ObamaCare Tax Credits and the IRS

5 WAYS THE IRS WILL ENTER YOUR LIFE UNDER OBAMACARE

INTRODUCTION

Many citizens are unaware of the extensive role the Internal Revenue Service (IRS) plays in the administration and compliance of ObamaCare (Affordable Care Act) tax credits. While some media attention has been paid to the enforcement of the individual mandate by the IRS, the agency’s role and scope over the tax credits is significantly greater.

With lingering concerns over the IRS targeting non-profit groups opposed to President Obama’s policies during the last election, taxpayers should be fully aware of the agency’s powers in administering ObamaCare. Before anyone considers taking the credits, they should become familiar with the relationship they will have with this large federal agency and the additional financial risk they may face as a result. To escape, or at least delay, involvement with the IRS, many individuals are renewing their existing health insurance plans for another year. However, many others are unable to do so since their insurance policy has been cancelled.

The Foundation for Government Accountability previously released “Too Risky to Exchange? The stories you need to read before enrolling in the ObamaCare Insurance Exchange,” a report documenting how common life changes can significantly impact people’s financial bottom line if they take the tax credits in advance. Many of those situations, along with dozens of others, will leave millions of Americans with an unexpected bill come tax time. These situations are hard to avoid as the lower-to-middle-class families that qualify for the tax credits rarely have static life situations.

AUTHORED BY

Josh Archambault | Senior Fellow
Joyce Errecart | Senior Fellow for Tax Policy

FOUNDATION FOR GOVERNMENT ACCOUNTABILITY
www.TheFGA.org
OBAMACARE TAX CREDITS BACKGROUND

ObamaCare features tax credits, also called premium subsidies. These credits are given on a sliding scale based on family size to those making between 138 percent and 400 percent of the federal poverty level (FPL) in states that have expanded Medicaid eligibility. In states that have not expanded Medicaid, the tax credits are available to those making between 100 percent and 138 percent FPL. The tax credits are unavailable to those with “affordable” employer-based insurance or for those on other forms of government-approved coverage like standard pre-expansion Medicaid or Medicare.

The tax credits can only be put toward a government-approved ObamaCare exchange plan. The exchange is simply an online website listing insurance plans. As a result of the individual mandate within ObamaCare, individuals who purchase private insurance on their own must decide if they want to keep their current insurance plan without a subsidy or drop their coverage to take the tax credit for a different ObamaCare-approved exchange plan.

The initial tax credit calculation is based on an applicant’s income tax return from the previous year. The credit can be taken in advance at the beginning of the year. However, individuals who enroll in the ObamaCare exchange risk having to pay back the tax credit if their life circumstances change, as well as paying the full cost of their ObamaCare plan premiums.

The credit can also be taken on that year’s tax return, filed the following year. Individuals who choose to take the credit on their tax return will be responsible for coming up with the full cost of the ObamaCare exchange insurance during the year. Individuals and families instead have the option of taking an advanced partial credit.

ObamaCare supporters have described the tax credits in positive terms during public appearances and statements to the media. But the complicated nature of their implementation and the IRS’s role in their administration has been largely ignored.

A MORE POWERFUL ROLE FOR THE IRS

The IRS plays a central role in ObamaCare. The law creates 18 new taxes and adds 47 separate tax provisions to the IRS that enable it to collect $1 trillion over 10 years.

Most news reports about the IRS’s enforcement role in ObamaCare have focused on the contentious individual mandate and controversy concerning income verification. This has distracted from a larger IRS role under ObamaCare; the administration of the premium tax credits.

The former commissioner of the IRS, Douglas Shulman, testified before Congress that the “…IRS’s most substantial [ObamaCare] implementation effort relates to the delivery of hundreds of billions of dollars in premium assistance tax credits…”¹ However, past experiences with other tax credits, such as the adoption tax credit, signal the IRS will commit substantial resources toward monitoring compliance and auditing individuals who receive the credits. There is sure to be renewed focus on anti-fraud efforts as the IRS's Inspector General recently released a report that highlighted how the agency is susceptible to tax credit fraud.² As part of those efforts, President Obama has requested an additional $440 million be added to the IRS budget for the implementation of ObamaCare and the IRS has asked Congress for 2,000 additional agents.³ (See below for more detail.)
FIVE QUESTIONS ABOUT THE OBAMACARE TAX CREDITS AND THE IRS

1] IS YOUR PERSONAL INFORMATION SAFE FROM IDENTITY THEFT AND FRAUD?

In order to sign up for an ObamaCare exchange plan you must submit an application ranging from 5 to 21 pages the government will use to determine if you are eligible to receive the tax credits. The length of the application varies depending on your life circumstances. Your information is then circulated to numerous state and federal agencies to verify the information you submitted on the application.

Your personal information is handled and scrutinized by the Department of Justice, Social Security Administration, Department of Homeland Security, Department of Health and Human Services, Treasury Department and the IRS and then returned back to the state level to determine eligibility. Unlicensed ObamaCare navigators have also been hired to aid exchange enrollment.

Concerns over privacy have run the gamut, from the role of unlicensed navigators to the federal government’s ability to protect private information. Some have called it, “the largest consolidation of personal data in the history of the republic,” warning that “…the potential for abuse is staggering.”

Lending credibility to this concern is the government’s recent track record on data security. Consider these stories:

- An employee at the Minnesota state-based ObamaCare exchange sent a file containing 2,400 names and social security numbers to a health insurance broker “by mistake.”
- Last year, in South Carolina, the IRS was blamed for its role in contributing to a data breach that exposed 3.8 million taxpayers’ social security numbers, credit card numbers and bank account data.
- Computer hackers accessed the personal information of 780,000 residents of Utah, including their names, addresses, dates of birth and medical diagnostic codes. Of that number, 280,000 also had their social security numbers stolen.
- In July it was reported that the IRS had posted up to 100,000 social security numbers online.
- A September Inspector General for Tax Administration report raised serious questions about the IRS’s ability to protect its basic IT resources and data. During a random and routine audit, the Inspector General documented dozens of instances of missing equipment and inadequate security procedures by the IRS in place to protect personal information.
- A lawsuit in California has been filed against the IRS and 15 unnamed IRS agents for seizing 60 million medical records of 10 million Americans in 2011.

Information Needed to Apply for a Tax Credit

- Name
- Social security number
- Home address
- Date of birth
- Marital status
- Family structure and living arrangement
- Information about children
- Income level, including tips
- Employment status and hours worked
- Insurance information
- Citizenship status
- Disability status
- Partial medical history, including problems paying medical bills
- Education level
- Race
- Sex
- E-mail address and cell phone number
- Foster care information
- Pension information and retirement accounts
- Social security payments
- Alimony payments
- Investment information

For those self-employed they can disclose:

- Car and truck expenses
- Property, liability or business interruption insurance
- Interest (including mortgage interest paid to banks, etc.)
- Legal and professional services
- Rent or lease of business property
- Business activity, including commissions, licenses and fees
- Advertising costs
- Contract labor
- Repairs and maintenance
- Certain business travel and meals
2) WILL CONGRESS KEEP CHANGING THE STANDARDS AND MAKE YOU PAY MORE?

Should you take the ObamaCare tax credit to enroll in an exchange plan, then find that your income has increased even slightly, you may be forced to pay back a portion or the entire value of the credit to the IRS. Congress has twice increased the payback liability since ObamaCare became law.¹¹ This also means you have little security or predictability of knowing what your payback amount would be as Congress could move the goal posts back yet again.

In both cases, Congress raised the repayment liability amounts required of taxpayers. Now families that see their income creep over 400 percent of the federal poverty level will be required to come up with the entire cost of the tax credit, upwards of $13,000-$15,000. Congress has also increased the payback amounts at 200% and 300% FPL from what they had been before.

Current Maximum Tax Credit Paybacks¹²

<table>
<thead>
<tr>
<th>Family Size</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>Maximum Tax Payback</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>&lt;$22,980</td>
<td>&lt;$31,020</td>
<td>&lt;$39,060</td>
<td>&lt;$47,100</td>
<td>$600</td>
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<td></td>
<td>&lt;$34,470</td>
<td>&lt;$46,530</td>
<td>&lt;$58,590</td>
<td>&lt;$70,650</td>
<td>$1,500</td>
</tr>
<tr>
<td></td>
<td>&gt;$45,960</td>
<td>&gt;$62,040</td>
<td>&gt;$78,120</td>
<td>&gt;$94,200</td>
<td>No limit on payback</td>
</tr>
</tbody>
</table>

The situations in which taxpayers will have to repay the IRS will be common under ObamaCare. A recent Health Affairs article examined the likelihood that California residents eligible for the ObamaCare tax credit will owe the government money at the end of the year.

The authors found substantial income fluctuation in this income group, explaining that “nearly three-quarters (73.3 percent) of the predicted subsidy recipients were in families with income changes of more than 10 percent …Of those recipients, 37.8 percent had large income increases…Thirty percent of recipients were in families whose income increased more than 20 percent, and 18.9 percent had income increases of more than 40 percent.”¹³

Almost 40 percent of the group of ObamaCare tax credit-eligible individuals would owe money to the IRS if they forgot to report minor changes in a timely manner. And even if all changes were reported for new income, 36 percent would still owe money to the IRS.

Given that the national debt now stands at more than $17 trillion, it is likely Congress will continue to raise the repayment liability for taxpayers taking the ObamaCare tax credits.
3) IS A LONG AND COSTLY IRS AUDIT IN YOUR FUTURE?

Enrolling in an exchange plan and taking the ObamaCare tax credit leaves you even more vulnerable to an audit by a newly-empowered IRS. Similar high-dollar tax credits have resulted in a greater likelihood of being targeted for an IRS audit. For example, almost 70 percent of the families that have participated in the adoption tax credit have been subject to an IRS audit. These audits routinely last years and can be costly.14

The IRS’s own national taxpayer advocate, Nina Olson, highlighted serious problems in how the IRS ran its audit process for the adoption credits. She also warned that the risk and harm to citizens as a result of that program will pale in comparison to the potential impact on your finances during administration of the ObamaCare tax credits.15 Ms. Olson has publicly stated that she is concerned the IRS will not be able to “administer the new health care credits and penalty taxes in a fair and compassionate way.”16

History matters. The experience with adoption tax credits serve as a warning of how the IRS could enforce the ObamaCare tax credits. Ms. Olson already raised concerns about the IRS’s management of the adoption tax credit, such as:

- The IRS did not inform taxpayers how long it would take to audit their returns and when they could expect a refund;
- The hold on the adoption credit portion of the refund caused financial burden for some eligible taxpayers;
- IRS auditors demanded documentation from taxpayers even before reviewing the information they had already included with their original returns, so taxpayers who already submitted the necessary documentation were required to send it twice;
- The IRS was unable to quickly address documentation issues or identify whether provided documentation was sufficient.

Ms. Olson concluded, “The IRS’s misguided procedures, and its failure to adequately adjust these processes when it learned its approach was seriously flawed, have caused significant economic harm to thousands of families... Unless the IRS changes its approach to refundable credits and adopts more taxpayer-focused procedures, it will continue to cause problems for eligible taxpayers, including those eligible for the new refundable credit contained in the Patient Protection and Affordable Care Act — the Premium Tax Credit.”

Ms. Olson further noted that while 80 percent of the applications for adoption tax credits contained minor missing information, only 2 percent of the credits were disallowed, implying there was not widespread fraud. Yet, “the IRS subjected all adoption credit claims with missing or potentially invalid documentation to correspondence audit.” She continued, “When problems emerged, the IRS simply continued selecting returns for audit. This approach forced taxpayers to withstand lengthy delays and the IRS to expend valuable resources with very little to show for them.”

The IRS’s response to its poor management of the adoption tax credit program and the lack of safeguards for taxpayers was telling:

“We must ensure delivery of the credit to those entitled while protecting the government’s interest in minimizing exposure to fraud... In FY 2012, we found errors in 44 percent of the returns we examined and closed...”

To which Ms. Olson responded:

“This means that in 56 percent of its adoption credit audits, the IRS found no errors. This no-change rate is among the highest the National Taxpayer Advocate has ever seen since she was appointed to this position. For the IRS to say, with a straight face, that this is a positive result of any audit strategy makes a mockery of effective tax administration. It also signals that the IRS continues to underestimate or ignore the true burden it placed on taxpayers who are legitimately claiming a tax benefit to which they are entitled and sorely need.” (emphasis added)

In the opinion of Taxpayer Advocate Nina Olson, “the IRS’s implementation of the expanded adoption credit does not bode well for its implementation of the premium tax credit... If the IRS does not take the time to learn from its adoption credit experience and be thoughtful about how it administers future refundable credits, it may face problems with the Premium Tax Credit — including high examination rates — that will overwhelm IRS resources and severely burden taxpayers.”
4. CAN YOU AFFORD TO BECOME A TARGET OF AN EMPOWERED IRS?

While the IRS is restricted in enforcement for the individual mandate, it is empowered to use all of the “tools” in its toolbox to recoup tax credit repayments.

What has not changed is the power the IRS has to collect back taxes if you are unable to repay a reconciled credit at tax time.

As described in the Foundation for Government Accountability’s “Too Risky to Exchange” report, common life events such as getting a raise at work, switching your job and getting married could leave you with a sizable and unexpected tax bill of several hundred or thousand dollars, particularly if you forget to immediately report to the ObamaCare exchange how your life circumstances have changed.

Once a tax bill is determined to be “unpaid,” the IRS is likely to step into action immediately. The agency sends a notice of intent to collect and can send a revenue officer to your door to try to collect. A federal tax lien can be placed on file in your town or city and your neighbors can easily find out if you are having tax problems. You must satisfy the lien in order to sell your house.

Generally, an IRS revenue officer will try to get the tax paid back in full and would consider an installment payment agreement, but could demand very difficult terms. For example, the IRS could demand you empty your bank account. If the IRS agent is not satisfied with your attempts at payment, that agent could seize (levy) your bank account, wages, retirement accounts, dividends, licenses, rental income, accounts receivables, the cash loan value of life insurance, or commissions.

The amount of salary that is exempt from levy is very small. For a single person, the exempt amount is only $192 per week. For a married couple, the exempt amount is $364 per week. For a family of four, the exempt amount is $534 per week.

Unpaid tax bills are subject to interest. The interest rate can change as often as quarterly. Penalties may also be due. There is a ‘failure to pay penalty’ between .25 percent and 1 percent of the underpayment amount per month, up to a maximum of 25 percent of the underpayment, and 20 percent of the underpayment for negligence. A tax bill could grow very quickly.
CASE STUDY: JOHN AND MARY OWE THE IRS THOUSANDS AFTER A SMALL PROMOTION

John and Mary are 60 years old and both still work full time making a combined $60,000. After taking an ObamaCare tax credit in advance, a small promotion and raise pushed them over 400% of the federal poverty level (FPL). Now they must repay the entire $8,061 tax credit. They already are paying $5,700 for their portion of the coverage.22 Now they have to try to come up with $8,061, money they simply do not have.

The IRS will send a bill for $8,061, plus 3% interest, plus a failure to pay penalty of one half of one percent per month. If they pay the bill immediately, the bill won’t increase by more than $100 for interest and penalties. But John and Mary simply do not have an extra $8,061.

If the bill goes unpaid for several months, an IRS collector can call or come to their home. As part of such a collection effort, the officer will require John and Mary to fill out an extensive financial information form. The collector will expect John and Mary to pay the IRS most of the balance of their bank account. If they have credit cards with balances less than the credit limit, the IRS collector may expect John and Mary to get cash advances for the unused credit limits. It is John’s and Mary’s problem to figure out how they can pay minimum balances on the credit cards, which assuredly charge far more interest than the IRS’s 3% interest rate.

To pay the rest of the $8,061 bill, the IRS collector could expect John and Mary to seek a loan from a family member and to cut living expenses to the bone, paying only for food, shelter, utilities, transportation, taxes, health and work expenses, paying the IRS any excess of income over essential living expenses.

The IRS collector has a lot of leverage. If John and Mary do not come to an agreement with the IRS collector, the IRS can levy on their bank account, taking everything out of the account, and can levy on their wages. If the IRS issued a levy on their wages, then their employer would give John and Mary a check for the levy exemption for a married couple of $364 per week, and would be required to give the rest of their weekly wages to the IRS. John and Mary would be forced to live on $364 per week.

John and Mary try to negotiate an installment agreement with the IRS. They have a bank account of $500. They agree to pay $400 from the bank account, leaving $7,661 still owing. Their essential monthly living expenses include $1,200 for rent, $100 for electricity, $100 for their phones, $800 for food, $850 for payroll taxes, $800 for car payments, $400 for gas and car insurance, $700 for employer-provided health care, $50 for basic cable TV and $100 for minimum payments on their two credit card balances. These expenses total $5,100, which in theory leaves $900 available for payment each month to the IRS, if no unexpected bill arises, such as a car repair or a medical need.

An IRS collector may agree to an installment plan of $100 per week. If that happens, then the failure to pay penalty is reduced to one quarter of one percent per month. With the additional penalties and interest, it would take John and Mary about 80 weeks of paying $100 per week to finish paying the remaining $7,661 tax bill because of the excess premium tax credits. This is a long, difficult two years for John and Mary. They barely have a spare dime after paying essential expenses.

In the alternative, John and Mary could file with their 2014 income tax return a form requesting an installment payment agreement. The resulting payment plan with the IRS should be similar; an initial payment of a few hundred dollars, plus weekly installments of at least $100 per month. Each IRS collector has a significant amount of discretion, and weekly installments of $150 to $175 per month might be required.

Under both scenarios, John and Mary could face penalties and interest of more than $800 in addition to having to pay back the credit.
5] IS A LENGTHY AND COMPLICATED FILING PROCESS WORTH IT?

In order to receive the health insurance premium tax credits to put toward an ObamaCare exchange plan, you are required to file a tax return every year.\(^{23}\) Failing to do so even once will make you ineligible for the tax credit in the future. This will likely leave you to pay the full sticker price for your ObamaCare insurance. If you drop your private coverage in order to enroll in the ObamaCare exchange, you would not have the option of going back onto your previous plan if the exchange becomes unaffordable or undesirable, as you would have missed the renewal deadline.

This requirement to file is especially complicated for low-income individuals who have not had to file a federal tax return in the past.

The Advanced Earned Income Tax Credit (EITC) had a similar level of complexity as the ObamaCare tax credits. That complexity contributed to low participation rates and, eventually, termination of the program in 2010. A 2007 Government Accountability Office report found that 80 percent of Advance EITC recipients failed to comply with at least one of the requirements of the program.\(^{24}\) Most revealing was that almost 40 percent of the recipients did not file the required tax form with the IRS.

The IRS has yet to publish the tax forms that tax credit recipients will file at the end of each year. Given the complicated nature of ObamaCare and the exchange tax credits it is likely those forms will be even more complex than the forms required for the failed EITC program.

CONCLUSION

Individuals must be fully aware of the relationship they are entering into with the IRS before they enroll in an exchange plan. Time will tell if the IRS’s troubling history of implementing other tax credits will resurface under the massive health insurance tax credit program. The IRS’ own taxpayer advocate has documented in painstaking detail the needless hardship the agency has caused while running the similarly-valued Adoption Tax Credit. The dismal filing record of beneficiaries in the Advanced EITC program could serve as a canary in the coal mine of future implementation challenges that lay ahead under the federal health law. Citizens should weigh all this information carefully before enrolling in an exchange plan paired with an ObamaCare subsidy.

REFERENCES


11. Medicare and Medicaid Extenders Act of 2010 (P.L. 111-309), and then under the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayment Act of 2011 (P.L. 112-9).


17. IRC Section 36B(f)(2)(A) states that “If the advance payments…exceed the credit allowed by this section…the tax imposed by this chapter for the taxable year shall be increased by the amount of such excess.” Excess credits will show up as additional taxes owed on a line used to compute total tax on the income tax return.

18. This is called a levy. A levy is a legal seizure of your property to satisfy a tax debt.


