Congressional Research Service

MEMORANDUM April 30, 2010

To: Hon. Tom Coburn
Attention: Josh Trent

From: Carol A. Pettit, Legislative Attorney, 7-9496
Edward C. Liu, Legislative Attorney, 7-9166

Subject: **The PPACA Penalty Provision and the Internal Revenue Service**

This memorandum responds to your request for information regarding the penalty imposed on those who fail to maintain minimum essential health benefits coverage. The requirement for coverage and the penalty for noncompliance, beginning in tax year 2014, were established by the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010, in new section 5000A of the Internal Revenue Code (IRC). You have asked about when the penalty would be imposed as well as the extent to which the Internal Revenue Service may assess and collect the penalty using civil rather than criminal provisions.

Information in this memorandum is drawn from publicly available sources and is of general interest to Congress. As such, all or part of this information may be provided in memoranda or reports for general distribution to the Congress. Your confidentiality as a requester will be preserved in any case.

The Penalty

Under section 1501 of the Patient Protection and Affordable Care Act, beginning in tax year 2014, some taxpayers will be assessed a monetary penalty for any months during which they or their dependents lack "minimum essential" health coverage.[1] The amount of the assessment for failing to meet the individual responsibility requirement, which can be prorated for partial compliance during the year, is determined by comparing the "flat dollar amount"[2] to the "percentage of income."[3] The greater of the two amounts is the amount used to determine the penalty. The total amount assessed for the taxable year shall not exceed the national average of the annual premiums of a bronze level health insurance plan, for the applicable family size, offered through the Exchanges created under PPACA.

The annual flat dollar amount is assessed per individual or dependent without coverage and will be phased in over three years. The amount is set at $95 for 2014; $325 for 2015; and $695 in 2016 and

[1] P.L. 111-148, § 1501(b), as amended by P.L. 111-152, § 1002.

[2] P.L. 111-148, § 1501(b) (adding I.R.C. § 5000A(c)(2)(A)).

[3] P.L. 111-148, § 1501(b), as amended by P.L. 111-152. § 1002(a)(1) (adding I.R.C. § 5000A(c)(2)(B)).

thereafter.[4] Although this is a fixed per person amount, it is capped at three times this amount per year, regardless of the number of individuals in the taxpayer's household who actually lack adequate coverage during the year. For example, a married couple filing jointly with two dependent children and no health insurance will have the same flat dollar assessment as a similarly situated married couple with three dependent children.

The "percentage of income" is determined by first subtracting the taxpayer's filing threshold[5] from the taxpayer's household income.[6] The result is then multiplied by the applicable percentage. As with the flat dollar amount, the applicable percentage to be used is phased in over three years, set at 1% for 2014, 2% for 2015, and 2.5% thereafter.

The greater of the amount calculated as either the "flat dollar amount" or the "percentage of income" is divided by twelve to determine the penalty due for each month for which the penalty is applicable. The total amount assessed for the taxable year shall not exceed the national average of the annual premiums of a bronze level health insurance plan, for the applicable family size, offered through the Exchanges created under PPACA.

Exemptions

PPACA provides a number of exemptions from the individual responsibility requirement. Some may be related to an individual's membership in a particular group, such as membership in an Indian tribe or membership in a religious sect whose beliefs conflict with commercial health insurance.[7]

Exemptions may also be available if an individual is without coverage for less than three months in a year. This exemption only applies to a continuous period of time without coverage, and may only be used for one period without coverage in a year. For example, an individual who lacked coverage for three non-continuous months in a year would only be exempt from the penalty for the first month without coverage.[8]

A number of exemptions may be based on an individual's household income. But, these exemptions are not explicitly tied to whether an individual pays no net income taxes or falls below the federal poverty guidelines. Nevertheless, individuals who fall into one of these two categories may qualify for any of three income based exemptions, described in greater detail in the sections below: 1) the exemption for individuals who cannot afford coverage; 2) the exemption for individuals whose household income does not exceed the filing threshold; or 3) the hardship exemption as determined by the Secretary of Health and Human Services (HHS). If noncompliant individuals cannot qualify for these exemptions or any others, they can be assessed a penalty at the rates described above, beginning in tax year 2014.

[4] For individuals under age 18, the applicable dollar amount would be one half the applicable dollar amount for other individuals. The applicable dollar amount for those age 18 and older will be adjusted for inflation in years beginning after 2016.

[5] The filing threshold for individuals is defined in I.R.C. § 6012(a)(1) and is roughly equal to the taxpayer's personal exemption (or exemptions in the case of a joint filer) plus the standard deduction for the appropriate filing status.

[6] "Household income" is defined in I.R.C. § 5000A(c)(4)(B).

[7] I.R.C. § 5000A(f)(3).

[8] I.R.C. § 5000A(f)(4).

Affordability Exemption

A taxpayer who is offered eligible-employer-sponsored coverage qualifies for the affordability exemption if the employee contribution for self-only coverage in the plan exceeds 8% of the taxpayer's household income. A taxpayer who only has access to health insurance in the individual health insurance market qualifies for the hardship exemption if the annual premium of the lowest cost bronze level plan, minus any potential premium subsidies, exceeds 8% of the taxpayer's household income.[9] The percentage of household income will be indexed in years after 2014 to reflect any difference in the rate of premium growth over the rate of income growth.[10]

Filing Threshold Exemption

Under § 6012 of the Internal Revenue Code, taxpayers whose gross income does not exceed a specified filing threshold are not generally required to file a federal income tax return. Similarly, § 5000A, as added by PPACA, does not impose any penalty on noncompliant taxpayers whose household income is less than the filing threshold.[11] It should be noted that "household income" under § 5000A is based on a taxpayer's modified adjusted gross income,[12] while the general filing requirement is based on gross income. Therefore, some individuals who are required to file a tax return may still be exempt from the individual responsibility requirement.

Hardship Exemption

PPACA also authorizes the Secretary of HHS to exempt individuals who "have suffered a hardship with respect to the capability to obtain coverage under a qualified health plan."[13] The Secretary of HHS is directed to prescribe what information individuals should provide when seeking a hardship exemption.[14]

Assessment and Collection of Tax by the Internal Revenue Service

Section 5000A(g)(1) of the Internal Revenue Code (IRC) states that "the penalty provided by this section shall be paid upon notice and demand by the Secretary." Subject to certain exceptions, the penalty is to be assessed and collected in the same way as assessable penalties. Assessable penalties generally are assessed and collected in the same manner as taxes.[15]

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[9] Although PPACA does not explicitly specify, for individuals purchasing health insurance in the private market, the affordability criteria will likely be made with respect to the cost of self only coverage under a bronze plan in the applicable Exchange.

[10] I.R.C. § 5000A(e)(1)(D).

[11] I.R.C. § 5000A(e)(2).

[12] Modified adjusted gross income, for these purposes, is defined in I.R.C. § 36B(d)(2)(B) (as added by P.L. 111-148, § 1401(a) and amended by P.L. 111-152, § 1004(a)(2)).

[13] I.R.C. § 5000A(e)(5).

[14] P.L. 111-148, § 1411(b)(5).

[15] I.R.C. § 6671(a).

Assessments

General Provisions for Assessments

This section describes general provisions regarding tax assessments. Information specific to individuals' requirements under PPACA is described in the next section, "Assessment of the Penalty for Failure to Maintain Minimum Coverage."

Under the U.S. income tax system, taxpayers self-declare their income and deductions and then calculate the income tax due on the taxable income. The Internal Revenue Service has the authority to ascertain the accuracy of a taxpayer's data and calculations and propose additional tax if inaccuracies are found.

Although the IRS may conduct formal examinations of taxpayers' returns (which taxpayers usually referred to as "audits"), it more frequently conducts correspondence audits in which the taxpayer is asked to provide additional information to support the information on the tax return or may be asked about income that appears to be missing from the return. The latter questions generally arise as the result of the "matching program."

Through the matching program, various information returns such as W-2s and 1099s are matched to the taxpayer's social security number. If it appears that an item of income has not been reported on the taxpayer's income tax return, the IRS will send out a letter explaining that there is income that was reported by a third party that was not shown on the return and proposing additions to tax as a result of the additional income. The taxpayer then has the opportunity to agree or disagree with all or some of the proposed changes. If the taxpayer agrees with the changes, the additional tax is then assessed.

When the taxpayer disagrees with the proposed changes, that disagreement generally must be accompanied by an explanation and relevant documentation. If the explanation and documentation do not satisfy the IRS regarding the proposed changes, the taxpayer will be advised of her right to appeal the IRS's determination. If the appeal is unsuccessful, the taxpayer will be issued a statutory notice of deficiency—often referred to as a "90-day letter." At this point, there has not yet been an assessment; however, at the end of the 90-day period, the proposed additions will be assessed unless the taxpayer files a petition with the U.S. Tax Court.

Assessment of the Penalty for Failure to Maintain Minimum Coverage

Once the penalty becomes effective, taxpayers who lack adequate health coverage at some time during the tax year should determine whether they are required to pay a penalty and, if so, should include that penalty on their tax return for that year. If they reported the amount, but failed to pay it with their return, the IRS would not need to take any further steps to assess the penalty. The IRS would be able to assess it based on the tax return. Nothing in PPACA limits the IRS's authority or means for assessing the penalty.

Given the reporting requirement PPACA imposes on anyone who "provides minimum essential coverage to an individual during a calendar year,"[16] it seems likely that the IRS will use its matching program to determine which taxpayers should have included the penalty on their returns and then determine whether

[16] P.L. 111-148, § 1502 (adding I.R.C. § 6055).

they did so.[17] Assessing the penalty should proceed as it does for other omissions discovered through the matching program as described above.

Although there is an automated aspect to this assessment process, the process is not an immediate one. Instead, there is a lag of approximately 10 to 18 months between the filing of a return and the IRS's issuing a letter proposing adjustments to the return based on the matching program. Thus, unless there is a change in procedures, it is unlikely that the IRS will assess the penalty on a return before routine processing of the return is completed. Accordingly, the taxpayer may have received in full the refund anticipated and reported on the return for which the penalty should have been calculated but was not.

Collection

General Provisions for Collection

This section describes general provisions regarding tax collection. Information specific to individuals' requirements under PPACA is described in the next section, "Collection of the Penalty for Failure to Maintain Minimum Coverage."

Once the tax is assessed, the taxpayer will receive a *Notice and Demand for Payment*, which will advise the taxpayer of the balance due—the sum of the assessed tax plus interest and applicable penalties—and request payment in full within ten days. If such payment is not made, a federal tax lien will be created under § 6321 of the IRC.[18] This is often referred to as a silent lien because, at this point, there has been no notice of federal tax lien (NFTL). Without notice, the IRS's claim against property still takes priority over most other claims; however, certain claims would be superior to the IRS claim. These include a subsequent purchaser of the property as well as holders of security interests, mechanic's liens, or judgments, even if they arise later in time.[19]

Generally an individual taxpayer may receive up to 3 more notices requesting payment. The last of these notices is sent by certified mail and is a notice of the IRS's intent to levy the taxpayer's assets to satisfy the tax debt. This notice also advises delinquent taxpayers that the IRS may file a NFTL if payment is not made within thirty days. If none of these notices results in payment or a payment arrangement,[20] in most cases the account is then transferred to the IRS's Automated Collection System (ACS).[21]

[17] The information reported by providers of minimum essential coverage should allow the IRS to identify those taxpayers who have coverage and are not subject to the penalty. Then, by a process of elimination, the IRS could determine taxpayers who appear to have been subject to the penalty and then, of those, determine who did not file a tax return showing the penalty.

[18] Section 6321 of the IRC provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

[19] I.R.C. § 6323.

[20] Payment arrangements include installment agreements and offers in compromise. Initial requests for payment will generally include information about entering into an installment agreement; however, such an agreement generally will be a possibility after the account has been transferred to ACS. There is a fee for entering into an installment agreement, and interest will continue to accrue until the entire balance is paid. Penalties on the liability will accrue until either they have reached their statutory cap or the entire balance is paid.

[21] Accounts with very large balances due may be transferred to a Revenue Officer (RO) rather than to ACS.

Once the account is transferred to ACS, there may be additional attempts to contact the taxpayer to arrange payment. ACS employees may call the taxpayer to discuss a payment arrangement. The taxpayer's account may be assigned to a Private Collection Agency.

Levies and Liens

Thirty days after providing a *Final Notice of Intent to Levy and Notice of Your Right to Appeal*, the IRS may levy the taxpayer's property, both real and personal.[22] This means that wages may be garnished until the tax is paid in full. All funds in a bank account that are available for withdrawal on the date the levy is received by the bank may be taken.[23] In some cases, the IRS may sell property belonging to the taxpayer after providing public notice and advising the taxpayer of the minimum bid price.

The IRS may also file a notice of federal tax lien (NFTL). This notice does not create the lien, which was created by statute ten days after a taxpayer has failed to pay the amount assessed and then requested in a *Notice and Demand for Payment*. However, the notice makes the existence of the federal tax lien part of the public record. Although the IRS does not report the lien to credit reporting agencies, the NFTL generally leads to the lien being reported on the taxpayer's credit report. The National Taxpayer Advocate's *2009 Annual Report to Congress* (*2009 Report to Congress*) says that the NFTL "can be an effective tool in tax collection."[24] However, the report also indicated that they "have the potential to cause needless harm to taxpayers and undermine long-term tax collection"[25] if applied improperly. Among the possible harms are the effect on the taxpayer's credit rating, which may affect the taxpayer's ability to pay amounts owed to the IRS. The *2009 Report to Congress* advises that the policy of automatic NTFL filing on accounts that are currently not collectible be abandoned and that managerial approval be required for NTFL filings when the taxpayer has no assets.[26] However, the NFTL establishes the priority of the IRS's claim as superior to that of a purchaser or holders of security interests, mechanic's liens, or judgments if those claims arose after the NFTL. Taxpayers have the right to a collections due process hearing to appeal the lien, but the hearing comes after the lien is filed; whereas for levies, the taxpayer may request a hearing before the levy is imposed.

A lien is the claim against property of the taxpayer, but does not involve the right to seize property. A levy is a seizure of property. A lien does not allow the IRS to sell property; however, when property subject to the lien is sold, the lien establishes the right to receive proceeds from the property before they are distributed to either junior lienholders or the seller. Even without having filed a NFTL, if the IRS were to become aware of a pending sale, it should be able to assert its claim privately and, thereby, collect on its claim prior to distribution of the proceeds to anyone other than those with superior claims.

Refund Offsets

Both levies and liens can result in collection of amounts owed to the IRS, however, according to data provided in the *2009 Report to Congress*, another means of collection provided the highest dollar amount in collections.[27] This method of collection is the "refund offset." Section 6402 of the IRC generally allows the IRS to credit the amount of any overpayment against any existing liability of the person who

[22] I.R.C. §§ 6330-6331.

[23] While a wage levy (garnishment) is a continuous levy, the levy on a bank account is effective only on the date received.

[24] National Taxpayer Advocate, *2009 Report to Congress*, I.R.S. Pub. No. 2104, at 17 (2009).

[25] *Id.*

[26] *Id.* at 30.

[27] *Id.* at 23.

made the overpayment. Any remaining overpayment would then be refunded to that person. The authority to offset refunds is separate from the IRS's authority to levy and is established in a separate chapter of Subtitle F of the IRC.

Collection of the Penalty for Failure to Maintain Minimum Coverage

Section 5000A(g)(2) of the IRC limits the means the IRS may employ to collect the penalty established in the section. First, the taxpayer is protected from either criminal prosecution or penalty for failure to pay the penalty. Second, the IRS is prohibited from either filing a NFTL or levying any property in an effort to collect the penalty. There is no prohibition, however, on establishing a statutory lien against the taxpayer's property under § 6321. No additional limits are placed on the IRS using correspondence or phone calls, either through its own employees or through private collection agencies, in an effort to collect the amount owed. Additionally, no restriction was placed on the IRS's ability to use the refund offset as a means of collecting the amount due.

Those who are required to pay the penalty for failure to maintain minimum coverage but choose not to do so will be subject to increases in the amount owed due to interest and late payment penalties imposed on the penalty after it has been assessed by the IRS. The IRS may impose interest on tax, including penalties, under § 6601(a), (e)(2), and it may impose penalties under § 6651(a)(3).

A taxpayer who chooses not to pay the required penalty may ultimately forfeit more than the amount of the penalty if that taxpayer is ever in the position of having an overpayment to the IRS for any reason, since the refund offset applies not only to overpayments shown on original tax returns, but also to any subsequent adjustments, for example an audit by the IRS that results in an overpayment. Further, as explained above, it is possible that the IRS could present its claim when property is being sold and collect both the original penalty amount along with accrued interest and applicable penalties.

Role of the Secretary of HHS

The Secretary of HHS, in coordination with the Secretary of the Treasury, is authorized to recognize other health benefits coverage as minimum essential coverage.[28] Additionally, the Secretary of HHS is to provide certifications to exempt individuals, based on information provided to the applicable Exchanges.[29] Among the information that is to be provided is information regarding income and family size; the name, address, and employer identification number of the individual's employer, if any; whether the individual is employed full time; whether the employer offers minimum essential coverage; and the cost of the cheapest health coverage options available from the employer and the employee's required contribution.[30]

Other Potential Effects of Non-compliance

Although federal tax debts may be used to offset other types of federal payments (such as Social Security retirement payments, federal salaries, or Medicare payments), the mechanism for collection of these tax

[28] I.R.C. § 5000A(f)(1)(E).

[29] P.L. 111-148, § 1411(e)(2)(B).

[30] *Id.*

debts is through the levy process.[31] Because the levy process is not authorized for the enforcement of tax debts attributable to the individual responsibility requirement, federal payments do not appear to be subject to levy for tax debts in this context.

Delinquency in federal taxes is a ground for debarment of a federal contractor. However, debarment is not an automatic process and requires that the contracting agency initiate debarment proceedings against a government contractor.[32]

Administration of Premium Tax Credits and Cost-Sharing Subsidies

You have also asked whether it is correct that the IRS will control the payment of tax credits, which will be paid "to insurance companies as the 'the issuer of a qualified health plan.'"[33] We understand this question to be asking whether the IRS will be the sole entity with the authority to determine eligibility for federal health insurance subsidies under PPACA. PPACA establishes a system of federal subsidies for low income persons who seek coverage in the Exchanges created under the Act. These subsidies take the form of tax credits and may be paid, in advance, directly to issuers of qualified health plans in some cases.[34] However, determinations of eligibility for these subsidies are not wholly within the purview of the IRS. For example, the validity of individuals' submitted Social Security Numbers and immigration status are to be determined by the Commissioner of Social Security or the Secretary of Homeland Security, respectively.[35]

[31] A separate provision, known as administrative offset, is used for the collection, via offsets, of nontax debt owed to the federal government. 31 U.S.C. § 3716.

[32] *See* CRS Report RL34753, *Debarment and Suspension of Government Contractors: An Overview of the Law Including Recently Enacted and Proposed Amendments*, by Kate M. Manuel, at "Agency Discretion, Administrative Agreements, Continuation of Current Contracts, and Waivers."

[33] In your request, you referenced an estimate of the deficit impact of "exchange subsidies and related spending" as provided by the Congressional Budget Office and the Joint Committee on Taxation over fiscal years 2010 to 2019. *See* CONGRESSIONAL BUDGET OFFICE, Letter to Speaker Pelosi, March 20, 2010. We have not independently assessed the accuracy of these estimates, but note that they would appear to include amounts in addition to the federal subsidies to be paid on behalf of qualifying individuals.

[34] P.L. 111-148, § 1412.

[35] P.L. 111-148, § 1411(c)(2).