



*Affordable Care Act: The Office of Appeals  
Planning Efforts for the Health Care  
Reform Legislation*

**December 23, 2011**

**Reference Number: 2012-13-009**

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

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## HIGHLIGHTS

### **AFFORDABLE CARE ACT: THE OFFICE OF APPEALS PLANNING EFFORTS FOR THE HEALTH CARE REFORM LEGISLATION**

## Highlights

**Final Report issued on  
December 23, 2011**

Highlights of Reference Number: 2012-13-009 to the Internal Revenue Service Chief of Appeals.

### **IMPACT ON TAXPAYERS**

The Patient Protection and Affordable Care Act (ACA) contains significant changes to the Nation's health care system, which the Office of Appeals (Appeals) expects will result in new Appeals cases over the next several years. Appeals has taken some initial actions to begin preparing for the anticipated new ACA Appeals cases. Because of the potential for the ACA to affect most taxpayers, effective planning is critical to ensuring Appeals' readiness to prepare for this legislation and resolve taxpayer requests in a timely and effective manner.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated as part of TIGTA's efforts to evaluate the IRS's plans for implementing the various ACA tax provisions.

The overall objective of our audit was to determine how Appeals planned for the implementation of the health care legislation. This review is included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Implementing Major Tax Law Changes.

### **WHAT TIGTA FOUND**

After the ACA was enacted in March 2010, the IRS ACA Office determined that the impact on Appeals would be minimal until after Calendar Year 2013. Given this time period, Appeals management has taken some initial actions to begin preparing for the ACA legislation. Appeals personnel have been detailed to the IRS ACA Office and other IRS ACA teams on an ongoing

basis to remain informed on how the IRS is preparing for the ACA and the potential impact of these efforts on Appeals. To lead its planning efforts, Appeals appointed a Senior Analyst in July 2011 to serve as the Appeals ACA Program Manager.

In addition, Appeals created an internal website with links to IRS ACA-related training, guidance, and other resources. Appeals management also informed TIGTA they are currently assessing how to code ACA cases on their inventory database to track the number of taxpayers and businesses that appeal the various health care provisions.

As Appeals moves forward with its planning efforts, TIGTA believes management should develop a more formal approach to its ACA planning activities to ensure they are ready to resolve taxpayer requests of ACA-related issues in a timely and effective manner. This should include outlining the key objectives/tasks that need to be addressed to prepare for the ACA-related impact on Appeals, who will be responsible for conducting these activities, and when these actions need to be completed over the next several years.

In addition, Appeals management should consider the type and frequency of communication between the Appeals internal working group, the IRS ACA Office, and other IRS operating divisions to ensure their planning efforts are coordinated as appropriate. This communication will assist Appeals management in staying informed of IRS actions to address the ACA provisions. Effective planning is critical to ensuring Appeals' readiness to prepare for this legislation and resolve taxpayer requests in a timely and effective manner.

### **WHAT TIGTA RECOMMENDED**

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



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 23, 2011

**MEMORANDUM FOR CHIEF, APPEALS**

*Nancy A. Nakamura*

**FROM:** (for) Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report - Affordable Care Act: The Office of Appeals  
Planning Efforts for the Health Care Reform Legislation  
(Audit # 201110026)

This report presents the results of our review of the Internal Revenue Service (IRS) Office of Appeals' (Appeals) planning efforts for the Patient Protection and Affordable Care Act<sup>1</sup> legislation. The overall objective of this review was to determine how Appeals planned for the implementation of the health care legislation. This review had a limited scope and focused on the status of Appeals' efforts to plan for the health care reform legislation applicable to its customers. This audit is included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Implementing Major Tax Law Changes.

We made no recommendations as a result of the work performed during this review. Appeals management reviewed the report before it was issued and offered clarifying comments and suggestions, which have been taken into account.

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

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<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).



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*Abbreviations*

ACA	Patient Protection and Affordable Care Act
IRS	Internal Revenue Service



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Planning Efforts for the Health Care Reform Legislation*

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## *Background*

The Patient Protection and Affordable Care Act (ACA),<sup>1</sup> along with amendments in the Health Care and Education Reconciliation Act of 2010,<sup>2</sup> contains significant changes to the Nation's health care system. The Department of Health and Human Services is responsible for the administration of changes to health care policy issues, and the Internal Revenue Service (IRS) is responsible for implementation of the multiple tax law changes included in the legislation. The ACA contains \$438 billion of revenue provisions in the form of new taxes and fees. To manage implementation of the ACA, the IRS established an overall ACA Office in mid-2010 headed by an executive dedicated solely to overseeing the IRS's ACA planning and implementation activities.

***The Patient Protection and Affordable Care Act, along with amendments in the Health Care and Education Reconciliation Act of 2010, contains significant changes to the Nation's health care system.***

The mission of the Office of Appeals (Appeals) is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the IRS. Taxpayers can request an independent review by Appeals when they have a dispute pertaining to additional taxes, denials of credits, assessments of penalties, and/or the means by which the IRS intends to collect a balance due.

Various provisions of the ACA could affect Appeals if taxpayers disagree with the IRS's position. Some of the ACA provisions that may result in disputes between the taxpayer and the IRS are:

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

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<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).

<sup>2</sup> Pub. L. No. 111-152, 124 Stat. 1029 (2010).



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While many tax provisions took effect in Tax Year<sup>3</sup> 2010, such as the Small Employer Health Care Tax Credit, the most significant provisions will be implemented during the next several years. Before a taxpayer can request a hearing with Appeals, the IRS usually must first process a tax return filed by the taxpayer and subsequently conduct an audit of that return or propose some other type of adjustment to the tax return, a process which could take several years. If the audit results in increased taxes, penalties, interest, or other type of adjustments and the taxpayer disagrees, he or she can generally request a hearing in Appeals. As a result, Appeals' cases are often closely tied to IRS enforcement actions taken to address tax deficiencies. Because of the timing of any enforcement action on ACA-related provisions, IRS management does not believe Appeals will be significantly affected by any ACA-related provisions until after Calendar Year 2013.

This review was performed by contacting Appeals personnel in San Francisco, California; Denver, Colorado; and Washington, D.C., during the period July through October 2011. This review had a limited scope and focused on the status of Appeals' efforts to plan for the health care reform legislation applicable to its customers. We relied primarily on interviews with IRS personnel and reviews of available documentation, such as meeting minutes and internal reports, and did not perform any detailed testing to evaluate the effectiveness of actions taken by Appeals to prepare for the health care reform legislation.

Otherwise, we conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>3</sup> A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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## *Results of Review*

After the ACA was enacted in March 2010, the IRS ACA Office determined that the impact on Appeals would be minimal until after Calendar Year 2013. Given this time period, Appeals management has taken some initial actions to begin preparing for the ACA legislation. Appeals personnel have been detailed to the IRS ACA Office and other IRS ACA teams on an ongoing basis to remain informed on how the IRS is preparing for the ACA and the potential impact of these efforts on Appeals. To lead its planning efforts, Appeals appointed a Senior Analyst in July 2011 to serve as the Appeals ACA Program Manager.

In addition, Appeals created an internal website with links to IRS ACA-related training, guidance, and other resources. Appeals management stated that the website will be updated as necessary and will provide useful information to employees who are working ACA-related issues. Appeals management also informed us they are currently assessing how to code ACA cases on their inventory database to track the number of taxpayers and businesses that appeal the various health care provisions.

As Appeals moves forward with its planning efforts, we believe management should develop a more formal approach to its ACA planning activities to ensure they are ready to resolve taxpayer requests of ACA-related issues in a timely and effective manner. This should include outlining the key objectives/tasks that need to be addressed to prepare for the ACA-related impact on Appeals, who will be responsible for conducting these activities, and when these actions need to be completed over the next several years. This will enable Appeals to determine when it will need to start advance planning work for specific provisions, such as preparing guidance and identifying potential resource needs.

In addition, Appeals management should consider the type and frequency of communication between the Appeals internal working group, the IRS ACA Office, and other IRS operating divisions to ensure their planning efforts are coordinated as appropriate. This communication will assist Appeals management in staying informed of IRS actions to address the ACA provisions. Effective planning is critical to ensuring Appeals' readiness to prepare for this legislation and resolve taxpayer requests in a timely and effective manner.

### ***Appeals Has Taken Some Initial Actions to Plan for the Affordable Care Act***

We determined that Appeals management has initiated some planning efforts to prepare for the ACA legislation. Specifically, Appeals has participated in the IRS ACA Office on an ongoing basis to remain informed on how the IRS is preparing for the ACA and the potential impact of these efforts on Appeals. Appeals management stated that the Office of Appeals has detailed a



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number of Appeals personnel, including an Appeals executive, to the IRS ACA Office on a full-time basis to assist with the implementation of the ACA provisions.

Appeals management also informed us that Appeals personnel participate on the Small Business/Self-Employed Division ACA Executive Steering Committee to monitor this operating division's ACA-related outreach and compliance activities of small business taxpayers. In addition, an Appeals senior manager is actively involved with the Large Business and International Division ACA team addressing the Branded Prescription Drug Fee.<sup>4</sup>

Furthermore, Appeals management recognized the need to designate a management official to lead its ACA planning efforts and appointed a Senior Analyst in July 2011 to serve as the Appeals ACA Program Manager. This manager, in conjunction with other regular duties, has begun to work with the IRS ACA Office to identify the extent and impact of ACA provisions on Appeals operations. Appeals indicated this role does not currently require a full time effort; however, we were advised that additional time and personnel would be assigned, as needed, to assist in planning efforts.

As of August 2011, Appeals management stated that they have not received any ACA-related cases. However, Appeals management could begin to receive cases related to the non-exchange provisions<sup>5</sup> of the ACA, which took effect in Calendar Year 2010. For example, the ACA provision involving the indoor tanning tax may affect Appeals sooner than Calendar Year 2013. We recently reported<sup>6</sup> that the number of taxpayers filing tax returns related to the indoor tanning tax is much lower than expected because some taxpayers may not be complying with the new law. The IRS has issued notices to some taxpayers who may be liable for the tanning tax, but who have not filed an excise tax return. The IRS also may initiate examinations to identify noncompliant taxpayers who filed excise tax returns but underpaid the tanning tax, which may result in some taxpayers requesting a hearing with Appeals personnel.

We also reported<sup>7</sup> that the IRS's Tax Exempt and Government Entities Division initiated compliance examinations on returns from tax-exempt organizations claiming the Small Employer Health Care Tax Credit. The IRS advised that, as of September 30, 2011, compliance personnel from its Tax Exempt and Government Entities Division had initiated examinations on 769 returns from tax-exempt organizations claiming the Small Employer Health Care Tax Credit. The outcomes of these examinations could also result in additional case receipts for Appeals if the IRS disallows or reduces the credits claimed and the tax-exempt organizations disagree.

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<sup>4</sup> An annual fee on covered entities engaged in the business of manufacturing or importing branded prescription drugs is imposed by Section 9008 of the ACA as amended by Section 1404 of the Health Care and Education Reconciliation Act of 2010.

<sup>5</sup> See Appendix IV for a description of the non-exchange and exchange provisions.

<sup>6</sup> Treasury Inspector General for Tax Administration, Ref. No. 2011-40-115, *Affordable Care Act: The Number of Taxpayers Filing Tanning Excise Tax Returns Is Lower Than Expected* (September 2011).

<sup>7</sup> Treasury Inspector General for Tax Administration, Ref. No. 2011-10-085, *Affordable Care Act: The Tax Exempt and Government Entities Division's Planning Efforts for the Health Care Reform Legislation* (August 2011).



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In addition, Appeals could see additional cases after the exchange provisions of the ACA take effect in Calendar Year 2014. These provisions are expected to affect most taxpayers and will likely also require additional planning efforts by Appeals in the future. Specifically, Appeals will need to consider whether new processes and procedures, as well as additional training requirements, are needed to prepare for these taxpayer requests for Appeals assistance.

Appeals management informed us that they have an established process to estimate their future workload and staffing needs. This process includes coordinating with the other IRS business units as well as using historical Appeals data. Appeals management believes this process will assist them with estimating future ACA workload. In addition, the IRS ACA Office prepared a presentation of the non-exchange provisions and their anticipated impact on Appeals' future workload. Appeals management stated that this presentation was provided to all executive areas in Appeals.

Currently, Appeals is faced with growing case receipts and inventory backlogs in existing workload, which affects its ability to work cases as quickly as taxpayers would like. As a consequence, the ACA has the potential to significantly impact Appeals operations with new case receipts in addition to an already growing workload. Therefore, we believe it is important that management plan for and consider this impact and how they will handle the increased workload.

Because of the potential for the ACA to impact most taxpayers, effective planning is critical to ensure Appeals is prepared for the impact of this legislation. As Appeals moves forward with its planning efforts, we believe a more formal approach will assist Appeals in ensuring it will be able to resolve taxpayer requests in a timely and effective manner. We made no recommendations in this report since Appeals' planning efforts are still being developed.



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## **Appendix I**

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

Our overall objective was to determine how the Office of Appeals (Appeals) planned for the implementation of the health care legislation. This review was of limited scope and the overall approach was to gather the information necessary to quickly report the status of Appeals' efforts to plan for the health care reform legislation applicable to its customers. To accomplish our objective, we:

- I. Determined whether Appeals has identified specific ACA<sup>1</sup> provisions that will affect its case load.
  - A. Interviewed Appeals management and obtained documentation identifying the provisions of the ACA that are likely to have the greatest impact on their function.
  - B. Obtained and reviewed internally established documentation pertaining to Appeals' interpretation of the ACA and how it will affect the function.
- II. Determined the status of Appeals' planning efforts to prepare for implementation of the ACA.
  - A. Determined the extent and nature of Appeals' participation with the IRS ACA Office.
  - B. Conducted interviews with Appeals staff and identified the actions that have been taken to date and planned future actions to prepare for the ACA.
  - C. Obtained plans/schedules developed by Appeals to guide and monitor its planning process for implementation of the ACA.
  - D. Determined the extent of Appeals' involvement with IRS operating divisions.

#### **Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: Appeals activities to plan for the new legislation. We evaluated these controls by interviewing management and reviewing available documentation.

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<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).



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**Appendix II**

*Major Contributors to This Report*

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Jeffrey M. Jones, Director

Janice M. Pryor, Audit Manager

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Mindy H. Dowdy, Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Chief, Appeals AP  
Director, Affordable Care Act Office SE:ACA  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Chief, Appeals AP  
    Director, Affordable Care Act Office SE:ACA



## Appendix IV

### *Affordable Care Act Provisions Expected to Have the Greatest Impact on Appeals*

The ACA<sup>1</sup> legislation includes numerous tax provisions whose effective dates span nine years from January 2009 through January 2018. The provisions consist of two distinct categories: non-exchange and exchange.

#### **Non-Exchange Provisions**

The non-exchange provisions, many of which have already been implemented, include various incentives and tax breaks for individuals and small businesses to offset health care expenses and:

- Relate to health policy or the expansion of coverage.
- Establish health care-related fees to fund the system.
- Include rules that have little to do with health care.

Figure 1 highlights the non-exchange provisions that IRS management determined will have the greatest impact on Appeals:

**Figure 1: Non-Exchange Provisions**

Provision Number	Type of Provision	Description	Effective Date <sup>2</sup>
1421	Small Employer Health Care Tax Credit	Provides a tax credit to small employers who contribute to health insurance premiums for their employees.	01/01/2010
10907	Excise Tax on Indoor Tanning	Imposes a 10 percent tax on indoor tanning services.	07/01/2010

Source: IRS Assessment of Non-Exchange Provisions Impact on Appeals, dated June 2011.

<sup>1</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).

<sup>2</sup> The effective date is the date when the ACA provisions should be implemented. However, Appeals will not be affected until after the taxpayer has filed or failed to file an applicable tax return, been subject to an IRS enforcement action related to an ACA-related provision, and requested a hearing with Appeals to resolve any disputes regarding the IRS's decision.



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**Exchange Provisions**

The exchange provisions, which take effect in Calendar Year 2014 and after, provide for State-based insurance market plans through which individuals and small businesses can purchase qualified coverage. The provisions:

- Require most individuals to purchase coverage.
- Require large employers to offer coverage.
- Establish premium tax credits to make coverage more affordable.

Figure 2 highlights the exchange provisions that IRS management determined will have the greatest impact on Appeals.

**Figure 2: Exchange Provisions**

Provision Number	Type of Provision	Description	Effective Date <sup>3</sup>
1401	Premium Assistance Tax Credit	This provision creates a refundable tax credit for eligible individuals and families who purchase insurance through an exchange. The premium assistance credit, which is refundable and payable in advance directly to the insurer, subsidizes the purchase of certain health insurance plans through an exchange.	01/01/2014
1501	Penalty for Individuals Without Minimum Coverage	Requires all United States citizens and legal residents and their dependents to maintain minimum essential insurance coverage unless exempted starting in 2014 and imposes a fine on those failing to maintain such coverage.	01/01/2014
1513	Penalty on Large Employers Who Do Not Offer Coverage	Imposes a penalty on large employers (50 or more Full-Time Equivalents) <sup>4</sup> who 1) do not offer coverage for all of their full-time employees, offer unaffordable minimum essential coverage, or offer plans with high out-of-pocket costs and 2) have at least one full-time employee certified as having purchased health insurance through a State exchange and who was eligible for a tax credit or subsidy.	01/01/2014

Source: Government Accountability Office, GAO-11-719, *Patient Protection and Affordable Care Act: IRS Should Expand Its Strategic Approach to Implementation* (June 2011).

<sup>3</sup> The effective date is the date when the ACA provisions are scheduled to be implemented. However, Appeals will not be affected until after the taxpayer has filed or failed to file an applicable tax return, been subject to an IRS enforcement action related to an ACA-related provision, and requested a hearing with Appeals to resolve any disputes regarding the IRS's decision.

<sup>4</sup> Full-Time Equivalent is defined as a measure of labor hours in which one Full-Time Equivalent is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.