



*Affordable Care Act: The Tax Exempt
and Government Entities Division's
Planning Efforts for the Health Care
Reform Legislation*

August 16, 2011

Reference Number: 2011-10-085

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.

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HIGHLIGHTS

AFFORDABLE CARE ACT: THE TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION'S PLANNING EFFORTS FOR THE HEALTH CARE REFORM LEGISLATION

Highlights

Final Report issued on August 16, 2011

Highlights of Reference Number: 2011-10-085 to the Acting Commissioner, Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

The Patient Protection and Affordable Care Act (ACA), along with amendments in the Health Care and Education Reconciliation Act of 2010, contains significant changes to the Nation's health care system. The Tax Exempt and Government Entities (TE/GE) Division has completed most of its initial planning activities for the ACA and is working on implementation activities. Our review did not identify any concerns relating to the methodology the TE/GE Division used to monitor and coordinate its planning efforts. Effective planning is critical to ensuring the TE/GE Division's readiness to implement this legislation.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine how the TE/GE Division is planning for the health care reform legislation. The review is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Implementing Health Care and Other Tax Law Changes.

WHAT TIGTA FOUND

The TE/GE Division established an internal Executive Steering Committee (ESC) and five implementation teams to oversee the planning for the ACA. Team meetings involving both the internal ESC and the five implementation teams were held on a monthly basis to discuss progress, issues identified, and actions planned. Significant action items and progress were also

documented in a consolidated monthly status report.

The TE/GE Division has completed most of its initial planning activities and is working on implementation activities for the ACA provisions that went into effect in Tax Year 2010. In its planning for the ACA, the TE/GE Division identified nine separate provisions that could impact its customers. In order to address these provisions, the TE/GE Division prepared 17 requests to revise tax forms and/or capture additional data. TIGTA did not identify any concerns relating to the TE/GE Division's identification of the ACA provisions applicable to its customers or the methodology used to monitor and coordinate its planning efforts.

Two of the nine provisions, the Small Employer Health Care Tax Credit and the additional requirements for tax-exempt hospitals, required the TE/GE Division to plan new processes for Tax Year 2010. To implement the Small Employer Health Care Tax Credit, the TE/GE Division coordinated the development of an IRS-wide strategy to address taxpayer compliance with requirements of the credit and planned for and initiated a program of compliance examinations of selected tax-exempt returns claiming the credit. As of May 21, 2011, TE/GE Division compliance personnel had initiated compliance reviews on 272 tax returns from tax-exempt organizations claiming this credit.

As required by the ACA, the TE/GE Division also planned and initiated a program of reviews of tax-exempt hospitals and began gathering information for the required annual report. As of April 30, 2011, the TE/GE Division had completed 570 (34 percent) of the 1,700 tax-exempt hospital reviews expected to be completed by the end of Calendar Year 2011.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in the report. TE/GE Division management reviewed the report before it was issued and offered clarifying comments and suggestions, which have been taken into account.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

August 16, 2011

MEMORANDUM FOR ACTING COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Affordable Care Act: The Tax Exempt and Government Entities Division’s Planning Efforts for the Health Care Reform Legislation (Audit # 201110020)

This report presents the results of our review of the Tax Exempt and Government Entities (TE/GE) Division’s planning efforts for the health care reform legislation. The overall objective of this review was to determine how the TE/GE Division is planning for the health care reform legislation. This review had a limited scope and focused on the status of the TE/GE Division’s efforts to plan for implementation of the provisions of the health care reform legislation applicable to its customers. We specifically focused on planning for the Small Employer Health Care Tax Credit and for the additional requirements for tax-exempt hospitals. This audit is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Implementing Health Care and Other Tax Law Changes.

The Treasury Inspector General for Tax Administration made no recommendations as a result of the work performed during this review. TE/GE Division management reviewed the report before it was issued and offered clarifying comments and suggestions, which have been taken into account.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report results. Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.



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Abbreviations

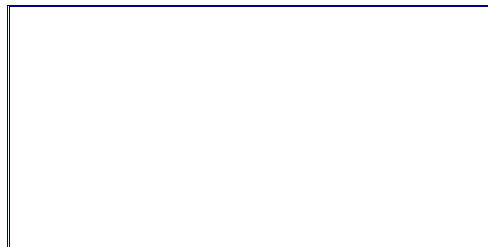
ACA	Patient Protection and Affordable Care Act
ESC	Executive Steering Committee
IRS	Internal Revenue Service
TE/GE	Tax Exempt and Government Entities Division



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Background

The Patient Protection and Affordable Care Act (ACA),¹ along with amendments in the Health Care and Education Reconciliation Act of 2010,² contains significant changes to the Nation's health care system. Administration of the changes falls upon the Department of Health and Human Services regarding health care policy issues and to the Internal Revenue Service (IRS) regarding multiple tax law changes included in the legislation. The ACA contains \$438 billion worth of revenue provisions in the form of new taxes and fees. The IRS's responsibilities include, but are not limited to:



- Delivering tax credits to businesses, tax-exempt organizations, and individuals to assist in covering the cost of health coverage.
- Administering the requirement for individuals to purchase health coverage (only for those who are deemed able to afford such coverage) or be subject to a penalty on their individual Federal tax returns.
- Administering the requirement for certain large employers to offer affordable health insurance coverage to employees or be subject to tax.
- Administering multiple tax provisions designed to raise revenues to offset the cost of health care reform.

While several tax provisions took effect in Tax Year³ 2010, such as the Small Employer Health Care Tax Credit, most will be implemented during the next several years. To manage implementation of the ACA, the IRS established an overall Executive Steering Committee (ESC) in mid-2010 headed by an executive dedicated solely to overseeing the IRS's ACA planning and implementation activities.

The IRS Tax Exempt and Government Entities (TE/GE) Division is responsible for meeting the special needs of pension plans, tax-exempt organizations, and government entities in complying with the tax laws. The ACA impacts the activities of the TE/GE Division in a number of areas. For example, the legislation contains provisions that impact TE/GE Division customers that are

¹ Pub. L. No. 111-148, 124 Stat. 119 (2010).

² Pub. L. No. 111-152, 124 Stat. 1029.

³ Tax year refers to 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.



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employers. Specifically, eligible tax-exempt organizations will be able to claim a credit of up to 25 percent of premiums paid for employees' health insurance for Tax Years 2010 through 2013. In addition, the legislation adds new requirements to the Internal Revenue Code that tax-exempt hospitals must meet to maintain their tax-exempt status.

This review was performed at the IRS National Headquarters in Washington, D.C., in the office of the TE/GE Division during the period March through June 2011. This review had a limited scope and focused on the status of the TE/GE Division's efforts to plan for the implementation of selected provisions of the health care reform legislation applicable to its customers. As such, we relied primarily on interviews with IRS personnel and reviews of available documentation, such as status reports and work requests, and did not perform any detailed testing to evaluate the effectiveness of actions taken by the IRS to implement the health care reform legislation. Otherwise, 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. 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

Preparing for implementation of the ACA tax provisions presented a number of critical challenges to the TE/GE Division, including the need to quickly identify the provisions applicable to its customers and develop a structure to manage planning for the implementation of those provisions. In order to address these challenges, the TE/GE Division established an internal ESC and five implementation teams to oversee planning for the ACA. Team meetings involving both the internal ESC and the five implementation teams were held on a monthly basis to discuss progress, issues identified, and actions planned. Significant progress and action items were documented in a consolidated monthly status report which was used by the internal ESC to monitor progress. In addition, the TE/GE Division provided monthly updates to the IRS-wide ACA ESC.

We did not identify any concerns relating to the TE/GE Division's identification of the ACA provisions applicable to its customers or the methodology it used to monitor and coordinate its planning efforts. At the time of our review, the TE/GE Division had completed most of its initial planning activities and was working on implementing the ACA provisions that went into effect in Tax Year 2010. In its planning for the ACA, the TE/GE Division identified nine separate provisions that could impact its customers.⁴ To address these provisions, the TE/GE Division prepared 17 requests to revise tax forms and/or capture additional data. Two of the nine provisions, the Small Employer Health Care Tax Credit and the additional requirements for tax-exempt hospitals, also required planning for additional compliance and review processes by the TE/GE Division. We specifically focused our audit work on these two provisions because they required the TE/GE Division to plan new processes for Tax Year 2010.

For implementation of the Small Employer Health Care Tax Credit, the TE/GE Division coordinated on the development of an IRS-wide strategy to address taxpayer compliance with the requirements of the credit and planned for and implemented a program of compliance examinations of selected tax-exempt returns claiming this credit. As required by the ACA, the TE/GE Division also planned for and initiated a program of reviews of tax-exempt hospitals and began gathering information for the annual report. Our limited scope review did not identify any concerns regarding the TE/GE Division's planning activities for the ACA provisions and we are making no recommendations in this report.

⁴ See Appendix IV for a listing of the provisions that could impact TE/GE Division customers.



Summary of Actions Taken to Plan for the Implementation of Selected Provisions of the Affordable Care Act

Small Employer Health Care Tax Credit

The Small Employer Health Care Tax Credit became effective for Tax Year 2010. The credit was designed to encourage small employers, including tax-exempt organizations, to offer health insurance coverage for the first time or maintain coverage they already have. For Tax Years 2010 to 2013, the maximum credit is 35 percent of premiums paid by eligible small business employers or 25 percent of premiums paid by eligible employers that are tax-exempt organizations. The credit for tax-exempt organizations is refundable. The IRS revised the Exempt Organization Business Income Tax Return (Form 990-T) and made programming changes to support processing of the credit for tax-exempt organizations. The IRS also created the Credit for Small Employer Health Insurance Premiums (Form 8941) and instructions to allow small employers, including tax-exempt organizations, to calculate the credit.

The IRS also developed an IRS-wide small employer tax compliance strategy to reduce opportunities for evasion, improve reporting compliance, and enhance taxpayer service. As a part of this strategy, TE/GE Division compliance staff is responsible for performing compliance examinations on selected returns from tax-exempt organizations claiming the Small Employer Health Care Tax Credit. On February 1, 2011, the TE/GE Division provided training to the staff assigned to these compliance examinations. Topics covered in the training included a general introduction to the credit, understanding the forms used to claim the credit, and allowable premium costs. The IRS advised that, as of May 21, 2011, TE/GE Division compliance personnel had initiated compliance examinations on 272 returns from tax-exempt organizations claiming the Small Employer Health Care Tax Credit. Because of the limited scope nature of this review, we did not perform any testing to evaluate the effectiveness of this process. The IRS also advised that through June 14, 2011, 3,980 taxpayers filing Form 990-T claimed the Small Employer Health Care Tax Credit, totaling \$16.6 million.

Additional requirements for tax-exempt hospitals

The ACA established additional requirements tax-exempt hospitals must meet in order to maintain their tax-exempt status. These requirements include implementing a financial assistance policy, limiting charges for emergency care, complying with new billing and collection requirements, and conducting community health needs assessments. These requirements affect approximately 5,100 tax-exempt hospitals. The IRS revised the Return of Organization Exempt From Income Tax (Form 990) Schedule H (Hospitals) for Tax Year 2010 in response to the new requirements. The revised Form 990 Schedule H provides a section for tax-exempt hospitals to describe their policies and activities in accordance with the new requirements, including new questions addressing the financial assistance, emergency medical care, and billing and collection policies of tax-exempt hospitals.



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In addition to new requirements for tax-exempt hospitals, the ACA requires the IRS to review the community benefit activities⁵ of tax-exempt hospitals at least once every 3 years. The TE/GE Division created a new group, the ACA Review of Operations, and provided training on November 16, 2010, to 10 employees responsible for performing the new reviews. Topics covered in the training included overall tax exemption requirements, community benefit standard factors, and unrelated business income issues.

The TE/GE Division advised that as of April 30, 2011, they had completed 570 (34 percent) of the 1,700 tax-exempt hospital reviews expected to be completed by the end of Calendar Year 2011. The ACA Review of Operations group performs these reviews to determine whether the tax-exempt hospitals report their community benefit activities. Because of the limited scope nature of this review, we did not perform any testing to evaluate the effectiveness of this process.

The ACA also requires an annual report to Congress on the levels of charity care⁶ provided by private tax-exempt, taxable, and government-owned hospitals and the costs incurred for community benefit activities by private tax-exempt hospitals. This report is to be prepared in consultation with the Department of Health and Human Services. The TE/GE Division identified and started capturing data on the financial assistance policies and community health benefits of tax-exempt hospitals as outlined on the revised Form 990 Schedule H. For example, the IRS made computer programming changes to record data on the financial assistance and other community benefit activities reported on Form 990 Schedule H. The IRS is exploring the need for a memorandum of understanding with the Department of Health and Human Services to help clarify data responsibilities regarding the preparation of this report.

⁵ Community benefit activities are tax-exempt hospital programs and services that promote the health of the community or communities served by the organizations.

⁶ Charity care refers to the provision of financial assistance at tax-exempt hospitals and other facilities, including providing free or discounted health services to persons who meet the tax-exempt hospital's criteria for financial assistance and are thereby deemed unable to pay for all or a portion of the services.



Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine how the TE/GE Division is planning for the health care reform legislation. This was a limited scope review and the overall approach was to gather the information necessary to quickly report the status of the TE/GE Division's efforts to implement the provisions of the health care reform legislation applicable to its customers. We specifically focused on planning for the implementation of the Small Employer Health Care Tax Credit and the additional requirements for tax-exempt hospitals because these provisions required the TE/GE Division to plan new processes for Tax Year 2010. To accomplish our objective, we:

- I. Determined whether the TE/GE Division identified the health care legislation provisions that could impact its customers.
- II. Determined the status of the TE/GE Division's efforts to prepare for the health care legislation.
 - A. Interviewed TE/GE Division senior managers regarding the overall actions planned/taken to prepare for the health care legislation.
 - B. Reviewed meeting minutes of any steering committees/implementation teams established within the TE/GE Division to guide planning for the health care legislation.
 - C. Interviewed applicable TE/GE Division personnel to obtain more detailed information on actions planned/taken for the health care provisions.
- III. Determined any plans by TE/GE Division management to develop new processes or programs or expand existing staffing to address implementation of the health care legislation.
 - A. Interviewed TE/GE Division management to determine any actions taken/planned to implement new processes or programs to prepare for the health care legislation.
 - B. Determined any plans to hire new staff or assign additional responsibilities to existing TE/GE Division personnel to prepare for the health care legislation.



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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 the following internal controls were relevant to our audit objective: the TE/GE Division's policies and procedures related to planning for the implementation of the health care legislation. We evaluated these controls by interviewing management, reviewing implementation team meeting minutes and status reports, and analyzing implementation plans.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations)

Jeffrey M. Jones, Director

Anthony J. Choma, Audit Manager

Angela Garner, Lead Auditor

Mary F. Herberger, Senior Auditor

Rashme Sawhney, 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
Acting Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
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

Affordable Care Act Provisions That Could Impact Tax Exempt and Government Entities Division Taxpayers

This appendix presents information on ACA tax provisions that could impact TE/GE Division taxpayers.

	Affordable Care Act Section	Affordable Care Act Provision	Provision Description	Effective Date
1	1322	Qualified Nonprofit Health Insurance Issuers	Provides tax-exempt status under section 501(c) (29) for qualified nonprofit health insurance issuers that meet certain requirements of the Consumer Operated and Oriented Plan program established by the Department of Health and Human Services.	3/23/2010
2	1341	Transitional Reinsurance Program	Provides tax exemption for applicable reinsurance entities.	3/23/2010
3	1421	Small Employer Health Care Tax Credit	Provides a refundable tax credit to small tax-exempt employers who contribute to health insurance premiums for their employees.	1/1/2010
4	5605	Key National Indicator System	Provides tax exemption for organizations that partner with the National Academy of Sciences to implement a Key National Indicator System.	3/23/2010
5	6301	Patient-Centered Outcomes Research	Added the Patient-Centered Outcomes Research Institute to the list of tax-exempt organizations.	3/23/2010



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	Affordable Care Act Section	Affordable Care Act Provision	Provision Description	Effective Date
6	9007	Additional Requirements for Tax-Exempt Hospitals	Imposes new requirements for tax-exempt hospitals to maintain their tax-exempt status. Also, tax-exempt hospitals are required to adopt a financial assistance and emergency medical care policy, billing and collection policies, and conduct community health needs assessments at least once every 3 years. Requires the IRS to perform a review of the community benefit activities at least once every 3 years for tax-exempt hospitals.	3/23/2010 Community assessment Beginning after 3/23/2012
7	9021	Exclusion of Health Benefits Provided by Indian Tribal Governments	Excludes from gross income the value of specified Indian tribal health benefits.	3/23/2010
8	9023	Qualifying Therapeutic Discovery Credit	Provides a 50 percent investment tax credit for qualified therapeutic discovery projects.	1/1/2009
9	10907	Excise Tax on Tanning Services	Imposes a 10 percent tax on indoor tanning services.	7/1/2010

Source: Legislative Analysis Tracking and Implementation Services reports and IRS internal documents.