Testimony

Subsidy Verification in the ACA: Complexity Creating Taxpayer Risk

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Chairman Boustany, Chairman Brady, Ranking Member Lewis, Ranking member McDermott and members of the committee, thank you for the opportunity to testify today regarding the budget vulnerabilities created by the Affordable Care Act's (ACA) income verification system. The American Action Forum has closely followed the implementation of the ACA, and I am pleased to discuss the potential impacts of determination of subsidy eligibility and the implications of delays in employer reporting requirements issued earlier this year by the Department of Health and Human Services (HHS). I will also address some of the burdens imposed on the tax system, the taxpayers and the federal budget through the ACA.

I hope to convey three main points:

- The subsidy eligibility system is too difficult for consumers to navigate. The complexity of the subsidy eligibility system, and the information required of the consumers and employers will result in erroneous subsidy allotments.
- The tax system is already too complicated and in need of reform. The additions to the tax code stemming from the ACA will continue to worsen this problem, placing taxpayers at risk when requesting ACA benefits.
- The complexities and burdens created by the subsidy eligibility system and income verification flaws in the ACA are generating serious vulnerabilities in the federal budget. These vulnerabilities will come in the form of fraudulent spending, increased program costs, and a heavier taxpayer burden.

I will discuss each of these issues in turn.

INTRODUCTION

The Affordable Care Act (ACA) was signed into law in 2010 with the goal of providing accessible, affordable health insurance coverage. In the fourth year of implementation, the administration has issued thousands of pages of regulations detailing the guidelines for the programs contained within the law, as well as requirements for stakeholders participating in these programs. The insurance subsidies and the guidance surrounding eligibility and employer involvement in this portion of the law were designed to provide insurance coverage deemed affordable. The provisions regarding subsidy eligibility and employer reporting requirements work together forming massive vulnerabilities for the federal budget and therefore the taxpayer.

COMPLICATIONS OF THE SUBSIDY ELIGIBILITY PROVISIONS IN THE AFFORDABLE CARE ACT

From a 30,000 foot view, subsidy eligibility requirements in the ACA seem straight forward. An individual applies for coverage through the newly created insurance exchange and requests assistance with their monthly premium payment. If an individual is between 100 percent and 400 percent of the federal poverty level (FPL) they are eligible for a credit, which the federal government pays directly to the insurance company of the individual's choice, thereby decreasing their share of the plan's premiums for the year. However, the closer to practical application you get, the more complicated the subsidy eligibility process becomes.

Consumers requesting an insurance subsidy must be within the income bracket described above, and the subsidy received for the year is based on the consumer's self-estimated income for that plan year. Though some people may experience a steady income throughout the year, many Americans change jobs, have children, receive unexpected bonuses or experience other life events that could greatly alter their originally predicted income. If these changes occur and consumers do not update their status through the exchange, then the amount of the premium received will have to be reconciled in their next tax return.

Figure 1walks through the potential steps faced by a consumer working to gain subsidy eligibility for 2014.

An individual (or family) applies for coverage through the online exchange portal, where they are then assessed for premium assistance eligibility. The eligibility process could turn out in a variety of ways. In order to be determined eligible for a subsidy, individuals must provide both income information and family size data. When the exchange sends consumer information to the federal data hub for verification, the IRS data available is from two years ago – so it may not be accurate, depending on the applicant's financial situation. Further, the exchanges currently do not have access to information that can verify family size and self-attestation is the only form of data at this time. If data is not available, the applicant must attest to their projected income for the plan year. Therefore, two pieces of information required to receive premium assistance need only to be attested by the applicant.

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This process is different for individuals in states that implemented a state based exchange, and documentation of income may not be needed at all. Instead, in 2014 state-run exchanges just have to verify income for a "statistically significant" sample of people who say their earnings will drop by at least 10 percent, under rules issued by the administration.[ii]

This process is further complicated by the delay in employer reporting requirements. According to the White House,[iii] the regulations imposed on employers were too complicated to implement for the 2014 plan year and the requirement for employers to provide affordable coverage to their employees was delayed one to two years, based on the size on the employer. For employees that are not offered coverage, they can receive coverage in the meantime through the insurance exchange. According to the final rule issued in March of 2010, employers do not have to begin reporting on the insurance offered to their employees until the 2015 plan year.[iv] However, this makes subsidy eligibility more complicated.

If an individual is offered employer sponsored coverage that is deemed affordable through the ACA's requirements, then the individual and their family are not eligible for subsidies through the exchange. This barrier prohibits those offered affordable employer sponsored insurance from signing up for exchange coverage. Though some employers only offer individual coverage, the barrier applies to the entire family, making those without coverage ineligible for a subsidy. However, the delay in reporting requirements makes it impossible to determine which employers are offering affordable coverage and which ones are not for 2014. For example, an employee could be offered affordable coverage through their employer, but choose to gain coverage through the exchange in order to receive a subsidy. Since an employer is not required to provide affordable coverage this year (it is optional for 2014), or report on the coverage offered, the federal government cannot determine who is offered ESI and whether or not it is an affordable option.

Once an applicant sifts through the subsidy process and is determined eligible for assistance, the applicant may choose to use the subsidy as an advanced premium tax credit (APTC) where the subsidy is sent directly to the insurer OR the individual can choose to wait until filing their taxes to claim their subsidy dollars.[v] The amount of money received in each subsidy is based on a sliding scale of income levels within the bracketed FPL range. A family of four could make up to $95,400 a year and receive a subsidy and a single, childless adult making $11,670 could receive a subsidy as well.[vi]

It is important to note that all individuals receiving a subsidy will have to reconcile the funds received on the next year's tax returns. Consumers could be held accountable for over payment of subsidies and inaccurate reporting. As is apparent above, this is a complicated system where consumers are asked to estimate their income a year in advance, and are then held accountable for a system that is difficult to navigate and understand. There are bound to be errors in consumer reporting. Even discounting those out to defraud the federal government by intentionally reporting lower incomes, consumers cannot always prevent major fluctuations in income, creating room for error in reporting. These errors will reflect on the federal budget and the country's taxpayers.

THE AFFORDABLE CARE ACT INCREASES BURDENS ON THE TAX CODE AND ON TAXPAYERS

As I have mentioned in previous testimony,[vii] the ACA creates an additional $30 billion in regulatory compliance costs. Some of these costs are generated by the increased burden on compliance with new tax requirements resulting from the subsidy eligibility process. Though HHS is responsible for determining subsidy eligibility and overseeing the insurance exchanges, the IRS is responsible for ensuring the repayment of subsidies that were inaccurately issued.[viii] Taxpayers will be required to present proof of health insurance to avoid the individual mandate penalty.[ix] Further, those qualifying for subsidies will have to maintain records in order to reconcile the credit and/or any discrepancies in the level of premium eligibility.[x] Needless to say, the subsidy provisions in the ACA generate more hours of regulatory burden and complicate tax filings for consumers.

For those consumers receiving exchange coverage and premium assistance, there is an increased risk. The reconciliation process for exchange subsidy discrepancies could become complicated if the consumer fails to report major life events that may impact the amount of subsidy received. If the subsidy received is too high, there are some “claw back” provisions in place where consumers must return part of the subsidy with their 2014 tax return. For example, if a consumer applies for a subsidy and subsequently receives an unexpected raise, their income is higher than originally estimated during the 2014 application process. When filing their 2014 taxes, the consumer may have to repay a portion of the subsidy, but it’s complicated. The amount you have to repay varies according to the following rules:[xi]

Below 200 percent FPL, an individual cannot be required to pay back more than $300. If the consumer’s income is between 200 and 300 percent FPL, individuals only have to pay up to $700. This limit is increased for those making between 300 and 400 percent FPL, with a $1,250 limit.[xii] Those making more than four times the poverty level[xiii] or that were inaccurately determined eligible have to repay the entire subsidy.[xiv]

These adjustments are in place for those that underestimate their income within reasonable levels. More serious consequences exist for income claims that are believed to be fraudulent. If the estimate is excessively low, the penalty for unintentional negligence could be as much as $25,000, and intentional misrepresentation could result in a fine of $250,000 or incarceration.[xv]

Risks also exist for the federal budget in the inaccurate estimation of income for insurance exchanges. If an individual underestimates their income, but does not pay taxes or are not eligible for a tax refund, no criminal penalties can be brought against the individual and no liens or levies may be imposed, therefore, actions do not exist for the federal government to recoup those funds.[xvi]

INCOME VERIFICATION AND RISKS TO THE FEDERAL BUDGET

With so much at stake, it is to be expected that the income verification process should be one that places extreme emphasis on program integrity. However, the administration has failed to build a system that allows for the protection of subsidy beneficiaries or for the taxpayers funding those subsidies.

The Earned Income Tax Credit (EITC) is a reasonable proxy for considering the potential for payment errors with respect to ACA subsidies. Like the ACA premium credits, the EITC is a means-tested, refundable tax credit, and is the largest refundable tax credit in the tax code at the moment. Eligibility for the credit is based on income and family size. However, the eligibility rules are complex – warranting a 60 page instruction booklet – and give rise to payment errors.[xvii] Owing to the size of the program, these payment errors present significant budgetary effects. According to the Treasury Inspector General for Tax Administration, 21 percent to 25 percent of EITC payments made in 2012 were in error – costing $11.6 to $13.6 billion.[xviii] Since 2003, even under the minimum estimated payment error rate, erroneous payments have exceeded $110 billion. The Treasury department attributed these errors to a host of factors that include general and specific areas of complexity that introduce confusion in eligibility determination, high turnover of claimants, as well as unscrupulous practices by tax-preparers and outright fraud.

There is every reason to suspect that ACA premium credit payments will be subject to similar if not greater challenges. ACA premium credits are novel, which when paired with a complex design will likely precipitate erroneous payments. The combination of these elements and lax enforcement standards risks error rates on the order of those observed in the EITC program. These erroneous payments will result in enormous budgetary costs. While the EITC is at present the largest refundable tax credit, it will soon be eclipsed in budgetary terms by ACA premium credits. By 2021, the cost of ACA premium credits will exceed the cost of the EITC by 80 percent. Accordingly, a payment error rate similar to that of the EITC program will be that much costlier. Outlays for premium credits are estimated to total $726 billion over 2015-2024.[xix] An error rate of 21 percent, the minimum rate estimated by Treasury over 10 years of EITC payments, would result in $152 billion in erroneous ACA premium credit payments.

The risk of erroneous payment as seen in EITC is especially important for 2014. This year the exchange subsidies are based on an honor system, creating an even greater vulnerability than exists within the EITC program and at a greater magnitude due to the size of the program. The administration announced in a July 2013 final rule that income verification will rely more heavily on self-attestation until 2015, when a reliable verification system will be up and running.[xx] This contradicts a letter Secretary Sebelius wrote to Vice President Biden at the beginning of the year, stating that HHS has put in place “numerous systems and processes” to ensure that incomes are verified.[xxi] Further, the so-called “back-end” of the healthcare.gov website that tracks payments to insurers is not yet functional, and the federal government is using a spreadsheet system to account for payments to insurers.[xxii] For a program that comprises $36 billion dollars of federal spending, there are many holes in the process that can and will compromise the integrity of the federal budget. [xxiii]

The inability of the administration to provide security for the federal tax dollars used in the dissemination of federal subsidies in an appropriate way creates large vulnerabilities in the budget. As reported last month by the *Washington Post*, up to 1.5 million individuals may be receiving inaccurate subsidy amounts.[xxiv] Some of these individuals could be receiving too low of a subsidy, harming tight family budgets. Others will be responsible for re-paying all or part of the subsidy granted to them through the exchange. Meanwhile, insurers are receiving payments based on a fragile system with high potential for human error.

The federal budget is further exposed to inaccuracies by the exceptions provided to states not implementing the ACA expansion of Medicaid. If a consumer resides in a state that has not expanded Medicaid, and the individual would be Medicaid eligible if the state expanded (i.e. the coverage gap), then the individual may not be held liable for intentionally inaccurately reporting income. If their income is overestimated so as to be exchange eligible, such as stating your income is 105 percent FPL instead of 90 percent FPL, there is no penalty for the overpayment.[xxv] This is just one quirk in a sweeping law that allows for holes in the budget.

Finally, the loose requirements for income verification will decrease the dollars gained through the individual mandate penalty. If an individual does not have to truly verify their income, and the consequences are minimal, revenue from those not gaining coverage will be diminished.[xxvi]

CONCLUSION

The process for verifying eligibility and receiving subsidies is far too complex to rely on such tenuous information. The enrollment period is over, and those that applied to receive subsides are currently receiving them in some form, and these individuals will be asked to provide an answer for inaccuracies in a system bound for error and fraudulent payments. Not only does this impact the taxpayer, but it could unnecessarily increase federal spending through inaccurate subsidy payments – both unintentional and fraudulent.

The additional burden of reporting health insurance status and payments through the tax filing process could create large liabilities for taxpayers, and increases the complexity of the federal tax system. The Treasury Inspector General even testified that the IRS will have difficulty implementing fraud prevention measures imposed on the agency until the system is more robust.[xxvii]

With the 2015 open enrollment season just around the corner, the administration should be ensuring that proper verification systems are in place and do away with the self-attestation honor system that leaves taxpayers liable and the encourages additional spending at the federal level. The current subsidy eligibility system places too heavy of a responsibility on the individual, the employer and the federal budget.

http://www.cms.gov/CCIIO/Resources/Letters/Downloads/verifications-report-12-31-2013.pdf