



*The Affordable Care Act: Processes Have
Been Implemented to Administer the
Patient-Centered Outcomes Research Fee,
but Controls Need Improvement to Ensure
Filing Compliance*

March 26, 2015

Reference Number: 2015-33-019

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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2 = Risk Circumvention of Agency Regulation or Statute

Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

Website / <http://www.treasury.gov/tigta>



HIGHLIGHTS

THE AFFORDABLE CARE ACT: PROCESSES HAVE BEEN IMPLEMENTED TO ADMINISTER THE PATIENT-CENTERED OUTCOMES RESEARCH FEE, BUT CONTROLS NEED IMPROVEMENT TO ENSURE FILING COMPLIANCE

Highlights

Final Report issued on March 26, 2015

Highlights of Reference Number: 2015-33-019 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

The Patient Protection and Affordable Care Act of 2010 (ACA) includes a tax provision that provides for an excise tax equal to one or more dollars based on the average number of lives covered under a specified health insurance policy or self-insured health plan during a specific year. The new Patient-Centered Outcomes Research (PCOR) fee is used to offset the costs of the PCOR Institute, which funds research that will provide information to assist patients and their healthcare providers make more informed healthcare decisions.

WHY TIGTA DID THE AUDIT

This audit is part of TIGTA's continued coverage of the IRS's implementation of key ACA tax provisions. The overall objective of this review was to evaluate the IRS's implementation of the ACA Section 6301 dealing with the PCOR Trust Fund.

WHAT TIGTA FOUND

TIGTA found that 72,035 health insurance policy issuers/self-insured plan sponsors filed a Form 720, *Quarterly Federal Excise Tax Return*, with PCOR fees totaling \$114 million for Tax Year 2012. Of these filers, 30,996 (43 percent) paid a PCOR fee of less than \$4.25, which is the IRS's cost to process these returns.

The IRS developed a PCOR compliance plan that states it will use third-party data sources to identify potential nonfilers. The IRS is in the

process of analyzing this information for use in evaluating Tax Year 2012 return filing compliance. However, the data that the IRS obtained do not include the necessary information to calculate the potential PCOR fees owed by these nonfilers.

TIGTA reviewed additional data from these third-party sources. For Tax Year 2012, TIGTA identified 25 health insurance policy issuers and 1,753 self-insured health plan sponsors that potentially did not file a Form 720 reporting a PCOR fee as required.

For the quarter ending June 30, 2013, TIGTA also found 2,242 transactions had transcription errors which resulted in an overstatement of approximately 359 million average lives covered. While the average number of lives recorded in the Business Return Transaction File is not reliable, these errors do not affect the PCOR fees paid.

WHAT TIGTA RECOMMENDED

TIGTA recommended that: 1) the IRS obtain the data needed to identify noncompliance with the filing and payment requirements for PCOR fees; 2) based on these results, identify nonfilers, send notices as appropriate, and determine if additional enforcement actions are required; 3) alert and instruct employees on how to avoid the significant Form 720 transcription errors that materially affect the accuracy of the average number of lives covered for the PCOR fees; and 4) establish a systemic error report for the Form 720 with a PCOR fee and refer accounts for possible examination that do not match.

In their response to the report, IRS officials agreed with the first three recommendations but disagreed with the fourth recommendation, stating that they have limited Information Technology resources and funding available. However, TIGTA believes establishing a systemic error report that generates when the PCOR fee and/or tax payments do not match for Forms 720 with a PCOR fee will have minimal impact on IRS resources and allow the IRS to improve its monitoring of PCOR fee reporting and payment compliance.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 26, 2015

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT**

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – The Affordable Care Act: Processes Have Been Implemented to Administer the Patient-Centered Outcomes Research Fee, but Controls Need Improvement to Ensure Filing Compliance (Audit # 201330348)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) implementation of the Affordable Care Act Section 6301 (codified in Internal Revenue Code Sections 4375 through 4377) dealing with the Patient-Centered Outcomes Research Trust Fund. This audit is included in the Treasury Inspector General for Tax Administration's Fiscal Year 2015 Annual Audit Plan and addresses the major management challenge of Implementing the Affordable Care Act and Other Tax Law Changes.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Abbreviations

| | |
|--------|--|
| ACA | Patient Protection and Affordable Care Act of 2010 |
| BRTF | Business Return Transaction File |
| DOL | Department of Labor |
| I.R.C. | Internal Revenue Code |
| IRS | Internal Revenue Service |
| NAIC | National Association of Insurance Commissioners |
| PCOR | Patient-Centered Outcomes Research |



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Background

The Patient Protection and Affordable Care Act of 2010¹ (ACA) was signed into law in March 2010. ACA Section (§) 6301 established the Patient-Centered Outcomes Research (PCOR) Institute.² The PCOR Institute³ was authorized by Congress to fund research that will provide information to assist patients and their healthcare providers make more informed decisions about the prevention, treatment, and healthcare options available to them.

The PCOR Institute is funded in three ways: (1) appropriations from the Department of the Treasury's general fund; (2) transfers from Medicare;⁴ and (3) fees assessed on health insurance policies and self-insured health plans.⁵ For "specified health insurance policies," the fee is to be paid by the issuer of the policy (*i.e.*, the insurance company or health maintenance organization).⁶ For "applicable self-insured health plans," the fee is to be paid by the plan sponsor, which is the employer in the case of a single-employer plan.⁷

The PCOR fee is imposed on health insurance policies and self-insured health plans to help fund the PCOR Institute.

The PCOR fee is treated as a tax⁸ and is required to be reported annually on the second quarter Form 720, *Quarterly Federal Excise Tax Return*, and be paid by July 31 each year. Figure 1 shows where the PCOR fee is reported as an excise tax on Form 720.

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 (I.R.C.) §§ 4375-4377.

³ See Appendix VI for a glossary of terms.

⁴ 26 U.S.C. § 9511(b)(2) covers trust fund transfers under the Social Security Act, which includes Medicare.

⁵ The ACA created a new Subchapter B in Chapter 34 of the I.R.C. and added §§ 4375, 4376, and 4377 to impose the PCOR fee on self-insured health plans and health insurance policies.

⁶ Certain policies are exempted from the definition of a "specified health insurance policy" and are not subject to the PCOR fee, such as insurance coverage for accident, disability, liability, workers' compensation and other coverage described in I.R.C. § 9832(c).

⁷ I.R.C. § 4376(c).

⁸ I.R.C. § 4377(c) provides that for Subtitle F purposes the fee is treated as a tax.



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Figure 1: Reporting of Patient-Centered Outcomes Research Fee on Form 720

| Part II | | | | | | |
|----------------|---|--|--------------------------------|----------------------------|--|-----|
| IRS No. | Patient-Centered Outcomes Research Fee (see instructions) | (a) Avg. number of lives covered (see inst.) | (b) Rate for avg. covered life | (c) Fee (see instructions) | | Tax |
| 133 | (a) Specified health insurance policies | | (see inst.) | | | |
| | (b) Applicable self-insured health plans | | (see inst.) | | | |

Source: Form 720 (Rev. 4-2014).

The PCOR fee is based on the average number of lives covered under a policy/plan during a specific fiscal year. The amount of the PCOR fee is equal to the average number of lives covered during the policy/plan year multiplied by the applicable fee dollar amount. The PCOR fee applies to all policies/plans with years ending after September 30, 2012, and before October 1, 2019. Figure 2 shows the PCOR fees reported for Processing Years 2013 and 2014.

Figure 2: PCOR Fees Reported for Processing Years 2013 and 2014

| Number of Transactions and Dollar Amounts Reported | | |
|---|-------------------------------|------------------------------|
| Processing Year | Number of Transactions | Dollar Amount |
| 2013 | 76,524 | \$117.5 million |
| 2014 | 75,469 | \$301.6 million ⁹ |

Source: The Treasury Inspector General for Tax Administration's analysis of the Business Return Transaction File (BRTF) as of October 21, 2014.

The Joint Committee on Taxation estimates revenues from the PCOR fee to be \$2.6 billion for Fiscal Years 2013 through 2019. Figure 3 shows the applicable fee dollar amount per average covered life for the policy/plan years ending after September 30, 2012.

⁹ For Processing Year 2014, policy issuers and plan sponsors reporting policies or plans with a fiscal year ending after December 31, 2012, but before October 1, 2013, owed a PCOR fee of \$1 per average covered life, while policy issuers and plan sponsors reporting policies or plans with a fiscal year ending after September 30, 2013, but before January 1, 2014, owed a PCOR fee of \$2 per average covered life.



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Figure 3: Comparison of Applicable PCOR Fee for Each Average Covered Life Based on Policy/Plan Years

| Dollar Amounts for Policy/Plan Years Ending After 9/30/12 | | |
|---|-----------------|--|
| Period Covered | Processing Year | Dollar Amount (Per Average Covered Life) |
| Fiscal year ending after 9/30/12 but before 1/1/13. | 2013 | \$1 |
| Fiscal year ending after 12/31/12 but before 10/1/13. | 2014 | \$1 |
| Fiscal year ending after 9/30/13 but before 1/1/14. | 2014 | \$2 |
| Fiscal year ending after 12/31/13 but before 10/1/14. | 2015 | \$2 |
| Fiscal year ending after 9/30/14 but before 10/1/19. | 2015-2020 | \$2 plus the annual inflation rate for medical costs accumulating each fiscal year through Fiscal Year 2019* |

Source: Final regulation for the fees on health insurance policies and self-insured health plans for the PCOR. *To be determined by the Secretary of the Department of Health and Human Services based on the National Health Expenditures.

The PCOR fee is imposed on an issuer of a specified health insurance policy or a plan sponsor of an applicable self-insured health plan based on the average number of lives covered under the policy for the policy year or under the plan for the plan year. The policy or plan issuers can use one of the following methods to calculate the average number of lives covered:

- **Actual Count Method** - Count the total number of lives covered for each day of the policy year and divide by the number of days in a year.
- **Snapshot Method** - Count the number of members on a single day (or days if consistent for each quarter) during a quarter and divide the total by the number of dates on which a count was made. The date used for each quarter must be the same (e.g., the first day, the last day).
- **Member Month Method** - The health insurance policy issuer determines the average number of lives covered based on member months reported to the National Association of Insurance Commissioners (NAIC) on the *Supplemental Health Care Exhibit* for the calendar year. The average number of lives in effect for the calendar year equals member months divided by 12.



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- **State Form Method** - This method is for health insurance policy issuers that are not required to file the NAIC's *Supplemental Health Care Exhibit*. These issuers may determine the average number of lives covered using a form that is filed with the issuer's State of residence, if the form reports the number of lives covered in the same manner as the NAIC's *Supplemental Health Care Exhibit*.
- **Form 5500 Method** - Determine the average number of plan participants by combining the total number of participants at the beginning of the plan year with the total number of participants at the end of the plan year as reported on the Department of Labor's (DOL) Form 5500, *Annual Return/Report of Employee Benefit Plan*, and divide by two.

The Internal Revenue Service (IRS) developed a PCOR Trust Fund compliance plan¹⁰ that provides its approach toward improving filing and reporting compliance. The compliance plan states that the Small Business/Self-Employed Division's Excise Tax Program will:

- Use the NAIC database of health policy issuers to identify health insurance policy issuers that are required to file Form 720 to report the PCOR fee.
- Use the Form 5500 data to identify self-insured plan sponsors required to file Form 720 to report the PCOR fee.
- Establish a threshold for PCOR fees reported below which resources will not be expended to verify compliance due to the extremely low amount of the fee. The IRS will also consider using soft notices to address noncompliant taxpayers identified as liable for a PCOR fee.

The PCOR fee is treated akin to an excise tax under law which is subject to delinquency filing and paying penalties. While the IRS's PCOR Trust Fund Compliance Plan does not address either failure to pay or failure to file penalties, the IRS stated that these penalties apply to the nonfiling of Form 720 and non-paying of the PCOR fee, and plans to appropriately assess the penalties.

This review was performed at the IRS Submission Processing Site in Covington, Kentucky, with information obtained from the Large Business and International Division Headquarters in Washington, D.C., and the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, during the period August 2013 through October 2014. 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,

¹⁰ *PCOR Fee Compliance Plan Affordable Care Act Provision 6301*, June 2013.



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scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

External Stakeholders' Comments Were Adequately Addressed

The IRS provided external stakeholders two opportunities to provide comments related to the PCOR fee before the final regulations were issued in December 2012. In June 2011, the IRS issued Notice 2011-35, *Request for Comments on Funding of Patient-Centered Outcomes Research Through Fees Payable by Issuers of Health Insurance Policies and Self-Insured Health Plan Sponsors*. This notice requested public comments on the proposed regulations in the ACA to fund the PCOR Institute research. The IRS received 121 comments in response to Notice 2011-35. The IRS received an additional 51 comments from external stakeholders¹¹ by July 2012 on the proposed regulations for Internal Revenue Code (I.R.C.) §§ 4375, 4376, and 4377.¹²

We traced all of the 172 comments from the proposed regulations to the final regulations to determine if the external stakeholders' concerns¹³ were addressed. Overall, we found that all external stakeholder comments were adequately addressed by the Department of the Treasury and the IRS Office of Chief Counsel's Financial Institutions and Products Division prior to the issuance of the final regulations.

Although Required by Law, the Processing of Some Forms 720 Related to the Patient-Centered Outcomes Research Fee Is Not Cost Effective

The PCOR fee is required to be reported annually on the second quarter Form 720. As of November 5, 2013, 72,035 Forms 720 were filed with PCOR fees totaling \$114 million for Tax

¹¹ External stakeholders who submitted comments include individuals, corporations, law firms, employee benefit advocates, health care organizations, insurance companies, trade associations, third-party administrators of self-insured health benefit plans, State retirement systems, health care consultants, human resource consulting firms, the American Federation of State, County, and Municipal Employees, and the Association of Federal Health Organizations.

¹² Stakeholder comments for Notice 2011-35 had to be received by September 6, 2011. These comments were reviewed and the proposed regulations were issued on April 17, 2012. Stakeholder comments on proposed regulations had to be received by July 16, 2012. Once these comments were reviewed, the final regulations were issued December 6, 2012.

¹³ See Appendix V for the Topics of Stakeholder Comments.



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Year 2012. It costs the IRS approximately \$4.25¹⁴ to process each Form 720. Of these 72,035 returns, we determined that 30,996 (43 percent) Forms 720 paid a PCOR fee of less than \$4.25. While many of these Forms 720 are not cost effective for the IRS to process, the IRS is still required to process them, as well as ensure the filers' PCOR fee compliance.

Potential Nonfilers of Forms 720 Related to the Patient-Centered Outcomes Research Fee Have Not Been Notified

We identified approximately \$3.3 million in unpaid PCOR fees, not including applicable penalties and interest, that are potentially owed by Form 720 nonfilers. Using data provided by the NAIC and the DOL, we found that some health insurance policy issuers and self-insured plan sponsors may not have filed a Form 720 to report and pay their Tax Year 2012 PCOR fees.¹⁵ The IRS is currently implementing its compliance efforts and working to identify potential nonfilers. However, if these potential nonfilers are not notified, the pattern of not reporting and paying their PCOR fees could continue into future tax years.

A few health insurance policy issuers may not be compliant with filing the Form 720 and paying the PCOR fee

We identified 25 health insurance policy issuers that may not be in compliance with filing a Form 720 and paying approximately \$1.5 million in PCOR fees.¹⁶ The IRS received Calendar Year 2012 data from the NAIC to help identify potential PCOR fee nonfilers; however, we found that the data the IRS requested from the NAIC did not include the number of lives covered.

The final regulations of the PCOR Trust Fund under Treasury Regulations 46.4375-1(c)(2)(v) allows the use of the NAIC *Supplemental Health Care Exhibit* to calculate what is required to be reported on Form 720. Because the PCOR fee is based on the average number of lives covered, we obtained data extracts from the NAIC showing that 391 health insurance policy issuers had submitted *Supplemental Health Care Exhibits*, reporting 148 million lives covered for Calendar Year 2012.

We matched the Employer Identification Numbers of 72,035 filed Tax Year 2012 Forms 720 related to the PCOR fees extracted from the BRTF¹⁷ with a data extract obtained from the NAIC

¹⁴ As of September 30, 2013, the IRS estimated that the average cost of processing a Form 720 is \$4.25 per return, including remittance processing. However, overhead costs such as real estate, equipment, and programming costs are not included in this amount.

¹⁵ The PCOR fees were calculated based on the data received from the NAIC and the DOL. However, if the policy or plan issuers had actually filed a Form 720, they could have used one of several methods to calculate the average number of lives covered and pay their Tax Year 2012 PCOR fees.

¹⁶ We computed the \$1.5 million by multiplying the \$1 PCOR fee by the 1.5 million lives covered as reported to the NAIC. See Appendix IV for more details.

¹⁷ This data extract was created on November 5, 2013.



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for Calendar Year 2012. We identified 25 health insurance policy issuers¹⁸ that reported to the NAIC 1.5 million lives covered, but had not filed a Form 720 to report and pay their PCOR fees for Tax Year 2012.

We provided our results to IRS management and they agreed. As a result, they requested that the NAIC include the number of lives covered for each record starting with the Fiscal Year 2014 data extract. This will give them the ability to identify potential nonfilers of the Form 720 related to the PCOR fees, as well as use the number of lives covered data reported to the NAIC for payment compliance purposes. In addition, the IRS plans to issue soft notices¹⁹ to the nonfilers that it identifies and will follow up with any necessary compliance actions.

Some self-insured health plan sponsors may not be compliant with the filing and payment requirements for the PCOR fee

We determined that 1,753 self-insured health plan sponsors (with approximately 1.8 million participants²⁰) may not be in compliance with filing a Form 720 and paying approximately \$1.8 million in PCOR fees for Tax Year 2012.²¹ When we discussed with IRS management the use of DOL Form 5500 data to identify Form 720 nonfilers, IRS management indicated that they are using the data. However, they have no plans to use the data to validate the average number of lives covered as reported on the Form 720 because they do not believe the Form 5500 is a reliable indicator for this information. This is due to single welfare plans that provide health benefits in combination with other welfare benefits (*i.e.*, dental, vision, disability, life insurance) and may be reported all together on a single Form 5500 filing. As such, they stated it is not always clear what share of participants reported on the main Form 5500 are associated with health care benefits and which are associated with other welfare benefits.

The IRS also stated that the Form 5500 actually reports the number of covered employees instead of the total number of lives covered. Because many employees would have family plans, the number of lives covered may actually be higher. When we provided our preliminary results to the IRS, IRS management stated that they are in the process of analyzing the DOL data and cited a Deloitte Advanced Analytical Consulting Group report²² that they plan to use to identify self-insured plans from the DOL data.

¹⁸ As of October 21, 2014, we found that one of the initial 26 potential nonfilers (as of November 5, 2013) had filed a Form 720 to report and pay PCOR fees for Tax Years 2012 and 2013. Also, six of the 26 had filed a Form 720 to report and pay PCOR fees for Tax Year 2013, but still had not filed for Tax Year 2012.

¹⁹ Soft notices are designed to serve as an educational tool, encourage self-correction, and improve voluntary compliance. Soft notices generally do not require the taxpayer to provide a response to the IRS.

²⁰ We determined the average number of plan participants, using the Form 5500 method, by combining the total number of participants at the beginning of the plan year with the total number of participants at the end of the plan year as reported on the Form 5500 and divided by two.

²¹ We computed the \$1.8 million in delinquent PCOR fees by multiplying the 1.8 million average number of participants by the \$1 PCOR fee. See Appendix IV for more details.

²² Deloitte Advanced Analytical Consulting Group, *Self-Insured Health Benefit Plan 2013*, February 14, 2013.



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Based on the report, a plan is classified as a self-insured plan if it did not report any Form 5500 Schedule A, *Insurance Information*, health insurance contracts and held at least one of the following three conditions:

- The Form 5500 plan indicated that its funding or benefit arrangement was, at least in part, through a trust or from general assets, Part II, Line 9a and 9b of Form 5500.
- The Form 5500 plan contained an attached Schedule H, *Financial Information*, or a Schedule I, *Financial Information – Small Plan* (which is required of plans operating a trust).
- The plan filed a Form 5500-SF, *Short Form Annual Return/Report of Small Employee Benefit Plan*.²³

The report also interprets Form 5500 Schedule A filings that include stop-loss insurance or lists fees or commissions paid to a third-party administrator contract as self-insurance related services rather than as evidence of health insurance.

Based on this information, we obtained various data extracts²⁴ from the DOL for Fiscal Year 2012. We matched the Employer Identification Numbers for 82,000 filed Tax Year 2012 Forms 720 related to the PCOR fees extracted from the BRTF²⁵ with the data extracts obtained from the DOL for Fiscal Year 2012. We identified 1,753 self-insured health plan sponsors²⁶ that had not filed²⁷ a Form 720 to report and pay their PCOR fees. We also computed that there were approximately 1.8 million participants based on the data from the DOL. These self-insured health plan sponsors may not be aware of their Form 720 PCOR filing and payment requirements. The IRS should notify these nonfiling plan sponsors of their potential PCOR fee requirements.

The IRS is in the process of matching the Form 5500 data it obtained from the DOL to its Form 720 filing data for the PCOR fee and states these data will be used as a starting point for additional research and analysis in an attempt to identify potential nonfilers. The IRS also stated that it will have to do more work in the classification area, such as researching the Internet for

²³ The Form 5500-SF is generally filed with fewer than 100 participants at the beginning of the plan year. Some plans, that filed the form, had more than 100 participants at the beginning and/or the end of the year. If the plan had an average of 100 or more participants (the number of participants at the beginning of the plan year combined with the number of participants at the end of the plan year, divided by two), it was included.

²⁴ We obtained data extracts from the DOL of Tax Years 2011, 2012, and 2013 Forms 5500, Forms 5500 – SF, Forms 5500 with an attached Schedule A, Forms 5500 with an attached Schedule H, and Forms 5500 with an attached Schedule I.

²⁵ The original data extract was created on November 5, 2013, and identified 72,035 Forms 720 with a PCOR fee in Tax Year 2012. Additional data extracts were created on January 27, 2014 (Processing Year 2013) and October 21, 2014 (Processing Year 2014) to account for the 82,000 Forms 720.

²⁶ These 1,753 self-insured plan sponsors reported 1,874 self-insured health plans and each of these plans has 100 or more participants.

²⁷ As of October 21, 2014, we found that 432 of the 1,753 potential nonfilers had filed a Form 720 to report and pay PCOR fees for Tax Year 2013, but still had not filed for Tax Year 2012.



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the number of possible employees, determining whether the parent or a subsidiary filed a Form 720, and identifying other sources of information that can be used to supplement the identification of potential nonfilers before any notices can be issued.

Recommendations

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

Recommendation 1: Collaborate with the NAIC to obtain the lives covered field and ensure that databases obtained from the DOL include Form 5500 and Form 5500-SF, along with attached Schedule A, Schedule H, and/or Schedule I, for health care benefits plans. Analyze this information to identify potential Form 720 PCOR fee nonfilers.

Management's Response: The IRS agreed with this recommendation. The IRS will continue requesting the lives covered data from the NAIC. Additionally, the IRS will continue to obtain the DOL data for health care benefits plans to assist in identifying potential PCOR fee nonfilers.

Although IRS management agreed that the Forms 720 were not filed, they disagreed with the outcome measures we reported because they indicated that all identified entities may not be subject to the PCOR filing requirements and all identified lives covered may not be subject to the fee under the ACA § 6301.

Office of Audit Comment: The final regulations of the PCOR under Treasury Regulations 46.4375-1(c)(2)(v) allows the use of the NAIC's *Supplemental Health Care Exhibit* to calculate what is required to be reported on Form 720. Additionally, IRS management cited a Deloitte Advanced Analytical Consulting Group report that they plan to use to identify self-insured plans from the DOL data, although the Form 5500 only reports the number of covered employees instead of the total number of lives covered. Because many employees would have family plans, the number of lives covered may actually be higher. Our projections are based on these criteria. As such, we believe that the outcome measure projections accurately demonstrate the potential impact of the recommendations.

Recommendation 2: Based on the NAIC and DOL database analysis results, identify a population of Form 720 PCOR fee nonfilers to send notices. Based on the response to these notices, determine if additional enforcement actions are required for these potential Form 720 nonfilers.



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Management’s Response: The IRS agreed with this recommendation. The IRS will continue to analyze the NAIC and DOL data to identify potential Form 720 nonfilers of the PCOR fee. The IRS will develop a soft notice to issue to potential PCOR nonfilers and initiate a review of taxpayer responses to determine if additional enforcement actions are needed.

Controls Need to Be Strengthened Over the Processing of Forms 720 Reporting the Patient-Centered Outcomes Research Fee

Our analysis of 72,035 Tax Year 2012 Form 720 transactions with a PCOR fee²⁸ identified discrepancies with 2,242 transactions that likely contained transcription errors. These 2,242 discrepancies resulted in the total average number of lives covered recorded on the BRTF to be off by 359.4 million when comparing it to the total PCOR fee amount. Because the PCOR fee for Tax Year 2012 is \$1 per average covered life, they should be equal. Discrepancies can result from taxpayer errors or IRS data transcriber errors when entering data from the filed Forms 720. Our analysis determined that the 2,242 Form 720 transactions with discrepancies contained an average number of lives covered amount with additional digits that were likely entered as decimal places. For example:

Taxpayer A enters the average number of lives covered as 100, and calculates the PCOR fee as \$100 (\$1 per average covered life). During tax return processing, an IRS data transcriber enters the PCOR fee as 10000 and the BRTF records it as \$100.00.²⁹ Instead of inputting the average number of lives covered as 100, the data transcriber mistakenly inputs 10000. The BRTF does not put decimal places in the average number of lives covered field. While the PCOR fee is correctly transcribed, this results in an overstatement of the average number of lives covered by 9,900.

When we visited the Cincinnati Submission Processing Site where the IRS processes the Form 720, we found that there is no math verification process (systemic or manual) to check the accuracy of the average number of lives covered to the PCOR fee. A systemic process is used by the IRS on the input of select fields for different types of tax forms and provides a control to ensure the accuracy of the input and could identify when decimal point errors occur. While the Form 720 can be filed for each quarter of the calendar year, it is used to report more than 50 different kinds of excise tax. *****2*****
*****2*****
*****2*****
*****2*****. When we provided our results to IRS management, they asserted that the transcription errors affect the average number of lives covered data and not

²⁸ This information is based on BRTF data for Tax Year 2012 as of November 5, 2013.

²⁹ Some fields (i.e., PCOR fee/tax amount) require the transcriber to enter extra digits for the decimal places.



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the PCOR fees paid. While the IRS does not currently use the average number of lives covered field to compute the PCOR fee, they do require input and correction of the field amount if it is determined to be incorrect. Because this field amount is not reliable, the IRS should not report the average number of lives covered to external stakeholders or use the data for payment compliance purposes until the accuracy of the data are validated.

IRS actions

In response to our findings, the IRS issued an alert on June 23, 2014, through the IRS intranet, to remind Submission Processing function employees to ensure that, when coding, editing, and transcribing the average number of lives covered field from the Form 720, decimal places are not inadvertently added to the number.³⁰ While Forms 720 are generally filed quarterly, PCOR fee filers are required only to report and pay annually on the second quarter Form 720 by its due date of July 31. Due to its versatility and use in reporting a number of different types of taxes, transcription of the information from the Form 720 to the BRTF may be more complex than transcribing an annual form like the Form 1120, *U.S. Corporation Income Tax Return*. Because the Cincinnati Submissions Processing Site processes Forms 720 with a PCOR fee only one quarter in a calendar year, PCOR fee transcription errors can occur. Our analysis of the average number of lives covered data recorded after the IRS alert determined that there continues to be a decimal place issue for the second PCOR fee filing season (Tax Year 2013).³¹ Although the number of transactions entered with decimal places has decreased,³² the discrepancies on these transactions for Tax Year 2013 continue to cause the average number of lives covered data field to be unreliable.

Recommendations

The Commissioner, Wage and Investment Division should:

Recommendation 3: Issue alerts during the third quarter of each fiscal year to remind Submission Processing function employees, when processing the Form 720 with a PCOR fee, to use caution when transcribing the average number of lives covered to avoid inadvertently recording the digits after decimal places.

Management's Response: The IRS agreed with this recommendation. The IRS will issue monthly alerts during the third quarter of each fiscal year to remind employees of the correct procedures for processing the Form 720.

³⁰ Service-Wide Electronic Research Program Alert #14A0322 (Form 720 IRS Number 133, *PCOR Average Number of Lives Coding/Editing and Transcription*).

³¹ This information is based on BRTF data for Tax Year 2013 as of September 3, 2014.

³² After the alert was issued on June 23, 2014, we identified 394 discrepancies resulted in the total average number of lives recorded on the BRTF to be off by 293.5 million when comparing it to the total PCOR fee amount.



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Recommendation 4: Establish a systemic error reporting process for Forms 720 with a PCOR fee to identify any accounts in which the transcribed average number of lives covered, the PCOR fee, and/or tax payments do not match. If any of the amounts do not match, refer these accounts for further analysis (and examination if appropriate).

Management's Response: The IRS disagreed with this recommendation. The IRS mentioned that in all cases in which transcription errors occurred, the correct amount of tax was recorded and therefore did not affect the assessment of the correct tax liability. The IRS stated that it has limited Information Technology resources and funding available and does not believe it would be prudent to use these resources to address a condition that does not result in erroneous tax assessments.

Office of Audit Comment: We believe establishing a systemic error report that generates when the PCOR fee and/or tax payments do not match for Forms 720 with a PCOR fee will have minimal impact on IRS resources. In addition, this report would allow the IRS to improve its monitoring of PCOR fee reporting and payment compliance.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS's implementation of the ACA § 6301 dealing with the PCOR¹ Trust Fund. To accomplish this objective, we:

- I. Interviewed PCOR working group members to identify any external stakeholders that provided feedback on the proposed PCOR fee regulations. Specifically, we:
 - A. Identified their concerns/comments with the proposed PCOR fee regulations.
 - B. Determined whether their concerns/comments were adequately addressed in the final PCOR fee regulations.
- II. Determined the status of the IRS's implementation of the PCOR fee.
 - A. Evaluated the IRS's efforts to process the Forms 720, *Quarterly Federal Excise Tax Return*, related to the PCOR fee.
 1. Determined what procedures, guidelines, and practices the IRS uses for processing the Form 720.
 - a) Interviewed PCOR working group members to determine what procedures, guidelines, and/or practices are used to process the Form 720 related to the PCOR fee.
 - b) Obtained and reviewed any documentation related to the processing of the Form 720 related to the PCOR fee to determine whether adequate controls are in place to ensure that the processing of the forms are timely and accurate.
 - c) Obtained and reviewed any managerial reports used to measure and monitor the processing of the Form 720 related to the PCOR fee.
 2. Conducted a walkthrough of how the Form 720 and PCOR fee is processed at the Cincinnati Submission Processing Site and compared the results to the procedures, processes, and practices identified in Step II.A.1.b.
 3. Obtained and reviewed the weekly/monthly tracking reports of Forms 720 with reported PCOR fees for the Tax Year 2012 policy/plan year that were processed during Processing Year 2013.

¹ See Appendix VI for a glossary of terms.



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- B. Assessed whether controls are in place to identify the method used by taxpayers to determine the average number of lives covered and the PCOR fee amount that should be correctly reported on the Form 720.
1. Obtained the PCOR population of 72,035 filed Tax Year 2012 Forms 720 processed by the IRS for the average number of lives covered, the dollar amount of the PCOR fee, and the PCOR tax amount as recorded on the BRTF.²
 - a) Determined the number of transactions that have a potential discrepancy by comparing the average number of lives covered and/or dollar amount of the PCOR fee to the PCOR tax amount.
 - b) Obtained from the Business Master File the Transaction Code 150 tax posted for the Form 720 and the Transaction Code 6xx (various types of payments posted on these accounts) for the payments made by the taxpayer on the transactions identified from Step II.B.1.a.
 - c) Compared the data from Step II.B.1.a. to Step II.B.1.b. and determined the variance of these transactions and the cause of the error (*i.e.*, taxpayer and/or IRS error), as well as the type of error (*e.g.*, decimal).
 - d) Discussed the results with the IRS and determined what actions should be taken to correct these processing and/or data transcription errors.
- III. Determined whether the IRS is properly identifying potential nonfilers of the Form 720 related to the PCOR fee.
- A. Matched the Employer Identification Numbers of filed Forms 720, used to report the PCOR fee, identified on the BRTF in Step II.B.1. to the NAIC database of health insurance policy issuers and IRS internal sources to identify health insurance policy issuers that are potentially required to file the Form 720 and pay the PCOR fee.
 - B. Matched the Employer Identification Numbers for 82,000 Tax Year 2012 Forms 720, used to report the PCOR fee, from extracts of the BRTF³ to data extracts⁴ obtained from the DOL for Fiscal Year 2012 to identify self-insured health

² This data extract was created on November 5, 2013.

³ The original data extract was created on November 5, 2013, and identified 72,035 Forms 720 with a PCOR fee in Tax Year 2012. Additional data extracts were created on January 27, 2014 (Processing Year 2013) and October 21, 2014 (Processing Year 2014) to account for the 82,000 Forms 720.

⁴ We obtained data extracts from the DOL of Tax Year 2012 Forms 5500, *Annual Return/Report of Employee Benefit Plan*, Forms 5500 – SF, *Short Form Annual Return/Report of Small Employee Benefit Plan*, Forms 5500 with an attached Schedule A, *Insurance Information*, Forms 5500 with an attached Schedule H, *Financial Information*, and Forms 5500 with an attached Schedule I, *Financial Information – Small Plan*.



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plan sponsors that are potentially required to file the Form 720 and pay the PCOR fee.

- C. Determined whether the IRS issued any notices to the potential nonfiling taxpayers to notify them of their new filing and payment requirements.
- D. Compared the results of Step III.A. against the BRTF extracts used in Step III.B. to determine whether any potential nonfilers identified from the NAIC data match have subsequently filed their delinquent Form 720 for Tax Year 2012.
- E. Compared the results of Steps III.A. and III.B. against a BRTF extract that contained the Employer Identification Numbers for 69,993 Tax Year 2013 filed Forms 720 used to report the PCOR fee. We determined whether any potential nonfilers identified from the NAIC and DOL data matches have filed a Form 720 for Tax Year 2013.
- F. Discussed the results with the IRS and determined what actions should be taken to identify and address these nonfilers.

Data validation methodology

During this review, we relied on Tax Year 2012 Form 720 data extracted from the BRTF for Processing Years 2013 and 2014 and taxpayer account transaction data extracted from the Business Master File through the end of Processing Year 2013 that were provided by the Treasury Inspector General for Tax Administration Office of Investigations' Strategic Data Services. To assess the reliability of computer-processed data, programmers within Strategic Data Services validated the data extract files, while we ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed 10 cases and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System and on the Form 720. As a result of our testing, we determined the data used in our review were reliable.

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: IRS communication/outreach efforts to ensure that tax returns were accurately and timely filed, as well as policies and procedures to ensure that taxpayers are filing required returns and paying the correct amount of tax. We evaluated these controls by reviewing external stakeholders' comments, data from the NAIC *Supplemental Health Care Exhibit*, data from the DOL Form 5500, *Annual Return/Report of Employee Benefit Plan*, and data extracts of the IRS's BRTF for Processing Years 2013 and 2014.



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Appendix II

Major Contributors to This Report

Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Nancy Nakamura, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Alan Lund, Acting Director
Tina Parmer, Acting Director
Christina Dreyer, Audit Manager
Ken Henderson, Lead Auditor
David Hartman, Senior Auditor
Gail Schuljan, Senior Auditor
Kevin Nielsen, Auditor



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
Director, Affordable Care Act Office SE:ACA
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
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:
 Commissioner, Large Business and International Division SE:LB
 Commissioner, Small Business/Self-Employed Division SE:S
 Commissioner, Wage and Investment Division SE:W



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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; \$1.5 million in PCOR fees associated with 25 health insurance policy issuers that reported 1.5 million lives covered. These policy issuers did not file Form 720, *Quarterly Federal Excise Tax Return*, to report the PCOR fees for Tax Year¹ 2012 (see page 7).

Methodology Used to Measure the Reported Benefit:

We matched the Employer Identification Numbers for 72,035 filed Tax Year 2012 Forms 720 related to the PCOR fees extracted from the BRTF with a Calendar Year 2012 data extract, obtained from the NAIC showing 391 insurance companies had submitted a *Supplemental Health Care Exhibit* reporting 148 million lives covered. We identified 25 health insurance policy issuers that reported 1.5 million lives covered to the NAIC, but had not filed a Form 720 to report their PCOR fees.² Based on our analysis, potentially 25 Form 720 nonfilers may owe \$1.5 million (1.5 million lives covered x \$1) in PCOR fees, based on information reported on their *Supplemental Health Care Exhibits*, which the IRS could potentially collect.³

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$1.8 million in PCOR fees associated with 1,753 self-insured health plan sponsors reporting 1,874 self-insured health plans with approximately 1.8 million participants. These plans did not file a Form 720 to report the PCOR fees for Tax Year 2012 (see page 7).

¹ See Appendix VI for a glossary of terms.

² As of October 21, 2014, we found that one of the initial 26 potential nonfilers (as of November 5, 2013) had filed a Form 720 to report and pay PCOR fees for Tax Years 2012 and 2013. Also, six of the 26 had filed a Form 720 to report and pay PCOR fees for Tax Year 2013, but still had not filed for Tax Year 2012.

³ The PCOR fees were calculated based on the data received from the NAIC. However, if the policy issuers had actually filed a Form 720, they could have used one of several methods to calculate the average number of lives covered and pay their Tax Year 2012 PCOR fees.



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Methodology Used to Measure the Reported Benefit:

We matched the Employer Identification Numbers for 82,000⁴ filed Tax Year 2012 Forms 720 related to the PCOR fees extracted from the BRTF with various Fiscal Year 2012 data extracts⁵ obtained from the DOL. We determined that 1,753 self-insured health plan sponsors, reporting 1,874 self-insured health plans (with 100 or more participants), may not be in compliance with filing a Form 720 to report and pay their PCOR fees.⁶ Based on our analysis, potentially 1,753 Form 720 nonfilers may owe approximately \$1.8 million (1.8 million number of participants x \$1) in PCOR fees, based on information reported on their filed Forms 5500 or 5500-SF, which the IRS could potentially collect.⁷

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 2,242 taxpayer account transactions in which the average number of lives covered were incorrectly recorded on the BRTF for Tax Year 2012 (see page 11).

Methodology Used to Measure the Reported Benefit:

Our analysis of 72,035 Form 720 transactions with a PCOR fee recorded⁸ identified 2,242 transactions that likely contained transcription errors where the average number of lives covered was entered incorrectly on the BRTF. We identified discrepancies totaling 359.4 million when comparing the PCOR fee to the average number of lives recorded by the IRS on the BRTF. Because the PCOR fee for Tax Year 2012 is \$1 per average covered life, they should be equal. We determined the approximately 359.4 million discrepancy in the average number of lives covered data resulted from decimal errors recorded on the BRTF for these 2,242 transactions.

⁴ The original data extract was created on November 5, 2013, and identified 72,035 Forms 720 with a PCOR fee in Tax Year 2012. Additional data extracts were created on January 27, 2014 (Processing Year 2013) and October 21, 2014 (Processing Year 2014) to account for the 82,000 Forms 720.

⁵ We obtained data extracts from the DOL of Tax Years 2011, 2012, and 2013 Forms 5500, *Annual Return/Report of Employee Benefit Plan*, Forms 5500 – SF, *Short Form Annual Return/Report of Small Employee Benefit Plan*, Forms 5500 with an attached Schedule A, *Insurance Information*, Forms 5500 with an attached Schedule H, *Financial Information*, and Forms 5500 with an attached Schedule I, *Financial Information – Small Plan*.

⁶ As of October 21, 2014, we found that 432 of the 1,753 potential nonfilers had filed a Form 720 to report and pay PCOR fees for Tax Year 2013, but still had not filed for Tax Year 2012.

⁷ The PCOR fees were calculated based on the data received from the DOL. However, if the plan issuers had actually filed a Form 720, they could have used one of several methods to calculate the average number of lives covered and pay their Tax Year 2012 PCOR fees.

⁸ This information is based on BRTF data for Tax Year 2012 as of November 5, 2013.



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Appendix V

Topics of Stakeholder Comments

| Stakeholder Comments on Notice 2011-35 | |
|---|---------------|
| Category Topics | Number |
| Calculation Method for Determining Average Number of Lives ¹ Covered Under Sections 4375, 4376, and 4377 | 20 |
| Duplication or Double Counting of PCOR Fees Under Multiple Plans | 15 |
| Exclusion of FSAs, HRAs, HSAs, and EAPs* | 14 |
| Third-Party Administrators | 12 |
| Expatriate Coverage and Defining U.S. Residency as It Relates to Paying the Fee | 9 |
| Transition Rules | 9 |
| Administrative Issues | 7 |
| General Comments on Subject Matter Not in the Notice 2011-35, Proposed and Final Regulation | 5 |
| Reporting Fees Monthly, Quarterly, or Annually | 5 |
| Single Employers and Consolidated Group Health Plan Under Section 414 | 3 |
| Fees on Specific Health Insurance Policies (Section 4375) and Applicable Self-Insured Plan (Section 4376) | 3 |
| Flexibility as to Timing and Method of Payment of the Fee | 2 |
| Safe Harbor to Report the Number of Lives Covered | 2 |
| Definition of a Plan/Policy Year | 2 |
| Other Various Topics (with one occurrence) | 13 |
| Total | 121 |

| Stakeholder Comments on Proposed Regulation | |
|---|---------------|
| Category Topics | Number |
| HRAs, FSAs, and VEBA*s* | 11 |
| General Comments on Subject Matter Not in Proposed and Final Regulation | 3 |
| Defining and Determining Whether an Individual Resides in the United States | 2 |
| Avoid Double Counting of Lives | 2 |
| Transition Rules | 2 |
| Determining Average Number of Lives | 2 |
| Self-Insured Expatriate Plans | 2 |
| Other Various Topics (with one occurrence) | 27 |
| Total | 51 |

| | |
|---|------------|
| Stakeholder Comments on Notice 2011-35 | 121 |
| Stakeholder Comments on Proposed Regulation | 51 |
| Total Stakeholder Comments | 172 |

*FSA – Flexible Spending Arrangement; HRA – Health Reimbursement Arrangement; HSA – Health Savings Account; EAP – Employee Assistance Program; and VEBA – Voluntary Employee Beneficiary Association.

¹ See Appendix VI for a glossary of terms.



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Appendix VI

Glossary of Terms

| Term | Definition |
|---|--|
| Average Number of Lives | A number, calculated by the taxpayer, used to calculate the amount to be paid for the PCOR fee on the Form 720, <i>Quarterly Federal Excise Tax Return</i> . |
| Benefit Arrangement | The method by which the plan provides benefits to participants. |
| Business Master File | 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. |
| Business Return Transaction File | Receives business tax return data, reformats and posts returns to the Return Transaction File, and does periodic file maintenance. |
| Calendar Year | The 12-consecutive-month period ending on December 31. |
| Department of Labor | A Federal agency of the United States in which its mission is to foster, promote, and develop the welfare of the wage earners, job seekers, and retirees of the United States; improve working conditions; advance opportunities for profitable employment; and assure work-related benefits and rights. |
| Direct Filing Entity | Plans that participate in certain trusts, accounts, and other investment arrangements that file the Form 5500, <i>Annual Return/Report of Employee Benefit Plan</i> . |
| Employee Assistance Program | A worksite-based program designed to assist in the identification and resolution of work-related and non-work-related issues associated with employees impaired by personal concerns including, but not limited to, health, marital, family, financial, alcohol, drug, legal, emotional, or other personal concerns which may adversely affect employee job performance. |



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| Term | Definition |
|---|--|
| Employer Identification Number | Is also known as a Federal Tax Identification Number and is a unique nine-digit number used to identify a taxpayer's business account. |
| Fiscal Year | Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30. |
| Flexible Spending Arrangement | A health flexible spending arrangement allows employees to be reimbursed for medical expenses. Flexible spending arrangements are usually funded through voluntary salary reduction agreements with your employer. No employment or Federal income taxes are deducted from your contribution. The employer may also contribute. |
| Form 5500, Annual Return/Report of Employee Benefit Plan | Form 5500 is used to report information concerning employee benefit plans and Direct Filing Entities. |
| Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan | Form 5500-SF is used to report information concerning small employee benefit plans and Direct Filing Entities (generally less than 100 participants at the beginning of the plan year). |
| Funding Arrangement | The method for the receipt, holding, investment, and transmittal of plan assets prior to the time the plan actually provides benefits. |
| General Assets of the Plan Sponsor | The plan had no assets or some assets were commingled with the general assets of the plan sponsor prior to the time the plan actually provided the benefits promised. |
| Health Reimbursement Arrangement | A health reimbursement arrangement must be funded solely by an employer. The contribution cannot be paid through a voluntary salary reduction agreement on the part of an employee. Employees are reimbursed tax free for qualified medical expenses up to a maximum dollar amount for a coverage period. A Health Reimbursement Arrangement may be offered with other health plans, including Flexible Spending Arrangements. |
| Health Savings Account | A tax-exempt trust or custodial account you set up with a qualified Health Savings Account trustee to pay or reimburse certain medical expenses you incur. You must be an eligible individual to qualify for a Health Savings Account. |



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| Term | Definition |
|--|---|
| Integrated Data Retrieval System | IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records. |
| Medical Loss Ratio Calculation | The percentage of insurance premium dollars spent on reimbursement for clinical services and activities to improve health care quality. |
| National Association of Insurance Commissioners | The United States' standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 States, the District of Columbia, and five U.S. territories. |
| Patient-Centered Outcomes Research Fee | A fee on issuers of specified health insurance policies and plan sponsors of applicable self-insured health plans that helps to fund the PCOR Institute. |
| Patient Centered Outcomes Research Institute | Authorized by Congress to fund and disseminate research that will provide information about the best available evidence to help patients and their healthcare providers make more informed decisions. |
| Processing Year | The calendar year in which the tax return or document is processed by the IRS. |
| Schedule A (Form 5500), <i>Insurance Information</i> | Must be attached to the Form 5500 for every defined benefit pension plan, defined contribution pension plan, or welfare benefit plan if any benefits under the plan are provided by an insurance company, insurance service, or other similar organization (such as a health maintenance organization). |
| Schedule H (Form 5500), <i>Financial Information</i> | Must be attached to the Form 5500 for pension benefit plans and welfare benefit plans filing as "large plans" and for all Direct Filing Entities. |
| Schedule I (Form 5500), <i>Financial Information – Small Plan</i> | Must be attached to the Form 5500 for pension benefit plans and welfare benefit plans filing as "small plans" rather than the Form 5500-SF. |
| Submission Processing | The data processing arm of the IRS. The submission processing sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. |



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| Term | Definition |
|---|--|
| Supplemental Health Care Exhibit | Assists State and Federal regulators with analyzing health insurance revenue and expense items that contribute to medical loss ratio calculations. The <i>Supplemental Health Care Exhibit</i> provides State-by-State financials and detailed enrollment information and is particularly useful for analyzing commercial health insurance businesses. |
| Tax Year | 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. |
| Transaction Code | A three-digit code used to identify actions being taken on a taxpayer's account. |
| Trust | Any fund or account that receives, holds, transmits, or invests plan assets other than an account or policy of an insurance company. |
| Voluntary Employee Beneficiary Association | An association organized to pay life, sick, accident, or similar benefits to members or their dependents, or designated beneficiaries. No part of the net earnings of the association may inure to the benefit of any private shareholder or individual. |



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Appendix VII

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

February 3, 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – The Affordable Care Act: Achievements Were Made in Implementing the Patient-Centered Outcomes Research Fee but Controls Need Improvement to Ensure Filing Compliance (Audit No 201330348)

Thank you for the opportunity to review your draft report titled: The Affordable Care Act: Achievements Were Made in Implementing the Patient-Centered Outcomes Research Fee but Controls Need Improvement to Ensure Filing Compliance (Audit No 201330348).

The Patient Protection and Affordable Care Act of 2010 (ACA) was signed into law in March 2010. ACA Section (§) 6301 established the Patient-Centered Outcomes Research (PCOR) Institute. The PCOR Institute was authorized by Congress to fund research that will provide information to assist patients and their healthcare providers make more informed decisions about the prevention, treatment, and healthcare options available to them.

We appreciate your recognition of the achievements and progress IRS has made in its administration of ACA provision 6301. Your review of this provision highlighted our engagement of external stakeholders and that IRS adequately addressed stakeholder comments and concerns regarding the issuance of final regulations in December 2012. We also appreciate your acknowledgement that the IRS is properly utilizing and analyzing data from external sources to evaluate return filing compliance and undertaking appropriate compliance efforts to identify additional potential nonfilers.

Your report includes outcome measures with monetary benefits of \$1.5 million in PCOR fees associated with 25 health insurance policy issuers that did not file Form 720 for tax year 2012. Your report also includes monetary benefits of \$1.8 million in PCOR fees associated with 1,753 self-insured health plan sponsors with approximately 1.8 million participants that did not file a Form 720 to report the PCOR fees for tax year 2012. While we agree in both of these instances that these returns were not filed, we do not agree with your stated monetary benefits of \$3.3 million, as all identified entities may not



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be subject to the PCOR filing requirements and all identified lives covered may not be subject to the fee under ACA Section 6301.

We have attached a detailed response outlining our corrective actions.

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



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3

Attachment

RECOMMENDATION 1:

Collaborate with the NAIC to obtain the lives covered field and ensure that databases obtained from the DOL include Form 5500 and Form 5500-S, along with attached Schedule A, Schedule H, and/or Schedule I, for health care benefits plans. Analyze this information to identify potential Form 720 PCOR fee nonfilers.

CORRECTIVE ACTION:

IRS agrees with this recommendation. SB/SE will continue to collaborate with LB&I, the designated NAIC point of contact, in requesting the lives covered data from NAIC. SB/SE will continue to obtain DOL data that includes Form 5500 and Form 5500-S, along with Schedule(s) A, Schedule(s) H, and Schedule(s) I, for health care benefits plans to assist in identifying potential PCOR fee non-filers.

IMPLEMENTATION DATE:

Completed

RESPONSIBLE OFFICIAL(S):

Director, Examination - Specialty Policy and Quality

RECOMMENDATION 2:

Based on the NAIC and DOL database analysis results, identify a population of Form 720 PCOR fee nonfilers to send notices. Based on the response to these notices, determine if additional enforcement actions are required for these potential Form 720 nonfilers.

CORRECTIVE ACTION:

IRS agrees with this recommendation. SB/SE will utilize a tolerance threshold of *****2***** and continue analyzing NAIC and DOL data to identify potential Form 720 non-filers for the PCOR fee. SB/SE will develop a soft notice to issue to potential PCOR non-filers. SB/SE will initiate a review of soft notice responses to determine if additional enforcement actions are needed.

IMPLEMENTATION DATE:

November 15, 2016

RESPONSIBLE OFFICIAL(S):

Director, Examination - Specialty Policy and Quality

CORRECTIVE ACTION MONITORING PLAN:

The IRS will monitor this corrective action as part of our internal management system of controls.



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RECOMMENDATION 3:

Issue alerts during the third quarter of each fiscal year to remind Submission Processing function employees, when processing the Form 720 with a PCOR fee, to use caution when transcribing the average number of lives covered to avoid inadvertently recording the digits after decimal places.

CORRECTIVE ACTION:

IRS agrees with this recommendation. Submission Processing will issue monthly alerts during the third quarter each fiscal year reminding employees of the correct procedures for processing Form 720.

IMPLEMENTATION DATE:

October 15, 2015

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division.

CORRECTIVE ACTION MONITORING PLAN:

The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:

Establish a systemic error reporting process for Forms 720 with a PCOR fee to identify any accounts in which the transcribed average number of lives, the PCOR fee and/or tax payments do not match. If any of the amounts do not match, refer these accounts for further analysis (and examination if appropriate).

CORRECTIVE ACTION:

We disagree with this recommendation on the basis that transcription errors that occurred during processing of some Forms 720, *Quarterly Federal Excise Tax Return*, did not affect the assessment of the correct tax liability. In all cases where transcription errors occurred, the correct amount of tax was recorded. We have addressed transcription accuracy with employees performing data entry and will continue to address the issue during training and in communications with employees. The monthly alerts issued to employees during the third quarter should have a positive impact by further reducing the already low error rate. With limited Information Technology resources and funding available for implementing systemic changes, we do not believe it is a prudent use of our resources to address a condition that does not result in erroneous tax assessments.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

N/A