Affordable Care Act: Processes to Identify Employers Subject to the Employer Shared Responsibility Payment Need Improvement

March 21, 2018

Reference Number: 2018-43-022

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AFFORDABLE CARE ACT: PROCESSES TO IDENTIFY EMPLOYERS SUBJECT TO THE EMPLOYER SHARED RESPONSIBILITY PAYMENT NEED IMPROVEMENT

Highlights

Final Report issued on March 21, 2018

Highlights of Reference Number: 2018-43-022 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

The Affordable Care Act's Employer Shared Responsibility Provision requires employers with an average of 50 or more full-time employees (including full-time equivalent employees) to offer health insurance coverage to full-time employees and their dependents beginning in January 2015. Employers that did not offer health insurance coverage, or offered health insurance coverage that did not meet minimum requirements or was not affordable, may be subject to an Employer Shared Responsibility Payment.

WHY TIGTA DID THE AUDIT

This audit was initiated as part of our coverage of the IRS's implementation of key Affordable Care Act tax provisions. This audit evaluated the IRS's implementation of processes to ensure compliance with the Employer Shared Responsibility Provision and related information reporting requirements.

WHAT TIGTA FOUND

The Employer Shared Responsibility Provision of the Affordable Care Act became applicable for tax periods after December 31, 2013. On July 9, 2013, the IRS issued notification providing transition relief for Calendar Year 2014 and making Calendar Year 2015 the first year the Employer Shared Responsibility Payment was applicable. On November 1, 2017, the IRS began sending letters advising Applicable Large Employers of their potential assessments of the Employer Shared Responsibility Payment for Tax Year 2015.

Our review of the IRS's process to identify Tax Year 2015 Applicable Large Employers potentially liable for the Employer Shared Responsibility Payment found that the IRS did not identify 840 employers potentially subject to more than $113 million in Employer Shared Responsibility Payments. The difference in identified Applicable Large Employers occurred because the data used by the IRS were not complete or accurate.

In addition, TIGTA found that additional improvements are needed to ensure that paper Affordable Care Act information returns are accurately processed. We identified that unclear form instructions and processing procedures contributed to unprocessable forms and unnecessary correspondence and that procedures for extracting and sorting mail caused unnecessary taxpayer correspondence.

Finally, a Service-wide strategy is needed to reduce resources expended on maintaining multiple Taxpayer Identification Number validation processes. TIGTA's review identified seven stand-alone systems and 28 different programs that perform validation processes. For the 15 systems and programs for which it could provide maintenance costs, the IRS indicated that it spent a total of $2.8 million in Fiscal Year 2016.

WHAT TIGTA RECOMMENDED

TIGTA made five recommendations to improve processes to identify employers subject to the Employer Shared Responsibility Payment, including ensuring that the data used to identify employers are complete and accurate and developing a Service-wide Taxpayer Identification Number validation strategy to reduce and streamline validation efforts.

IRS management agreed with all five of our recommendations.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

March 21, 2018

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Affordable Care Act: Processes to Identify Employers Subject to the Employer Shared Responsibility Payment Need Improvement (Audit # 201740317)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) implementation of processes to ensure compliance with the Employer Shared Responsibility Provision and related information reporting requirements. This review is included in our Fiscal Year 2018 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 VIII.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. 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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Appendices

Abbreviations

ACA	Affordable Care Act
AIR	ACA Information Returns
e-file, e-file(d)	Electronically File; Electronically File(d)
IRS	Internal Revenue Service
PTC	Premium Tax Credit
SCRIPS	Service Center Recognition Image Processing System
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
TINV-ECS	TIN Validation – Enterprise Common Service
TY	Tax Year

Background

The Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act of 2010 (collectively referred to as the Affordable Care Act (ACA))[1] include the Employer Shared Responsibility Provision.[2] The Employer Shared Responsibility Provision applies to employers that had an average of 50 or more full-time employees,[3] including full-time equivalent employees,[4] during the prior calendar year. These employers are referred to as Applicable Large Employers. Under the provision, Applicable Large Employers must offer health insurance to full-time employees (and their dependents) during the calendar year through an employer-sponsored plan beginning in January 2015 or a shared responsibility payment may apply. The health insurance coverage offered must:

- **Provide Minimum Essential Coverage** – health coverage that contains essential health benefits including emergency services, hospitalization, doctor visits, prescription drugs, and preventive and wellness services.
- **Be affordable** – the employee's share of the self-only premium does not exceed 9.5 percent of the employee's annual household income.
- **Provide minimum value to full-time employees (and their dependents)** – the health plan covers at least 60 percent of the total allowed cost of benefits that are expected to be incurred under the plan.[5]

Applicable Large Employers that do not offer health insurance coverage, or offer health insurance coverage that does not meet these requirements, are subject to an Employer Shared Responsibility Payment when at least one of the Applicable Large Employer's full-time employees purchases coverage through a Health Insurance Exchange[6] and is allowed a Premium Tax Credit (PTC).[7] Specifically, an Applicable Large Employer will be liable for the Employer Shared Responsibility Payment if the employer:

[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] Internal Revenue Code § 4980H.
[3] An employee who works an average 30 or more hours per week or 130 hours during the calendar month.
[4] An estimate of the number of full-time employees based on hours worked by employees working less than 130 hours per month. An employer calculates full-time equivalents by totaling the number of hours worked (limited to 120 hours per employee) for all part-time employees during the month and divides the total hours worked by 120.
[5] The Department of Health and Human Services developed a minimum value calculator, which is available on its website (www.CMS.gov), for employers to use to determine if a health insurance plan provides minimum value.
[6] The Exchange is where individuals find information about health insurance options, purchase qualified health plans, and, if eligible, obtain help paying premiums.
[7] A PTC is a refundable tax credit to assist eligible taxpayers with paying their health insurance premiums.

1. Does not offer health insurance coverage to at least 95 percent of its full-time employees (and their dependents) ***and*** at least one full-time employee receives the PTC. These payments are assessable under Section 4980H(a).
2. Offers health insurance coverage to 95 percent of full-time employees (and their dependents), ***but*** at least one full-time employee receives the PTC because he or she was one of the five percent of full-time employees who were not offered coverage or the coverage offered either was unaffordable or did not provide minimum value. These payments are assessable under Section 4980H(b).

The Internal Revenue Service (IRS) estimates that there were approximately 300,000 Applicable Large Employers for Tax Year[8] (TY) 2016.

Employer reporting requirement provision

The ACA requires Applicable Large Employers to file information returns annually with the IRS and provide statements to their full-time employees about the health care coverage they offered (or did not offer).[9] Figure 1 summarizes the information returns reporting requirements for Applicable Large Employers beginning in Processing Year[10] 2016.

Figure 1: Information Reporting Requirements for Applicable Large Employers

Information Return Required[11]	Purpose of Information Return
Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*	Used to report summary information of health insurance offered and coverage information by the Applicable Large Employer and to transmit Forms 1095-C.
Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage*	Used to report health insurance offer and coverage information for each full-time employee. This includes the name and Employer Identification Number[12] of the employer, the name and Social Security Number of the employee, the type of health insurance offered by the employer by month, and the months of health insurance coverage for the employee and each of the employee's dependents if self-insured.

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of information on IRS.gov.

The information included on Forms 1094-C and 1095-C is needed by the IRS to verify the accuracy of reported health insurance offers of coverage and for calculating the Employer Shared

[8] 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.
[9] Internal Revenue Code § 6056.
[10] The calendar year in which the tax return or document is processed by the IRS.
[11] See Appendices V and VI for examples of Forms 1094-C and 1095-C, respectively.
[12] A unique nine-digit number used to identify a taxpayer's business account.

Responsibility Payment. Employers that file 250 or more information returns during the calendar year must electronically file (e-file) Forms 1094-C and 1095-C with the IRS by March 31. Employers filing by paper are required to submit Forms 1094-C and 1095-C to the IRS by the last day of February. Applicable Large Employers are also required to furnish each full-time employee with a completed Form 1095-C or a substitute form that includes the same information by January 31 each year.

Beginning in Processing Year 2016, the ACA Information Returns (AIR)[13] system was used to process paper and electronically filed (e-filed) Forms 1094-C and 1095-C along with other ACA information returns. E-filed Forms 1094-C and 1095-C are transmitted directly to the AIR system, and paper Forms 1094-C and 1095-C are sent to the Kansas City, Missouri, or Austin, Texas, Submission Processing Sites to be scanned into the Service Center Recognition Image Processing System (SCRIPS).[14] Once scanned, the data are then transmitted from the SCRIPS to the AIR system.

Taxpayer Identification Number (TIN)[15] validation process

The AIR system is used by the IRS to validate the TINs included on Forms 1094-C and 1095-C in order to ensure that the forms are associated with and report data on the correct taxpayer. To validate a TIN, the AIR system sends the TIN, name, and request type (individual, business, or unknown) to the TIN Validation – Enterprise Common Service (TINV-ECS) to match against Individual Master File[16] and Business Master File[17] information. The TINV-ECS then sends a response back to the AIR system including the match results. The match results include one of the following:

- **TIN not found**.
- **Exact match –** TIN and generated name control.[18]
- **Proximal match –** *****************2************, the second and third letters can be switched, ******************2*********************************** *********************************2*****************.
- **No match**.

[13] The AIR system accepts ACA information return transmittals and documents, including Forms 1094-C and 1095-C. It will process each submission and provide a status and detailed acknowledgement for the transmitter.
[14] The SCRIPS is a data capture, management, and storage system that uses high-speed scanning and digital imaging technology to process tax documents.
[15] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, a Social Security Number, or an Individual TIN.
[16] The IRS database that consists of Federal tax–related transactions and accounts for individuals.
[17] 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.
[18] Name control is first four characters of the individual's last name or business.

- **Match to a prior name control –** A taxpayer's name control can change if a taxpayer changes his or her name, *e.g.*, due to a marriage. The IRS checks the taxpayer's prior name controls for a match.

The AIR system then uses this information to accept *********2*********** or reject ***2*** information returns. If the system rejects the information return, the employer will be notified of the rejection and the reason for the rejection.

A prior TIGTA audit identified that the IRS implemented processes and procedures in an effort to ensure that employers could comply with information reporting requirements

In April 2017, we reported that some processes related to the receipt and readiness of information reporting returns did not function as intended.[19] This resulted in the IRS not having accurate and complete data for use in its compliance strategy to identify employers potentially subject to the Employer Shared Responsibility Payment. In addition, the development and implementation of key systems needed to identify employers subject to an Employer Shared Responsibility Payment had been delayed, not initiated, or cancelled. For example, the IRS's implementation of the post-filing compliance validation system was initially scheduled for January 2017 but had been delayed to May 2017. TIGTA made seven recommendations. IRS management agreed with six of the seven recommendations. The IRS did not agree that it should establish a time frame for employers to correct errors identified on Forms 1094-C and reevaluate the need for additional written guidance in the future.

This review was performed at the Small Business/Self-Employed Division's Employment Tax Examination offices in Florence, Kentucky, and Bloomington, Minnesota; the Wage and Investment Division's Submission Processing Sites in Kansas City, Missouri, and Austin, Texas; and the Information Technology organization office in Austin, Texas, during the period of December 2016 through October 2017. 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.

[19] TIGTA, Ref. No. 2017-43-027, *Affordable Care Act: Assessment of Efforts to Implement the Employer Shared Responsibility Payment* (Apr. 2017).

Results of Review

Technology Limitations and Unissued Guidance Resulted in the Delayed Assessment of the Employer Shared Responsibility Payment

The Employer Shared Responsibility Provision of the ACA became applicable for tax periods after December 31, 2013. On July 9, 2013, Notice 2013-45, *Transition Relief for 2014 Under § 6055 (§ 6055 Information Reporting), 6056 (§ 6056 Information Reporting) and 4980H (Employer Shared Responsibility Provisions),* was issued by the IRS providing transition relief for Calendar Year 2014 and making Calendar Year 2015 the first year the Employer Shared Responsibility Payment was applicable. IRS management indicated that they originally planned to select TY 2015 case inventory by March 2017. On November 1, 2017, the IRS began sending letters advising Applicable Large Employers of their potential assessments of the Employer Shared Responsibility Payment for TY 2015. Reasons why the issuance of the notices were delayed until November included:

- A Revenue Procedure was not issued giving direction to Applicable Large Employers on the process once they receive a letter with a proposed Employer Shared Responsibility Payment. The Revenue Procedure would provide guidance to taxpayers who are sent notices proposing Employer Shared Responsibility Payments. IRS management noted that the Revenue Procedure was not issued because they did not receive final approval from the Department of the Treasury. However, in lieu of not receiving the final approval, IRS management provided guidance by updating its Frequently Asked Questions and posting Letter 226J,[20] which informs Applicable Large Employers of their potential liability, on IRS.gov on November 2, 2017.

- The server the IRS planned to use to store and process data for use in determining the Applicable Large Employer liability and to calculate the Employer Shared Responsibility Payment had security restrictions that interrupted its ability to process the data. For example, the time necessary to complete a particular data run may have exceeded the time limit established by the IRS's Information Technology security organization. This required the IRS to revise its determination and calculation process.

It should be noted that the IRS now has the data to begin the analysis to determine and calculate the potential Employer Shared Responsibility Payment for TY 2016.

[20] Letter 226J is the initial letter issued to Applicable Large Employers to notify them that they may be liable for an Employer Shared Responsibility Payment. See Appendix VII for an excerpt of Letter 226J.

Processes to identify potentially liable employers and calculate potential Employer Shared Responsibility Payments

The IRS uses a multistep process to identify the Applicable Large Employers that are potentially liable for the Employer Shared Responsibility Payment. This process starts with analyzing Form 1094-C, Form 1095-C, and PTC data to identify the population of Applicable Large Employers potentially subject to the Employer Shared Responsibility Payment. Next, the IRS determines which of these Applicable Large Employers qualify to receive transition relief[21] or safe harbor,[22] removing the Applicable Large Employer from the case selection population of those employers potentially subject to the Employer Shared Responsibility Payment. Once this is completed, the IRS will then calculate the Employer Shared Responsibility Payment. The calculation is based on the extent to which insurance coverage is offered. Figure 2 summarizes the calculation of the Employer Shared Responsibility Payment for Processing Year 2016 and later.

Figure 2: Employer Shared Responsibility Payment Calculation

Shared Responsibility Payment Provisions	Payment Calculation
Section 4980H(a)[23] provides for an assessable payment for employers that do not offer health coverage. Under Treasury Regulations,[24] the payment applies if: 1. The Applicable Large Employer offered health insurance coverage to less than 95 percent[25] of its full-time employees (and their dependents). 2. At least one of the Applicable Large Employer's full-time employees receives the PTC.	The Employer Shared Responsibility Payment is $2,000 per employee[26] for the number of full-time employees in excess of 30. The IRS calculates the payment on a month-by-month basis. Thus, an employer who owes the payment will pay $166.67 (1/12 of $2,000) per month per the number of full-time employees in excess of 30.
Hypothetical example: *Company K has 100 full-time employees for each month of the calendar year. Company K does not offer the Minimum Essential Coverage to its full-time employees (and their dependents) for any month of the calendar year. Fourteen full-time employees obtain health insurance through an Exchange and receive the PTC for each month. The Employer Shared Responsibility Payment is calculated as: [the number of full-time employees (100) less 30] x $2,000. This results in an Employer Shared Responsibility Payment for Company K of $140,000 for the calendar year.*	

[21] There are eight forms of transition relief for TY 2015 that apply to various aspects of the Employer Shared Responsibility Provisions. Each form of relief is described on IRS.gov and in section XV.D of the preamble to the Employer Shared Responsibility regulations.
[22] There are three affordability safe harbors available for Applicable Large Employers. The Form W-2, *Wage and Tax Statement,* wages safe harbor; the rate of pay safe harbor; and, the Federal poverty line safe harbor.
[23] Internal Revenue Code § 4980H(a).
[24] Treasury Decision 9655, *Shared Responsibility for Employers Regarding Health Coverage* (Feb. 2014).
[25] Due to transition relief rules, the coverage required for TY 2015 was 70 percent.
[26] The amount of the payment per employee is indexed to inflation beginning in Processing Year 2015.

Shared Responsibility Payment Provisions	Payment Calculation
Section 4980H(b)[27] provides for a payment for those Applicable Large Employers that offer coverage to employees but an employee obtains coverage from an Exchange because the coverage offered was either unaffordable or did not provide minimum value. Under Treasury Regulations, the payment applies if: 1. The Applicable Large Employer offered health insurance coverage to 95 percent or more of full-time employees (and their dependents). 2. At least one of the Applicable Large Employer's full-time employees receives a PTC.	The Employer Shared Responsibility Payment is equal to the lesser of $3,000[28] for each full-time employee who receives the PTC or the payment calculated under Section 4980H(a). The IRS calculates the payment on a month-by-month basis. Thus, an Applicable Large Employer that owes the payment will pay $250 (1/12 of $3,000) per month per the number of full-time employees receiving the PTC.
Hypothetical example: *Company M has 100 full-time employees for each month of the calendar year and offers the Minimum Essential Coverage to its full-time employees (and their dependents). However, the Minimum Essential Coverage is not affordable for all of the employees. Fourteen of its full-time employees obtain health insurance through an Exchange and receive the PTC for each month of the calendar year. The Employer Shared Responsibility Payment is calculated as the lesser of the:* • *Number of full-time employees who received the PTC for each month of the calendar year (14) x $3,000 = $42,000.* • *Number of full-time employees (100) less 30 x $2,000 = $140,000.* *For the calendar year, Company M is subject to an Employer Shared Responsibility Payment of $42,000.*	

Source: TIGTA analysis of information on IRS.gov.

Due to Incomplete and Inaccurate Data, Some Applicable Large Employers That Were Potentially Liable Were Not Identified

TIGTA's review of the IRS's process to identify TY 2015 Applicable Large Employers potentially liable for the Employer Shared Responsibility Payment from the population of 318,296 employers that filed 434,507 Forms 1094-C as of June 2017 found that the IRS did not identify 840 employers potentially subject to more than $113 million in Employer Shared Responsibility Payments. Figure 3 shows the comparison of the IRS's and TIGTA's identification of potentially liable Applicable Large Employers for TY 2015.

[27] Internal Revenue Code § 4980H(b).

[28] The amount of the payment per employee is indexed to inflation beginning in Processing Year 2015.

Figure 3: Comparison of the IRS's and TIGTA's Identification of Potentially Liable Applicable Large Employers for TY 2015

		Potential Employer Shared Responsibility Payment Amount Calculated by TIGTA
TIGTA-Identified Applicable Large Employers	33,080	$4.49 billion
Less: IRS-Matched Applicable Large Employers	32,240	$4.37 billion
Applicable Large Employers Not Identified by the IRS	840	$113 million

Source: TIGTA and IRS analysis of TY 2015 Forms 1094-C, Forms 1095-C, and PTC claims.

The difference in identified Applicable Large Employers occurred because the data used by the IRS were not complete or accurate. For example, the data used by the IRS did not always use the most current and correct Forms 1094-C when identifying potentially liable employers. Our analysis showed that of the 434,507 filed Forms 1094-C, 185,421 (42.7 percent) represented multiple submissions by Applicable Large Employers. Additionally, 34,345 (7.9 percent) Forms 1094-C filed by Applicable Large Employers were omitted from the IRS's data due to the forms not having attached Forms 1095-C, even though the form instructions direct the Applicable Large Employer to submit corrected Forms 1094-C as a stand-alone document.

When we brought our concerns to IRS management's attention in September 2017, they said that they agreed with our analysis and acknowledged that the data they used to identify potentially liable Applicable Large Employers were incomplete and inaccurate. Subsequently, the IRS informed us that it had extracted new data that were complete to include stand-alone Forms 1094-C and had refined the business rules to select the most appropriate Form 1094-C when a taxpayer submitted multiple forms.

Additional improvements are needed to ensure that paper information returns are accurately processed

As of October 24, 2017, the IRS reported processing more than 120 million Forms 1094-C and 1095-C. Of those, 115.5 million (96 percent) forms were e-filed and 4.8 million (4 percent) were submitted on paper. In April 2017, we reported that the IRS was unable to process paper information returns timely and accurately. In large part, this resulted from various errors associated with processing of these information returns. IRS management agreed with our recommendations to correct the identified errors. However, our current review continues to identify errors in the scanning of paper information returns. Our review of a judgmental sample[29] of 20 Forms 1094-B/C and 100 Forms 1095-B/C received on or before May 18, 2017, found that five (25 percent) of the Forms 1094-B/C and 43 (43 percent) of Forms 1095-B/C had entries that were missing or incorrectly captured when scanned into the SCRIPS. For example, in the responsible individual date of birth field, the scanner read the taxpayer's birth year entry of 1953 as 1983.[30]

When we discussed our concerns with IRS management, they indicated that needed major enhancements to the SCRIPS have not been made since the issuance of the prior report. In that report, the errors were caused by SCRIPS employees failing to correct scanning errors during data verification and the optical character recognition incorrectly reading form entries. IRS management stated that they would not be in a position to begin reviewing this process until later in Processing Year 2017.

Unclear form instructions and processing procedures contributed to unprocessable forms and unnecessary correspondence

Our review of a judgmental sample of 246 information returns processed by the Austin and Kansas City Submission Processing Sites in Processing Year 2017 identified that 17 (7 percent) of the forms were rejected from being processed by the SCRIPS because the forms used were not in the correct format (*i.e.*, they were in portrait, not landscape, format). As a result, these taxpayers received letters from the IRS directing them to resend their entire submission. This occurred because the *Instructions for Forms 1094-B and 1095-B* and *Instructions for Forms 1094-C and 1095-C* do not provide specific information as to the format that employers should use to submit information returns on paper.

It should be noted that the IRS was unable to provide the number of letters sent to employers requesting the resubmission of their paper information returns resulting from the incorrect portrait formatting because the letter it issues is a general letter sent for all information returns and not specific to ACA forms. We notified IRS management of this issue on June 14, 2017, and recommended that the language in the *Instructions for Forms 1094-B and 1095-B* and *Instructions for Forms 1094-C and 1095-C* be updated. IRS management agreed and incorporated the suggested language in the 2018 Filing Season[31] revisions of the instructions for Forms 1094-B and 1095-B and Forms 1094-C and 1095-C.

Procedures for extracting and sorting mail caused unnecessary taxpayer correspondence

Our review also identified that procedures used to extract and sort paper information returns resulted in some taxpayers having to needlessly resubmit information returns that were originally properly submitted. For example, our judgmental sample of 246 paper information returns found that 39 (16 percent) of the 246 did not have either a Form 1094 or Form 1095 as required. This occurred because IRS employees failed to keep entire submissions together when opening and

[29] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.
[30] TIGTA hypothetical example.
[31] The period from January through mid-April when most individual income tax returns are filed.

sorting the mail. Sorting mail clerks open the mail to review and place them with like forms. Batching mail clerks then collect the Forms 1094 and 1095 from the sorting mail clerks and place the forms in bins to be processed. As the bins would become full, the batching mail clerks would take a portion of the submissions and place them into a new bin, resulting in some submissions of Forms 1094 and 1095 for the same employers being separated. When we brought this issue to management's attention, they stated that they are going to improve sorting procedures to reduce the chance of separation and train employees on ensuring that forms are not separated during processing.

Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 1: Ensure that the data used to identify Applicable Large Employers potentially liable for the Employer Shared Responsibility Payment are complete, and refine the business rules to use the most current and correct Form 1094-C data when identifying potentially liable Applicable Large Employers.

> ***Management's Response:*** The IRS agreed with this recommendation. IRS management plans to review and refine the previously established business rules (as necessary) to use the appropriate Form 1094-C data when identifying potentially liable Applicable Large Employers for the Employer Shared Responsibility Payment.
>
> ***Office of Audit Comment:*** The IRS did not agree with the potential increased revenue outcome measure of $113 million, citing that the outcome was computed prior to the IRS using updated data to identify the Applicable Large Employer population. Our outcome measure is the amount of the potential Employer Shared Responsibility Payment associated with 840 employers that the IRS did not identify. This resulted from the IRS's use of inaccurate and incomplete data. After we brought this to management's attention, they corrected their analysis.

Recommendation 2***:*** Ensure needed enhancements are made to the SCRIPS system so that it accurately captures Forms 1094-C and 1095-C data during scanning.

> ***Management's Response:*** The IRS agreed with this recommendation. IRS management plans to perform enhanced managerial reviews immediately to evaluate the data conversion accuracy rate. Management also plans to take appropriate actions to address employee and systemic performance improvement needs based on the cumulative results of the reviews. The actions could range from individual counseling that would occur immediately to identifying areas in which training materials or programming requirements need to be revised.

Recommendation 3: Improve the mail sorting process and provide additional training and guidance to employees to ensure that related paper Forms 1094 and Forms 1095 remain together during processing.

> ***Management's Response:*** The IRS agreed with this recommendation and plans to reinforce existing procedures during training. IRS management also plans to issue an alert via the Service-Wide Electronic Research Program prior to training to ensure that employees understand the system capabilities and the importance of maintaining the integrity of submissions.

The Case Selection Process Was Recently Modified to Address Applicable Large Employers That Self-Reported Not Providing Coverage

IRS management indicated that once potentially liable employers are identified, they plan to use a computer program to randomly select cases to work. The random selection will be made without regard to the dollar value of the potential Employer Shared Responsibility Payment assessment amounts. It should be noted that although the IRS identified 49,259 potentially liable Applicable Large Employers to be assessed the Employer Shared Responsibility Payment,[32] resources limited the number of cases the IRS selected to 6,015 as of December 2017. IRS management explained that they planned to select Applicable Large Employer cases to work based on a percentage of Section 4980H(a), Section 4980H(b), and combined Sections 4980H(a) and (b) cases based on the number of employees who received a PTC and the number of months liable for the payment, as shown in Figure 4.

[32] The difference between the population of cases identified by TIGTA and the IRS is due to the timing of the data used and the IRS using incomplete and inaccurate data. TIGTA's data were as of April 2017, whereas the IRS used data as of July 2017.

Figure 4: IRS Case Selection Percentages

Case Type	Selection Rate of Applicable Large Employers With: Two or less employees receiving a PTC or payment liability is applicable for only one month	Selection Rate of Applicable Large Employers With: More than two employees receiving a PTC and payment liability is applicable for more than one month	Total Percentage of Case Type Worked
Section 4980H(a)	11 percent	33 percent	44 percent
Section 4980H(b)	11 percent	33 percent	44 percent
Both Sections 4980H(a)&(b)	3 percent	9 percent	12 percent
Total	25 percent	75 percent	100 percent

Source: Prior IRS case selection methodology.

Similar to other case selection processes we have reviewed, we raised concerns to IRS management that the use of a random selection process continues to be contrary to the IRS's current Future State vision for allocating its budget and resources.[33] Specifically, this vision seeks to improve tax administration by selecting the highest value work using data analytics.

Subsequent to our meeting with IRS management, they advised us that they changed their case selection process. According to IRS management, the new process for selecting cases ***2*** **************************************2********************************** **************************************2********************************** **************************************2********************************** *****2*****. For the 6,015 cases the IRS selected as of December 2017, a total of 5,932 cases *****2************. Potential assessments associated with these 5,932 employers total $3.5 billion. ***************************2********************************** ************************2**************************. According to IRS management, since the Employer Shared Responsibility Payment case selection methodology is new, they are using these cases to gather data to analyze all segments of the population to assist in future case analysis, selection, and assignment. This will also allow the IRS to use the data gathered from working the TY 2015 cases to further refine case selection methodologies and increase the probability subsequent tax year case selections include those with the highest compliance impact. Figure 5 shows the potential number of cases and assessment amounts by

[33] TIGTA, Ref. No. 2017-40-038, *Case Selection Processes Result in Billions of Dollars in Potential Employer Underreported Tax Not Being Addressed* (July 2017).

case type that the IRS identified and selected for TY 2015 using its new approach as of December 7, 2017.

Figure 5: Potential Employer Shared Responsibility Payment Cases and Dollars

Case Type	Selected IRS Cases	Potential Employer Shared Responsibility Payments	Total IRS Cases	Total Potential Employer Shared Responsibility Payments
Section 4980H(a)	***2***	***2***	***2***	***2***
Section 4980H(b)	***2***	***2***	***2***	***2***
Both Sections 4980H(a) and 4980H(b)	***2***	***2***	***2***	***2***
Total	***2***	***2***	***2***	***2***

Source: IRS analysis of TY 2015 Forms 1094-C, Forms 1095-C, and PTC claims.

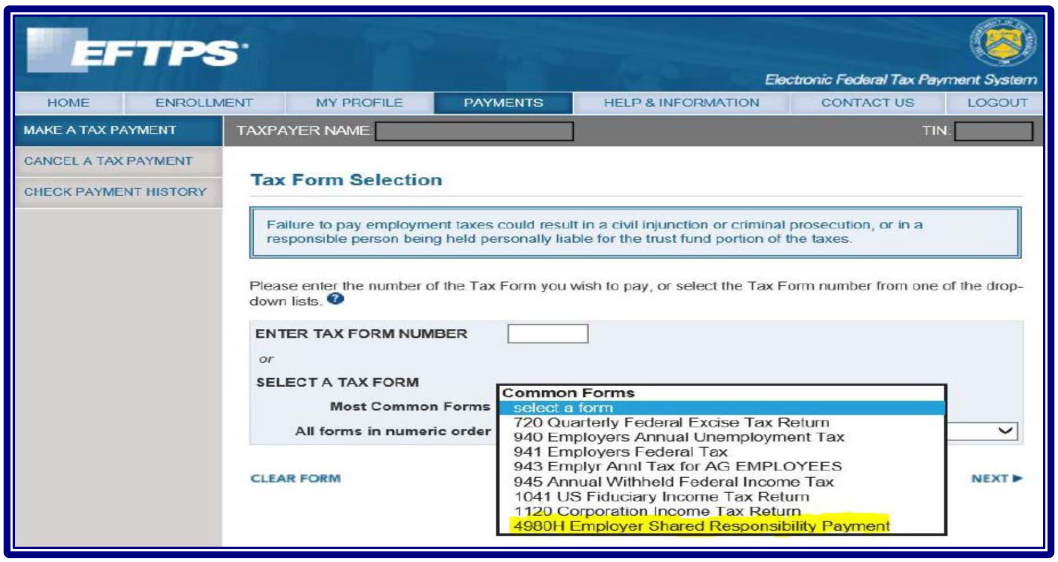
Misapplied Employer Shared Responsibility Payments Likely Result From Taxpayer Error When Using the Electronic Federal Tax Payment System

Our analysis of taxpayer accounts for TYs 2015 and 2016 (as of December 28, 2016) and TY 2017 (as of April 26, 2017)[34] identified 124 taxpayers that made Employer Shared Responsibility Payments totaling $584,466. The IRS posted these payments to the associated tax accounts as an Employer Shared Responsibility Payment. However, as we detailed earlier, the IRS had not selected or sent potential assessment letters to employers until November 2017; as such, there would not have not been an associated Employer Shared Responsibility Payment due by these taxpayers at the time their payments were credited to their account. Further analysis of these tax accounts identified that 41 (33 percent) of the 124 taxpayer accounts had payments totaling $133,620 that were identified as being misapplied as an Employer Shared Responsibility Payment and subsequently refunded to the taxpayer or transferred to another of the taxpayer's tax accounts.

[34] As of December 28, 2016, there were 103 TY 2015 and 2016 taxpayer accounts with current payments totaling $442,299. In addition, as of April 26, 2017, there were 21 TY 2017 taxpayer accounts with current payments totaling $142,166.

The misapplied payments are likely the result of taxpayer error when sending payments to the IRS via the Electronic Federal Tax Payment System.[35] For example, the Electronic Federal Tax Payment System includes an option, via its "Most Common Forms" drop-down box, for Applicable Large Employers to make an Employer Shared Responsibility Payment and have that credited to their tax account. Taxpayers were likely selecting this payment option in error. Figure 6 provides an example of this payment feature.

Figure 6: Screenshot of the Electronic Federal Tax Payment System Web Page



Source: Electronic Federal Tax Payment System business web page captured June 26, 2017.

When we brought our concern to IRS management's attention, they stated that the Employer Shared Responsibility Payment option was made available, as requested by external stakeholders, so Applicable Large Employers could make advance payments to their accounts. However, it seems unlikely that any Applicable Large Employer would pay the Employer Shared Responsibility Payment in advance because part of the computation of the Employer Shared Responsibility Payment includes knowing how many employees received the PTC, which would not likely be known by the employer.

To verify whether any Applicable Large Employers had actually paid in advance, we surveyed a judgmental sample of 20 (16 percent) of the 124 taxpayers whose tax accounts showed that they made an Employer Shared Responsibility Payment. All 20 taxpayers that we interviewed stated that they were not familiar with the Employer Shared Responsibility Payment and instead intended their payments to be applied to either their employment or excise taxes. As of

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[35] The system designed to process Federal tax deposits and other types of business and individual payments.

August 14, 2017, there were Employer Shared Responsibility Payments totaling $450,846 still remaining on 83 accounts.

Recommendation

Recommendation 4: The Commissioner, Small Business/Self-Employed Division, should research the 83 taxpayers we identified and contact them, if necessary, to resolve the credit balance and ensure that these payments were not posted as Employer Shared Responsibility Payments in error.

> **Management's Response:** The IRS agreed with this recommendation. IRS management researched the 83 taxpayers and ensured that procedures are in place to resolve the credit balances. Actions included ensuring that all accounts on the Employer Shared Responsibility Payment master list are assigned for contact to be made if resolution is necessary. The accounts that are not part of the Employer Shared Responsibility Payment master list are addressed through the current Accounts Maintenance Research Hold procedures.

A Service-Wide Strategy Is Needed to Reduce Resources Expended on Maintaining Multiple Taxpayer Identification Number Validation Processes

Our review identified that the IRS is replacing the existing TIN validation system, the TINV-ECS, used to perform TIN validation for ACA information returns. IRS management stated during this review that, for the 2018 Filing Season, they plan to transition the TIN validation for ACA information returns to a new application called the TIN Discovery Service.[36] To date the IRS has spent more than $2.3 million to develop the TIN Discovery Service. The IRS stated that the new system is designed to better align with the overall requirements of the Information Returns Systems Modernization[37] program, which strives to modernize the information returns intake process. IRS management indicated that they plan to use this system to eventually process all types of information returns. For example, the new system will be able to validate approximately 30 times more TINs per day in order to meet new service demands.

[36] The TIN Discovery Service will perform the following on information returns: validate issuer and recipient TINs, discover a TIN based on name and date of birth, discover a TIN based on name and address, determine TIN type, and reattempt to validate TINs that were unable to be previously validated.
[37] The Information Returns Systems Modernization program will address the limitations presented by the existing Information Returns Systems by consolidating intake, leveraging new data formats, and storing data in a modernized database environment to increase business efficiency.

Multiple TIN validation processes exist, with no consolidation strategy to reduce resources expended maintaining these processes

Our review of documentation provided by the IRS identified multiple systems and processes used to perform TIN validation. These include validating TINs on information returns, tax returns, *etc*. Figure 7 provides a description of some of the multiple stand-alone systems used by the IRS to validate TINs.

Figure 7: Description of Stand-Alone Systems Designed to Perform TIN Validation

Stand-Alone Systems	
System Name	**Description**
Branded Prescription Drug	Employer Identification Numbers detailed on Forms 8947, *Report of Branded Prescription Drug Information*, are validated manually by IRS employees using the National Account Profile.
Information Return Processing Input Processing*[38]	Used to validate payee TINs on legacy Information Return documents (Form 1099-MISC, *Miscellaneous Income*; Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*; *etc*.).
Online Payment Agreement Application	Used to validate TINs from online installment agreements made by individuals, businesses, and authorized powers of attorney.
Payer Master File*	Used to validate payer TINs on legacy Information Return payer documents (Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*; Form 1042-T, *Annual Summary and Transmittal of Forms 1042-S*; *etc*.).
TIN Entry	Used to validate TINs for most of the IRS telephone applications.
TINV-ECS*	Used to validate TINs and the associated name against IRS taxpayer records.
Where's My Amended Return	Used to validate TINs for taxpayers entered on the Where's My Amended Return IRS web page.

Source: IRS Information Technology organization management.

Figure 8 provides a description for the 28 programs that are part of existing IRS systems or databases that have built-in programming to perform the validation of TINs. As part of their programming, they perform validations of the TIN, name control, or both against IRS databases

[38] Asterisks in Figures 7 and 8 identify the systems and programs for which the IRS provided TY 2016 maintenance cost data.

to ensure the accuracy of the taxpayer's information being recorded or researched in these systems. It should be noted that there is no centralized process or system by which these programs perform TIN validations.

Figure 8: Description of Systems That Include TIN Validation Programming

Programs That Include TIN Validation Programming	
System Name	**Description**
Account Transfers	An IRS system used to make transfers between accounts when an assessment has posted to an incorrect account.
Audit Inventory and Management System	A monitoring and reporting tool used to perform detailed analysis of tax cases within the Examination function.
Automated Insolvency System*	The IRS's primary tool for tracking legal requirements for dealing with taxpayers under bankruptcy protection.
Automated Offers in Compromise*	An application that tracks and controls offers in compromise.
Automated Trust Fund Recovery Program*	Computes trust fund amounts to assist the Collection function with making assessments on individual taxpayers who are officers in companies owing taxes on business accounts.
Business Maser File Posting and Analysis*	Determines if information can post to a business return. For example, it posts transactions, reconciles debits and credits, and assesses and abates penalties.
Business Master File Pre-Posting*	Receives, controls, and formats tax account updates from various sources.
Disclosure of Federal State and Local Agencies*	Allows participating Federal, State, and local agencies to request data for use in public assistance programs.
Duplicate TIN Online Research	Provides information on duplicate uses of an individual's TIN and maintains how each Social Security Number was used.
Electronic Federal Payment Posting System	The IRS component of the Department of the Treasury's Electronic Federal Tax Payment System, an electronic system for reporting and paying payroll taxes.
Electronic Funds Transfer	Used to collect direct debit installment agreements for individual and business taxpayers.
Error Resolution System*	Provides for the correction of errors associated with input submissions received by the IRS.
Generalized Mainline Framework	Validates data from tax returns, remittances, information returns, and adjustments.
Generalized Mainline Framework 15	Balances most generated transactions that go forward for processing.

Programs That Include TIN Validation Programming	
System Name	**Description**
Identity Protection Personal Identification Number	Provides a Personal Identification Number to taxpayers that are victims of identity theft.
Individual Master File*	Primarily used to display tax account information on individual taxpayers to internal IRS users.
Individual Master File Document Specific*	Provides processing of individual returns and individual and business payments.
International Web Application	Consists of two application systems that process data for the IRS's international program.
Modernized e-File*	Receives and processes e-filed returns in an Internet environment.
Modernized Internet Employer Identification Number	Allows the general public to apply for an Employer Identification Number from the Internet and receive the number in the same session.
National Account Profile Online Research	Research tool used to display IRS database information for TINs and name controls.
Partnership Control System Legacy	Provides the capability to research the relationship among partners and partnerships.
Questionable Refund Program	A noncompliance detection program designed to identify refund fraud schemes.
Remittance Processing System	An automated system for remittance data.
Returns Inventory and Classification System*	Provides access to return and filer information related to the filing and processing of tax returns.
Third-Party Contact	System that collects third-party contact information.
Transcript Delivery System	Provides self-service for taxpayer return and account information requested by external customers.
Various Integrated Data Retrieval System Command Codes*	Tools used by IRS employees to research taxpayers' accounts.

Source: IRS Information Technology organization management.

Although we requested data to quantify the cost associated with maintaining the stand-alone and TIN validation programs, the IRS was unable to provide this information for the majority of the systems and programs. IRS management indicated that the information would need to be gathered from multiple functions and was not readily available. For the 15 systems and programs for which the IRS could provide maintenance costs, the IRS indicated that a total of $2.8 million was expended in Fiscal Year 2016. Further, when we asked IRS management if they had a Service-wide strategy to consolidate all TIN validation processes within the IRS to one group or function, they stated that they have no such plans. Given the IRS's current budget and resource constraints, the IRS should evaluate the resources being expended to maintain duplicate TIN validation systems and processes.

Recommendation

Recommendation 5***:*** The Commissioner, Small Business/Self-Employed Division, and the Commissioner, Wage and Investment Division, should work with the Chief Information Officer to develop a Service-wide TIN validation strategy to reduce the number of TIN validation systems and programs to streamline and consolidate TIN validation efforts.

> ***Management's Response:*** The IRS agreed with this recommendation. IRS management responded that the Commissioner, Small Business/Self-Employed Division, and the Commissioner, Wage and Investment Division, plan to work with the Chief Information Officer to develop a common TIN validation strategy for all new applications that need to perform TIN validation. In addition, with support of the Small Business/Self-Employed and Wage and Investment Divisions, the Information Technology organization will analyze existing legacy applications (per Figures 7 & 8) that are performing in-line TIN Validation to identify potential candidates, based on technical merits and cost/benefit analysis, for modification and migration to a Service-wide TIN validation system.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's implementation of processes to ensure compliance with the Employer Shared Responsibility Provision[1] and related information reporting requirements. To accomplish our objective, we:

I. Reviewed the IRS's TIN[2] validation strategies.

   A. Determined if the IRS has an overall corporate IRS TIN validation strategy and whether the strategy includes plans for consolidation of the various TIN validation processes.

   B. Determined if the IRS has a TINV-ECS[3] validation strategy and if the strategy includes plans for consolidation of TIN validation functions.

   C. Determined the number of other functions within the IRS that perform TIN validation and identified the specific TIN validation processes that are used.

   D. Quantified the amount of resources that are expended as a result of the duplicate TIN validation processes.

II. Ensured that the corrective actions for recommendations on paper returns in TIGTA's prior audit report[4] were implemented for Processing Year[5] 2017.

   A. Determined if the IRS has developed a process to ensure that the SCRIPS[6] accurately captures Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, and Forms 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, data and that sufficient fields are captured to assess the Employer Shared Responsibility Payment.

   B. Reviewed the SCRIPS processing of Forms 1094-C and 1095-C.

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[1] Internal Revenue Code § 4980H.

[2] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, a Social Security Number, or an Individual TIN.

[3] Used to validate TINs and the associated name against IRS taxpayer records.

[4] TIGTA, Ref. No. 2017-43-027, *Affordable Care Act: Assessment of Efforts to Implement the Employer Shared Responsibility Payment* (Apr. 2017).

[5] The calendar year in which the tax return or document is processed by the IRS.

[6] The SCRIPS is a data capture, management, and storage system that uses high-speed scanning and digital imaging technology to process tax documents.

1. Reviewed a judgmental sample[7] of 246 paper information returns of 5.2 million paper-filed forms to identify unprocessable and unscannable paper Forms 1094-C and 1095-C at the Austin and Kansas City Submission Processing Sites and determined if the forms were properly classified. We selected these returns on-site at random while performing our walk-through in order to obtain the sample during processing.
2. Determined the volume and circumstances under which the IRS sends correspondence to employers notifying them of unprocessable or unscannable forms, whether the correspondence adequately identifies the error so that the employer can make the needed correction, and the amount of time that is allowed for the employer to respond.
3. Determined if the SCRIPS machines at the Austin and Kansas City Submission Processing Sites are properly scanning and reading paper forms by selecting a judgmental sample of 20 paper-filed Forms 1094-C from a population of 74,544 and 100 paper-filed Forms 1095-C from a population of 4,806,730. We selected this judgmental sample at random while performing our walk-through in order to obtain the paper sample during IRS processing.

III. Determined if the IRS correctly identified and properly selected the most productive Employer Shared Responsibility Payment cases for TY 2015.

A. Determined if the IRS correctly identified the full population of Applicable Large Employers that are subject to the Employer Shared Responsibility Payment.

1. Obtained the IRS's population of Applicable Large Employers that are subject to the Employer Shared Responsibility Payment.
2. Compared the IRS's population to TIGTA's population of Applicable Large Employers subject to the Employer Shared Responsibility Payment and determined if the IRS identified the entire population.
3. For those not identified by the IRS, quantified the number of Applicable Large Employers that should have been included in the population and the potential amount of the Employer Shared Responsibility Payment that should have been assessed on these Applicable Large Employers.

B. Determined if the IRS selected the most productive cases to be worked.

1. Obtained and reviewed the criteria that the IRS used to select the cases to be worked from the overall population. We determined if the criteria included the highest dollar cases.

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[7] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

2. Determined if the case selection criteria properly include cases that should be worked and properly excludes cases that should not be worked.

3. Quantified the potential amount forgone by not selecting the most productive cases.

IV. Determined if the IRS's processes to calculate and assess the Employer Shared Responsibility Payment are correctly determining the Employer Shared Responsibility Payment.

A. Obtained and analyzed Internal Revenue Manuals, desk procedures, and other documentation for calculating and assessing the Employer Shared Responsibility Payment.

B. Determined what caused taxpayer payments to be misapplied as Employer Shared Responsibility Payments and if these payments are being accurately corrected. From the 124 taxpayers, contacted a judgmental sample of 20 taxpayers to determine if their payment was misapplied. We selected this sample size because it represented taxpayers with misapplied payments on their accounts and taxpayers with payments that had been transferred or refunded.

Data validation methodology

For this review, we relied on TY 2015 Forms 1094-C and Forms 1095-C data extracted from the Information Returns Database.[8] We also relied on data contained on the IRS's Business Objects Enterprise Report as well as taxpayer payment records extracted from the Business Master File.[9]

To assess the reliability of the computer-processed data, programmers within TIGTA's Strategic Data Services validated the data extract files, and we ensured that the data extract contained the specific data elements we requested and that the data elements were accurate. In addition, we selected judgmental samples and verified that the data in the extracts were the same as the data contained in the IRS's Integrated Data Retrieval System.[10] We determined the data were sufficiently reliable for our intended purposes.

[8] A database used to receive and persist validated information return data from the AIR system.
[9] 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.
[10] IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

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: the IRS's policies and procedures for the receipt and processing of Forms 1094-C and 1095-C and processes for ensuring employer compliance with the shared responsibility provision and information reporting requirements. We also evaluated the controls incorporated into the SCRIPS system to help ensure the accuracy and completeness of Forms 1094-C and 1095-C processed during the 2017 Filing Season.[11] We accomplished this by interviewing IRS management and reviewing the Internal Revenue Manual, management information reports, and key system documentation related to the receipt and processing of Forms 1094-C and 1095-C. Additionally, we evaluated the controls related to the data used to identify and select Applicable Large Employers potentially liable for the Employer Shared Responsibility Payment.

[11] The period from January through mid-April when most individual income tax returns are filed.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Chief Information Officer
Associate Chief Information Officer, Affordable Care Act (PMO)
Director, Affordable Care Act Office
Director, Affordable Care Act, Small Business/Self-Employed Division
Director, Customer Account Services, Wage and Investment Division
Director, Program Management Office, Affordable Care Act Office
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination

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:

- Increased Revenue – Potential; $113,899,153[1] in Employer Shared Responsibility Payments (see page 7).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of TY[2] 2015 Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, Forms 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, and PTCs[3] claimed by employees. We captured the data for those individuals who received a PTC and then matched those data to the Form 1095-C for that individual. We then gathered the Form 1094-C data for these employees that received the PTC. We compiled the employee data for each Applicable Large Employer to determine the number of employees that trigger the Employer Shared Responsibility Payment for each Applicable Large Employer. We then filtered out those Applicable Large Employers that claimed tax year transition relief or a safe harbor. This resulted in 33,080 potentially liable Applicable Large Employers. We compared our identified potentially liable Applicable Large Employers to the IRS's data and found that the IRS had not properly identified 840 Applicable Large Employers as potentially liable due to using incomplete and inaccurate source data. We then computed the Section 4980H(a) and Section 4980H(b) penalties, if applicable, for each of these Applicable Large Employers. We found that the 840 Applicable Large Employers that the IRS did not identify were potentially liable for $113,899,153 in Employer Shared Responsibility Payments. These employers were not identified as potentially liable for the Employer Shared Responsibility Payment because IRS data used to identify those potentially liable were not complete or accurate.

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[1] The IRS has not worked these types of returns before. As such, there is no historical data showing how much of the $113 million will likely be assessed. Collection of the entire amount is unlikely, but the amount likely to be collected could not be quantified more accurately with the information available.

[2] 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.

[3] A PTC is a refundable tax credit to assist eligible taxpayers with paying their health insurance premiums.

When we brought our concerns to IRS management's attention in September 2017, IRS management said that they agreed with our analysis and acknowledged that the data they used to identify potentially liable Applicable Large Employers were incomplete and inaccurate. Subsequently, the IRS informed us that it had extracted new data that were complete to include stand-alone Forms 1094-C and had refined the business rules to select the most appropriate Form 1094-C when a taxpayer submitted multiple forms.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 83 taxpayer accounts with tax payments misapplied as Employer Shared Responsibility Payments (see page 13).

Methodology Used to Measure the Reported Benefit:

We conducted analysis of TYs 2015, 2016,[4] and 2017[5] taxpayer accounts and found that 124 taxpayers had payments on their accounts totaling $584,466. We then monitored these accounts and found that as of August 14, 2017, 83 taxpayers still had $450,846 in payments misapplied to Section 4980H Employer Shared Responsibility Payments on their accounts and 41 taxpayers had the payments either refunded or transferred to another account. Starting on August 28, 2017, we contacted a judgmental sample[6] of 20 taxpayers to determine if the taxpayer intended to make a payment towards the Section 4980H Employer Shared Responsibility Payment. Ten of these taxpayers had payments still on their account, and 10 had the payments refunded or transferred. All 20 taxpayers we contacted stated that they did not intend the payment to be applied towards the Section 4980H Employer Shared Responsibility Payment. Instead, they intended the payment to be applied to either employment or excise taxes.

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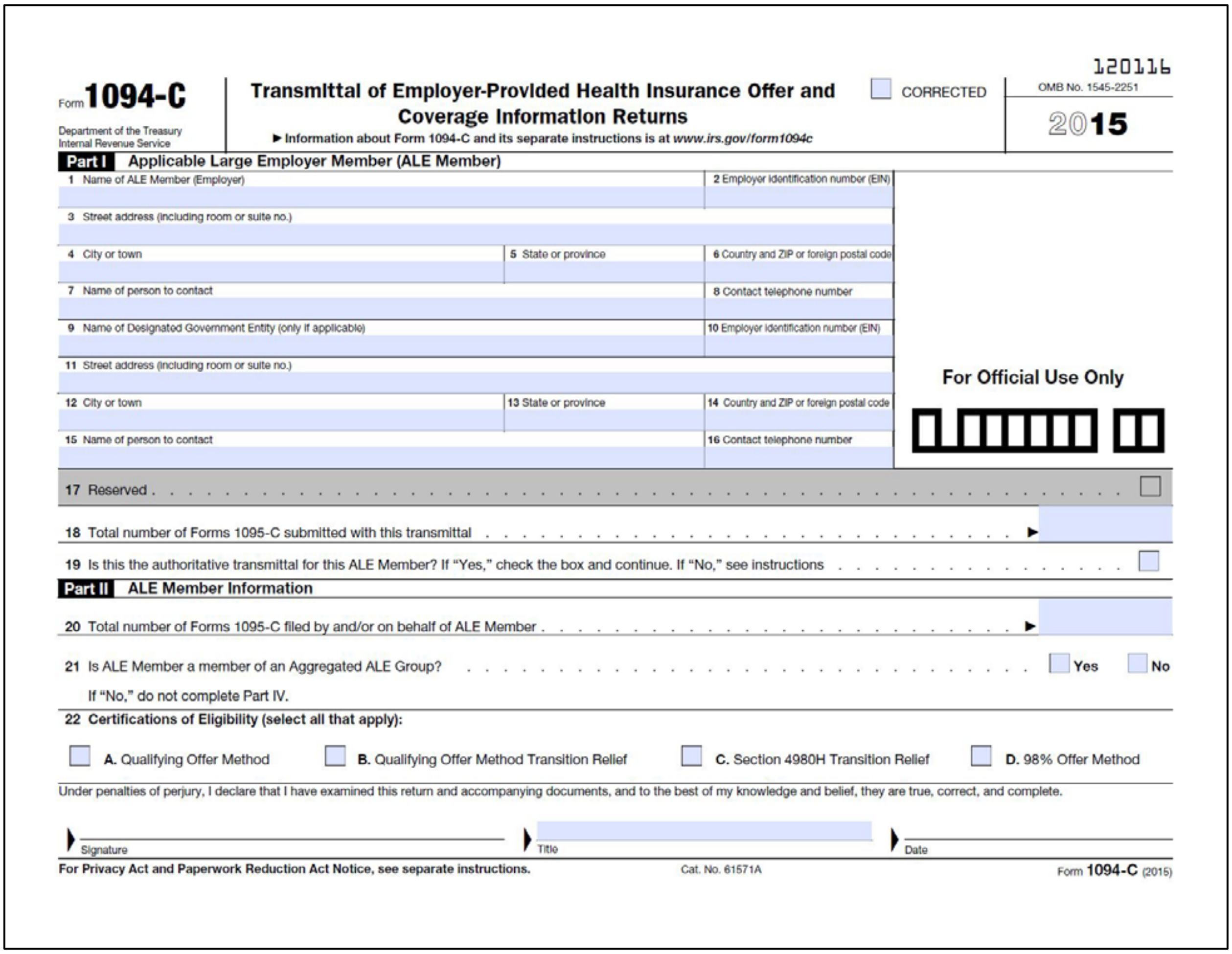
[4] As of December 28, 2016, for TYs 2015 and 2016.
[5] As of April 26, 2017, for TY 2017.
[6] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

Appendix V

Form 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns



120116

Form **1094-C**

Department of the Treasury
Internal Revenue Service

Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns

► Information about Form 1094-C and its separate instructions is at *www.irs.gov/form1094c*

☐ CORRECTED

OMB No. 1545-2251

2015

Part I **Applicable Large Employer Member (ALE Member)**

1 Name of ALE Member (Employer)
2 Employer identification number (EIN)
3 Street address (including room or suite no.)
4 City or town
5 State or province
6 Country and ZIP or foreign postal code
7 Name of person to contact
8 Contact telephone number
9 Name of Designated Government Entity (only if applicable)
10 Employer identification number (EIN)
11 Street address (including room or suite no.)
12 City or town
13 State or province
14 Country and ZIP or foreign postal code
15 Name of person to contact
16 Contact telephone number

For Official Use Only

17 Reserved . . . ☐

18 Total number of Forms 1095-C submitted with this transmittal . . . ►

19 Is this the authoritative transmittal for this ALE Member? If "Yes," check the box and continue. If "No," see instructions . . . ☐

Part II **ALE Member Information**

20 Total number of Forms 1095-C filed by and/or on behalf of ALE Member . . . ►

21 Is ALE Member a member of an Aggregated ALE Group? . . . ☐ **Yes** ☐ **No**

If "No," do not complete Part IV.

22 Certifications of Eligibility (select all that apply):

☐ **A.** Qualifying Offer Method ☐ **B.** Qualifying Offer Method Transition Relief ☐ **C.** Section 4980H Transition Relief ☐ **D.** 98% Offer Method

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and to the best of my knowledge and belief, they are true, correct, and complete.

► Signature ► Title ► Date

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 61571A Form **1094-C** (2015)

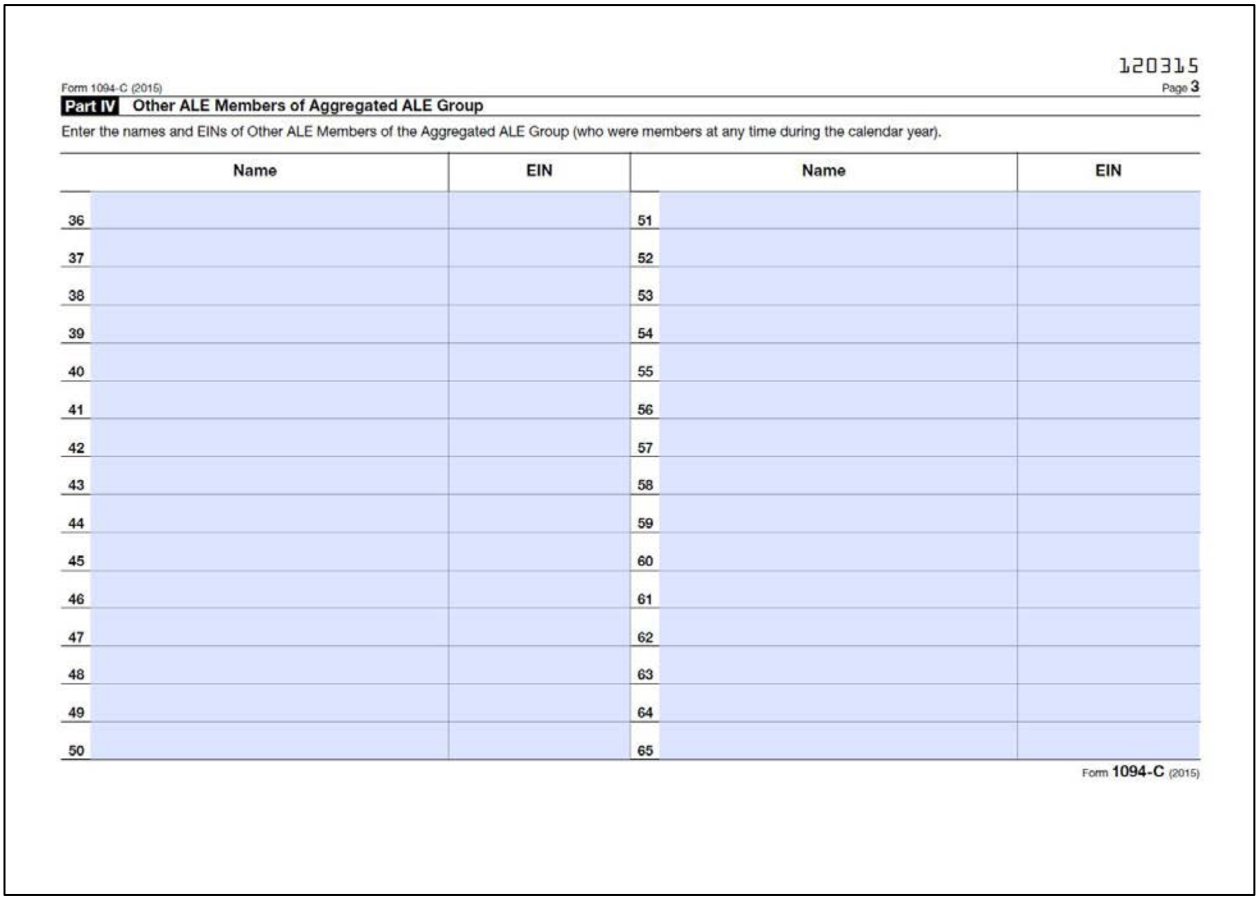
120216

Form 1094-C (2015) Page 2

Part III ALE Member Information—Monthly

		(a) Minimum Essential Coverage Offer Indicator		(b) Full-Time Employee Count for ALE Member	(c) Total Employee Count for ALE Member	(d) Aggregated Group Indicator	(e) Section 4980H Transition Relief Indicator
		Yes	No				
23	All 12 Months	☐	☐			☐	
24	Jan	☐	☐			☐	
25	Feb	☐	☐			☐	
26	Mar	☐	☐			☐	
27	Apr	☐	☐			☐	
28	May	☐	☐			☐	
29	June	☐	☐			☐	
30	July	☐	☐			☐	
31	Aug	☐	☐			☐	
32	Sept	☐	☐			☐	
33	Oct	☐	☐			☐	
34	Nov	☐	☐			☐	
35	Dec	☐	☐			☐	

Form **1094-C** (2015)



120315

Form 1094-C (2015) Page 3

Part IV **Other ALE Members of Aggregated ALE Group**

Enter the names and EINs of Other ALE Members of the Aggregated ALE Group (who were members at any time during the calendar year).

	Name	EIN		Name	EIN
36			51		
37			52		
38			53		
39			54		
40			55		
41			56		
42			57		
43			58		
44			59		
45			60		
46			61		
47			62		
48			63		
49			64		
50			65		

Form **1094-C** (2015)

Source: IRS.gov.

Appendix VI

Form 1095-C, Employer-Provided Health Insurance Offer and Coverage

Form **1095-C**
Department of the Treasury
Internal Revenue Service

Employer-Provided Health Insurance Offer and Coverage

► Information about Form 1095-C and its separate instructions is at *www.irs.gov/form1095c*

VOID
CORRECTED

600116
OMB No. 1545-2251
2015

Part I **Employee**

1 Name of employee
2 Social security number (SSN)
3 Street address (including apartment no.)
4 City or town
5 State or province
6 Country and ZIP or foreign postal code

Applicable Large Employer Member (Employer)

7 Name of employer
8 Employer identification number (EIN)
9 Street address (including room or suite no.)
10 Contact telephone number
11 City or town
12 State or province
13 Country and ZIP or foreign postal code

Part II **Employee Offer and Coverage**

Plan Start Month (Enter 2-digit number):

	All 12 Months	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
14 Offer of Coverage (enter required code)													
15 Employee Share of Lowest Cost Monthly Premium, for Self-Only Minimum Value Coverage	$	$	$	$	$	$	$	$	$	$	$	$	$
16 Applicable Section 4980H Safe Harbor (enter code, if applicable)													

Part III **Covered Individuals**

If Employer provided self-insured coverage, check the box and enter the information for each covered individual.

	(a) Name of covered individual(s)	(b) SSN	(c) DOB (If SSN is not available)	(d) Covered all 12 months	(e) Months of Coverage Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
17																
18																
19																
20																
21																
22																

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 60705M Form **1095-C** (2015)

Source: IRS.gov.

Appendix VII

Excerpt of Letter 226J

Department of the Treasury
Internal Revenue Service
Group 2219
7300 Turfway Road, Suite 410
Florence, KY 41042

Tax year:

Letter date:

Employer ID number:

Contact name:

Contact ID number:

Contact telephone number:

Contact e-fax number:

Response date:

Dear

We have made a preliminary calculation of the Employer Shared Responsibility Payment (ESRP) that you owe.

Proposed ESRP $ [XXXXXX]

Our records show that you filed one or more Forms 1095-C, Employer-Provided Health Insurance Offer and Coverage, and one or more Forms 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, with the IRS. Our records also show that for one or more months of the year at least one of the full-time employees you identified on Form 1095-C was allowed the premium tax credit (PTC) on his or her individual income tax return filed with the IRS. Based on this information, we are proposing that you owe an ESRP for one or more months of the year.

You generally owe an ESRP for a month if either:

- You did not offer minimum essential coverage (MEC) to at least [ ]% of your full-time employees (and their dependents) and at least one of your full-time employees was certified as being allowed the PTC; or

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- You offered MEC to at least [ ] % of your full-time employees (and their dependents), but at least one of your full-time employees was certified as being allowed the PTC (because the coverage was unaffordable or did not provide minimum value, or the full-time employee was not offered coverage).

This letter certifies, under Section 1411 of the Affordable Care Act, that for at least one month in the year, one or more of your full-time employees was enrolled in a qualified health plan for which a PTC was allowed. Based on this certification and information contained in our records, we are proposing that you owe an ESRP of $[ ].

What you must do

Review this letter carefully. It explains the proposed ESRP and what you should do if you agree or disagree with this proposal. You must tell us whether you agree or disagree with the proposed ESRP by the Response date on the first page of this letter.

The following items are included:

- An explanation of the employer shared responsibility provisions in Internal Revenue Code (IRC) Section4980H, which are the basis for the ESRP. See **About the ESRP**;
- An **ESRP Summary Table** itemizing your proposed ESRP by month;
- An **Explanation of the ESRP Summary Table**;
- Form 14764, **ESRP Response**; and
- Form 14765, **Employee Premium Tax Credit (PTC) Listing (Employee PTC Listing)**

It will be useful to have the Form(s) 1094-C and 1095-C that you filed with the IRS for the tax year shown on the first page of this letter available when you review this letter.

If you agree with the proposed ESRP

- Complete, sign, and date the enclosed Form 14764, ESRP Response, and return it to us by the Response date on the first page of this letter.
- Include your payment of $[**XXXXXX**]. If you're enrolled in the Electronic Federal Tax Payment System (EFTPS), you can pay electronically instead of by check or money order.
- If you don't pay the entire agreed-upon ESRP, you will receive a Notice and Demand (your "bill") for the balance due. For additional payment options, refer to Publication 594, The IRS Collection Process, or call the telephone number on your bill. We will begin the collection process if you do not make payment in full and on time after you receive your bill.

If you disagree with the proposed ESRP

- Complete, sign, and date the enclosed Form 14764, ESRP Response, and send it to us so we receive it by the Response date on the first page of this letter.
    - Include a signed statement explaining why you disagree with part or all of the proposed ESRP. You may include documentation supporting your statement.
    - Make sure your statement describes changes, if any, you want to make to the information reported on your Form(s) 1094-C or Forms 1095-C. Do not file a corrected Form 1094-C with the IRS to report any changes you want to make to your Form 1094-C filed for the tax year shown on the first page of this letter.

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Source: IRS.gov.

Appendix VIII

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

February 22, 2018

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Affordable Care Act (ACA): Processes to Identify Employers Subject to the Employer Shared Responsibility Payment Need Improvement (Audit # 201740317)

Thank you for the opportunity to review the above subject draft report. We agree with the recommendations and appreciate the acknowledgement of our efforts to extract updated data and refine our business rules to ensure a complete data set was used before any letters were issued.

Linking the implementation and administration of key health care reform provisions, including the individual and employer mandates, with the compliance systems designed for information reporting and the employment tax laws was a substantial challenge for the IRS. We developed new information technology systems, information returns, tax forms, instructions, guidance, educational materials, training, and data exchange partnerships. We continue to work closely with the Department of Health and Human Services, insurance industry, tax preparation industry, and other public and private sector stakeholders to administer all ACA tax related provisions. After the implementation of an ACA provision, we increase our focus on refining the post-filing compliance programs envisioned during the design phase. We will continue to refine our ACA compliance programs and maintain the appropriate balance between compliance burden and risk.

To reduce employer burden, instructions for Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, and 1095-C, *Employer-Provided Health Coverage*, were updated to clarify that all forms must be filed using landscape format. This clarification will reduce the number of forms rejected. The report notes that the delay in issuing the Employer Shared Responsibility Payment (ESRP) notices was attributable to a delay in the approval process for a Revenue Procedure. Issuance of a Revenue Procedure was not a prerequisite for issuance of the ESRP notices and, therefore, did not delay the issuance of the notices.

We do not agree with the increased revenue outcome measure of $113,899,153. The outcome measure was computed prior to the IRS using updated data to identify its potentially liable Applicable Large Employer (ALE) population. Subsequently, the discrepancy between the number of potentially liable ALEs identified by TIGTA and those identified by the IRS was reduced from 840 to 262. Thus, the outcome measure of $113,899,153 is not accurate. We do not have access to the TIGTA data set to produce an updated computation.

We agree with the potential taxpayer burden outcome measure of 41 taxpayers and have taken steps to ensure the payments are posted correctly as noted in our response to your recommendations. Attached is an outline of our corrective actions to address your recommendations.

If you have any questions, please contact me, or a member of your staff may contact Brenda Dial, Director, Examination.

Attachment

Attachment

RECOMMENDATION 1:
The Commissioner, Small Business/Self-Employed Division, should ensure that the data used to identify Applicable Large Employers potentially liable for the Employer Shared Responsibility Payment are complete, and refine the business rules to use the most current and correct Form 1094-C data when identifying potentially liable Applicable Large Employers.

CORRECTIVE ACTION:
We will review and refine the previously established business rules (as necessary) to use the appropriate Form 1094-C data when identifying Applicable Large Employers potentially liable for the Employer Shared Responsibility Payment.

IMPLEMENTATION DATE:
October 15, 2018

RESPONSIBLE OFFICIAL:
Director, Examination Headquarters, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
The Commissioner, Small Business/Self-Employed Division, should ensure needed enhancements are made to the Service Center Recognition Image Processing System (SCRIPS) system so that it accurately captures Forms 1094-C and 1095-C data during scanning.

CORRECTIVE ACTION:
To improve the accuracy of the SCRIPS data capture of paper Forms 1094-C and Form 1095-C, enhanced managerial reviews of the SCRIPS output will be performed immediately to evaluate the data conversion accuracy rate. Based on the cumulative results of the reviews, appropriate actions will be taken to address employee and/or systemic performance improvement needs. These actions could range from individual counseling that would occur immediately to identifying areas where training materials or programming requirements need to be revised.

IMPLEMENTATION DATE:
February 15, 2019

RESPONSIBLE OFFICIAL:
Director, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
The Commissioner, Small Business/Self-Employed Division should improve the mail sorting process and provide additional training and guidance to employees to ensure that related paper Forms 1094 and Forms 1095 remain together during processing.

CORRECTIVE ACTION:
We will reinforce existing procedures during training and issue an alert via the Servicewide Electronic Research Program (SERP) prior to training to ensure employees understand the system capabilities and the importance of maintaining the integrity of submissions.

IMPLEMENTATION DATE:
April 15, 2018

RESPONSIBLE OFFICIAL:
Director, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:
The Commissioner, Small Business/Self-Employed Division, should research the 83 taxpayers we identified and contact them if necessary to resolve the credit balance and ensure that these payments were not posted as Employer Shared Responsibility Payments in error.

CORRECTIVE ACTION:
We researched the 83 taxpayers and ensured procedures are in place to resolve the credit balances. Actions included ensuring all accounts on the ESRP master list are assigned for contact to be made if resolution is necessary. The accounts that are not part of the ESRP master list are addressed through the current Accounts Maintenance Research Hold (AMRH) procedures. The procedures are in place to ensure all accounts with a credit balance identified in the future will be addressed and resolved.

IMPLEMENTATION DATE:
Implemented

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RESPONSIBLE OFFICIAL:
Director, Examination Headquarters, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 5:
The Commissioner, Small Business/Self-Employed Division, and the Commissioner, Wage and Investment Division, should work with the Chief Information Officer to develop a Service-wide TIN validation strategy to reduce the number of TIN validation systems and programs to streamline and consolidate TIN validation efforts.

CORRECTIVE ACTION:
The Commissioner, Small Business/Self-Employed Division, and the Commissioner, Wage and Investment Division, will work with the Chief Information Officer to develop a common TIN validation strategy ('Servicewide TIN Validation') for all new Applications that need to perform TIN Validation. In addition, with support of the SB/SE and W&I organizations, IT will analyze existing legacy Applications (per Figure 7 & 8) that are performing in-line TIN Validation to identify potential candidates, based on technical merits and cost/benefit analysis - for modification and migration to a 'Servicewide TIN Validation'.

IMPLEMENTATION DATE:
February 15, 2020

RESPONSIBLE OFFICIAL:
Director, Enterprise Architecture, Information Technology

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.