forms 8963.
- A. Interviewed fee program personnel to obtain an understanding of the policies, procedures, and practices used to verify the amount of net premiums reported on Forms 8963.
  - B. Determined whether the IRS properly identified covered entities that underreport the amount of net premiums written.
    1. Using the data extract from Step I.D.1., independently identified 13 potential underreporters and compared them to underreporters identified by the IRS. We determined that based on the data sources available, the IRS properly identified underreporters.
    2. Identified and evaluated the IRS's process for including or excluding underreported amounts identified by the IRS in Step II.B.1. in the preliminary and final fee calculation. This included identifying the IRS's efforts to have providers file corrected reports, notify covered entities of underreported amounts in the preliminary fee letter, and document the determinations of whether potential underreported amounts the IRS identified should be included in or excluded from the fee calculation.
    3. Determined whether other information could be used to identify additional underreporters that were not identified by the IRS. Our review identified no additional data sources that the IRS had not already considered.
  - C. Determined that there was no impact attributable to the underreported net premiums we identified.
  - D. Determined the fee amount that should have been assessed to the underreporters but that was shifted to other covered entities. Because all underreporters were identified by the IRS, the amount was zero.
- III. Assessed the IRS's efforts to administer penalties for health insurance providers that failed to report timely.
- A. Determined if the IRS assessed the failure to report penalty on covered entities that did not submit Form 8963 by April 15, 2014.



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1. Identified 168 covered entities that did not file Form 8963 by April 15, 2014.
  2. Identified 143 covered entities from the Step III.A.2. that filed after May 15, 2014, and were not assessed the failure to report penalty. We determined that \$4,906,407 in penalties were not assessed as of February 13, 2015. We used May 15, 2014, (31 or more days late) as a conservative measure.
- IV. Evaluated the effectiveness of the IRS's processes to determine providers' market shares and annual fee amounts.
- A. Evaluated the accuracy and completeness of the fee data to ensure that all appropriate Forms 8963 received by the IRS were accurately included in the fee data.
  - B. Determined if the IRS used the most current premiums written information for all 470 known covered entities to calculate market shares. This included using Form 8963 data and corrected Form 8963 data.
  - C. Determined if the IRS correctly computed net premiums subject to the fee.
    1. Verified the accuracy of the IRS's calculation of the \*\*\*\*\*2\*\*\*\*\* aggregate net premiums written.
    2. Calculated the net premiums subject to the fee for all 470 known covered entities by applying the \$25 million exclusion, partial exclusion, and 50 percent exclusion for premiums attributable to 501(c) activities.
  - D. Identified each covered entity's market share and annual fee amount and compared them to fee amounts assessed by the IRS.
- V. Evaluated whether data from the fee application are correctly transferred to the Business Master File.<sup>3</sup> In addition, we determined that the IRS received almost \$7.99 billion in fee payments from the 292 covered entities assessed a portion of the fee as of November 28, 2014.

**Data validation methodology**

During this review, we relied on fee data provided by the IRS. We validated the data against filed Forms 8963 and found them to be reliable. We also relied on extracts from the Business Master File to obtain information on the posting of the fee and determination of tax-exempt status. Before relying on the data, we conducted validation tests and determined that the data were reliable.

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<sup>3</sup> The IRS database that consists of Federal tax-related transactions and accounts for businesses.



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**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 that the following internal controls were relevant to our audit objective: policies and procedures used to implement the insurance provider fee, and processes and procedures to ensure that covered entities file Form 8963, market share is properly calculated, and applicable penalties are properly assessed. We evaluated the controls by reviewing the IRS's Internal Revenue Manual, interviewing IRS management, reviewing laws and Treasury Regulations applicable to Section 9010, and evaluating applicable documentation and management information reports.



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**Appendix II**

*Major Contributors to This Report*

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)  
Diana M. Tengesdal, Director  
Darryl Roth, Audit Manager  
Johnathan D. Elder, Lead Auditor  
Levi J. Dickson, Senior Auditor  
David Robben, Senior Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Large Business and International Division SE:LB  
Director, Affordable Care Act Office SE:ACA  
Director, Planning Analysis Inventory and Research, Large Business and International Division  
SE:LB:P  
Director, Pre-Filing and Technical Guidance, Large Business and International Division  
SE:LB:PFTG  
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: Large Business and International Division SE:LB



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## **Appendix IV**

### *Outcome Measure*

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

#### **Type and Value of Outcome Measure:**

- Increased Revenue – Potential; \*\*\*\*2\*\*\*\*\* of health insurance provider fee reductions that the IRS did not redistribute proportionately to other covered entities for Fee Year 2014 (see page 9).

#### **Methodology Used to Measure the Reported Benefit:**

We identified that two of the 470 covered entities filed corrected Forms 8963 before the final fee calculation; however, the IRS did not calculate their fees using information from the corrected Forms 8963, *Report of Health Insurance Provider Information*. The covered entities notified the IRS of the errors after the final fee calculation and mailing of the final fee letter. The IRS recalculated the fee for these two covered entities, resulting in the reduction of \*\*\*\*2\*\*\*\* in fees, but the IRS did not recalculate or reallocate, for all covered entities, the resulting underassessment of the fee for Fee Year 2014.

The \$8 billion fee for Fee Year 2014 is to be assessed to covered entities with net premiums in excess of \$25 million based on each covered entity's portion of total market share. We calculated our outcome based on the total underassessment of the \$8 billion fee for Fee Year 2014, which totaled \*\*\*\*2\*\*\*\*. If a reconciliation process existed, this underassessment could have been redistributed to all covered entities with net premiums in excess of \$25 million, including the covered entities that filed Forms 8963 after the final fee calculation.



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**Appendix V**

*Form 8963, Report of  
Health Insurance Provider Information*

<input type="button" value="Save As"/>	<input type="button" value="Blank Form 8963"/>	<input type="button" value="Form 8963 Instructions"/>	<input type="button" value="Clear All Form Fields"/>	<input type="button" value="Print Form"/>
				Page 1 of 2
<b>Form 8963</b> (January 2014) Department of the Treasury Internal Revenue Service	<b>Report of Health Insurance Provider Information</b> <small>► Information about Form 8963 and its separate instructions is at <a href="http://www.irs.gov/form8963">www.irs.gov/form8963</a>. Read the instructions before you complete Form 8963.</small>			OMB Number 1545-2249  <b>Publicly Available Information</b>
<b>Check only one box below</b> (see instructions)				<input type="checkbox"/> <b>Corrected report</b> (see instructions)
<b>Single-person covered entity:</b> <input type="checkbox"/> 1 Single-person covered entity		<b>Designated entity:</b> <input type="checkbox"/> 2a Agent of an affiliated group <input type="checkbox"/> 2b Other		
Employer identification number (EIN)	Number of controlled group members included in Schedule A (see instructions)	Reporting year  2014		
Entity name				
Entity name (continued)				
Address (number and street). If you have a P.O. Box, see instructions.				
Address (continued)				
City, town, or post office (Foreign addresses should complete fields below - see instructions)			State	ZIP code
Foreign country name		Foreign province/state/county	Foreign postal code	
<b>PART I Signature of Official Signing on Behalf of the Single-Person Covered Entity or Designated Entity (Agent of an Affiliated Group, or Other Designated Entity) and Consent by the Designated Entity (if applicable)</b>				
<small>Under penalties of perjury, I declare that I have examined this report, including accompanying statements, and, to the best of my knowledge and belief, it is true, correct, and complete. I further certify that I am an officer of the single-person covered entity or the designated entity, and that I am duly authorized to sign this report on behalf of that covered entity.</small>				
<small>[If you checked box 2a or 2b] I also declare that the above named entity is the agent of an affiliated group or other designated entity (as per the instructions). I understand that the designated entity will receive IRS communications relating to the fee imposed by ACA section 9010 and is to pay this fee to the IRS on behalf of the controlled group. Each entity that is a member of the controlled group is jointly and severally liable for this fee. I further declare that each entity in the controlled group identified on this report consents to the choice of the designated entity indicated on this report. Each member of the controlled group that is a covered entity as of the end of the day on December 31, 2013, is jointly and severally liable for any applicable penalty under ACA section 9010. (If the designated entity is selected by the IRS, each entity in this report is deemed to consent to the choice of designated entity.)</small>				
<b>Sign Here</b> ►	Signature of official	Date signed	Business phone number	Business fax number
	Printed name of signing official		Title of signing official	
<b>PART II Alternate Contact Person Designee</b> (see instructions)				
Do you want to designate an employee to discuss this report with the IRS? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No				
Name of designee			Designee phone number	
Title of designee			Designee fax number	
<b>File the form electronically using e-File or mail Form 8963 to:</b> Internal Revenue Service 1973 Rulon White Boulevard Mail Stop 4916 IPF Ogden, UT 84404		Send the forms in a flat mailing envelope (not folded). Do not staple, tear, or tape any of these forms. If you are sending a large number of forms in conveniently sized packages, write your name on each package and number the packages consecutively.  United States postal regulations require forms and packages to be sent by First-Class Mail. However, you may use private delivery services such as DHL, FedEx and UPS.		
For Paperwork Reduction Act Notice, see the separate instructions.		Page 1 of 2	Cat. No. 37785K	Form 8963 (1-2014)



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Save As
Blank Form 8963
Form 8963 Instructions
Clear All Form Fields
Print Form

Publicly Available Information
Page 2 of 2

**Schedule A** Single-person covered entity or controlled group member information

On the first line, list information for the single-person covered entity or designated entity, whichever applies. Next, for a controlled group, list the information for all members of the controlled group who, as of the end of the day on December 31, 2013, are covered entities (see instructions). Complete a separate line on the schedule for each entity.

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Employer identification number (EIN)	Entity name	Address (number & street, city, state, postal (ZIP) code, and country). If you have a P.O. box or a foreign address, see instructions.	NAIC code	NAIC group code	Direct premiums written	MLR rebates	Stand-alone dental or vision direct premiums written	Net premiums written Subtract column (g) from column (f) and combine the result with column (h) [(f) - (g) + (h)]	Amount in column (i) attributable to 501 (c)(3), (4), (26) or (29) entities. Enter qualifying paragraph and related premiums
1									▼
2									▼
3									▼
4									▼
5									▼
6									▼
7									▼
8									▼
9									▼
10									▼
11									▼
12									▼
13									▼
14									▼
15									▼
16									▼
17									▼

Add new member
Click on the button to add a new member of the controlled group



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**Appendix VI**

*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

June 16, 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Heather C. Maloy   
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report – *The Affordable Care Act: Improvements Are Needed to Ensure the Accuracy of the Allocation of the Health Insurance Provider Fee* (Audit No. 201440303)

Thank you for the opportunity to review and comment on the subject draft report. The section 9010 Fee was enacted as part of the Patient Protection and Affordable Care Act, and it imposes an annual fee on health insurance providers (hereinafter "feepayers") starting in 2014. The fee is calculated by reference to each feepayer's portion of the market share of premiums.

We appreciate your acknowledgement of the achievements and progress that the IRS has made in its administration of the Section 9010 Fee, and your recognition of IRS' significant efforts to educate the feepayers and ensure their compliance with the fee filing and payment requirements. Your report also acknowledges that IRS is properly utilizing and analyzing data from external sources to evaluate return filing compliance and undertaking appropriate compliance efforts to identify underreporters and additional potential nonfilers.

Your report proposes only one recommendation, and it is that the "Commissioner, Large Business and International Division, should work with the Department of the Treasury to amend the regulations to provide for a reconciliation process to ensure that the fee is accurately allocated among covered entities." TIGTA does not address what a reconciliation process would look like, how it should be implemented, or what implementation costs to both the government and feepayers would be appropriate.

During the development of the Section 9010 regulations, IRS, the Office of Chief Counsel and the Department of the Treasury carefully considered whether a reconciliation process could be applied to the Section 9010 Fee. While certain stakeholders made comments on the proposed regulations favoring a "true-up" process by which the fee would be continually adjusted from year to year, IRS, the Office of Chief Counsel and the Department of the Treasury rejected such a process because it would lead to a lack of certainty and finality with regard to the fees for each year. IRS



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has not received any stakeholder comments since the issuance of the final regulations asking it to revisit a reconciliation process. IRS believes that overall, feepayers highly value the certainty and finality of the current process.

Also, the report shows that the effect of a reallocation of the \$8 billion fee for 2014 would be a net change to the remaining feepayers of \$1.2 million, or 0.015% of the total \$8 billion fee, spread among hundreds of feepayers. Given that a reconciliation process would likely substantially increase the cost and complexity of the fee determination process for both the government and the feepayers, IRS does not believe that this relatively low adjustment rate warrants such a change at this time.

The first year of administration of this fee was 2014. IRS continues to be engaged in ongoing due diligence with respect to the fee. Additional years of experience with the administration of the fee are needed to determine whether the current process is effective.

The report includes an outcome measure of potential increased revenue of \*\*\*\*\*<sup>2</sup>\*\*\*\*\*, representing fee reductions that IRS did not redistribute proportionately to other covered entities for fee year 2014. While IRS agrees that the identified amount is correct, this only impacts 2014. IRS disagrees with the conclusion that this outcome measure represents future potential revenue.

Also, we note that your report does not clearly reflect the significance of third-party sources on the administration of the fee. Specifically, your report states that 53.9% of the 1233 providers report premium information to third party sources. However, we note that the 46.1% of providers reporting to third parties represents approximately 94% of the premiums subject to the fee.

Finally, your report covers the potential penalties that can be assessed with regard to the fee under Section 9010. IRS will continue to consider and assess penalties as appropriate, on a case-by-case basis, based on all the facts and circumstances, to promote and encourage future compliance with the filing requirements of Section 9010.

Attached is the response outlining IRS actions.

If you have any questions, please contact me, or a member of your staff may contact Tina Meaux, Director, Pre-Filing and Technical Guidance, at (713) 209-4074.



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Attachment

**RECOMMENDATION 1:**

The Commissioner, Large Business and International Division, should work with the Department of the Treasury to amend the regulations to provide for a reconciliation process to ensure that the fee is accurately allocated among covered entities.

**CORRECTIVE ACTION:**

We disagree with this recommendation. Provision 9010 is an allocated fee across all feepayers. Providing for a reconciliation process would result in adjustments to the fee for the entire population of feepayers and would lead to a lack of certainty and finality for the feepayers as to their fee liability. In addition, based on fee year 2014, we cannot currently justify the cost versus benefit of a reconciliation process. IRS will continue to review the effectiveness of the current administrative process over the next three years and evaluate with the Department of the Treasury the potential costs and benefits to the government and feepayers to determine whether to amend the regulations to provide for a reconciliation process.

**IMPLEMENTATION DATE:**

NA

**RESPONSIBLE OFFICIAL(S):**

NA

**CORRECTIVE ACTION MONITORING PLAN:**

NA