JOINT HEARING BEFORE THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM, SUBCOMMITTEE ON ENERGY POLICY, HEALTH CARE AND ENTITLEMENTS AND THE COMMITTEE ON HOMELAND SECURITY, SUBCOMMITTEE ON CYBERSECURITY, INFRASTRUCTURE PROTECTION, AND SECURITY TECHNOLOGIES
U.S. HOUSE OF REPRESENTATIVES

"ACA – INFORMATION TECHNOLOGY READINESS AND DATA SECURITY"

Testimony of
Alan R. Duncan, Assistant Inspector General for Audit
Treasury Inspector General for Tax Administration

July 17, 2013

Washington, D.C.

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TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
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"ACA – Information Technology Readiness and Data Security"

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Chairman Lankford, Chairman Meehan, Ranking Member Speier, Ranking Member Clarke, and Members of the Subcommittees, thank you for the opportunity to testify on the Internal Revenue Service's (IRS) Information Technology systems for the Affordable Care Act, how information will be sent and exchanged, and the safeguards to protect taxpayer data.

The Patient Protection and Affordable Care Act[1] and the Health Care and Education Reconciliation Act of 2010 that made amendments to it (collectively referred to as the "ACA") contain an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The ACA provisions provide incentives and tax breaks to individuals and small businesses to offset health care expenses. They also impose penalties, administered through the tax code, for individuals and businesses that do not obtain health care coverage for themselves or their employees. The ACA represents the largest set of tax law changes in more than 20 years and represents a significant challenge to the IRS.

The ACA will require collaboration and coordination among many players including the IRS; the Departments of Health & Human Services (HHS), Treasury, Labor, Veterans Affairs, and Homeland Security; the Social Security Administration; State governments; and the private sector including insurers, employers, individuals, hospitals, practitioners, etc.

[1] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

The IRS's role with respect to the ACA is to implement and administer its various provisions that have an impact on tax administration. This requires numerous actions, activities, and programs, such as revising or developing new forms, publications, and instructions; creating new computer programs; training IRS employees; revising Internal Revenue Manuals; issuing revenue procedures and regulations; and providing outreach to taxpayers and tax professionals. The effective dates of the ACA provisions range from Tax Year 2009 (retroactively) to 2018.

While the Department of Health & Human Services will take the lead in developing the policy provisions of the Act, the IRS will be required to build new computer applications and business processes that do not exist within the current tax administration system and to modify existing systems and processes. The IRS's Fiscal Year 2014 budget request includes additional funding needs of $440 million for continued efforts related to the implementation of the ACA. The largest component of this increase is $306 million for the implementation of the information technology changes needed to deliver income information, tax credits, and other ACA requirements.

One major provision of the ACA is the requirement for individuals to maintain minimum essential health care coverage or face a continuous tax penalty. The penalty will be imposed on any taxpayer who, for any month after Calendar Year 2013, fails to maintain minimum essential health care coverage. Individuals can obtain health care coverage from their employers, purchase individual coverage, or obtain coverage through one of the State Exchanges or the Federal Exchange (collectively referred to as the Exchanges).[2]

The open enrollment period for the Exchanges starts in October 2013 and the first health insurance coverage year is 2014.[3] With the ACA, the IRS will be receiving returns and health insurance-related information from many sources to support the 2015 Filing Season. The Non-Exchange portion of the ACA includes additional taxes and fees as well as new tax filing requirements. The Non-Exchange provisions will require the IRS to develop systems to implement various ACA funding provisions, including computer applications to collect and process industry fees and taxes; ensure

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[2] Exchanges are intended to allow eligible individuals to obtain health insurance, and all Exchanges, whether State-based or established and operated by the Federal government, will be required to perform certain functions.

[3] Open enrollment is the period of time that individuals who are eligible to enroll in a Qualified Health Plan can enroll in a plan at an Exchange. The open enrollment period is October 1, 2013 to March 31, 2014.

compliance with ACA provisions; and manage the collection and processing of ACA information returns.

The information technology and security challenges for the ACA are considerable and include implementation of interdependent projects in a short span of time, evolving requirements, coordination with internal and external stakeholders, cross-agency system integration, and testing. ACA implementation will have a significant impact on existing systems, so there must be bandwidth to support all provisions. Finally, projects must be staffed with personnel who have the required knowledge and skills to efficiently deploy new technologies. To manage these challenges, the IRS created a Project Management Office for the ACA within the Information Technology Services program area.

Role of the IRS in Information Technology Support for the ACA

The IRS's implementation plan for ACA Exchange provisions includes providing information on eligibility and enrollment, developing calculations for the Advanced Premium Tax Credit,[4] reconciling Premium Tax Credits[5] with reported taxable income, and developing new ACA information collection and processing systems. These provisions require development of new computer systems, modification of existing systems, revision and/or creation of new fraud detection systems, and deployment and testing of new interagency communication portals to support ACA operations.

The ACA health coverage enrollment process starts when an applicant applies at the Federal or State Exchanges. The Social Security Administration will verify the applicant's Social Security Number, lawful presence, and prisoner status. The Department of Homeland Security will provide the legal immigration status of the applicant and dependents.

The enrollment process carried out by the HHS and the Exchanges is illustrated in Appendix 1.

The Exchanges will request income and family size information for each applicant and family members who are qualified to apply for health insurance and will forward the request to the IRS. The HHS Data Services Hub provides the connections

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[4] An Advanced Premium Tax Credit is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.
[5] A refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Affordable Insurance Exchange.

for the Exchanges and all other Federal agencies, including the IRS. The HHS Data Services Hub is connected to the IRS through the IRS Transactional Portal Environment.

The IRS, using Federal tax data, will determine the applicant's historical household income, family size, filing status, adjusted gross income, taxable Social Security benefits, and other requested information. The IRS will then transmit the Federal tax data to the HHS Data Services Hub for delivery to the appropriate Exchange. The Exchanges will compare the IRS information with the information provided by the applicant and other available data.

The Treasury Inspector General for Tax Administration (TIGTA) has issued a report on the IRS Income and Family Size Verification Project and found that the project was on schedule and the IRS was managing known information technology risks at the time the audit was conducted.[6] TIGTA made recommendations to improve the management of ACA changes to requirements and to use an integrated suite of automated tools to manage ACA requirements and application test cases. TIGTA remains concerned about the protection of confidential taxpayer data that will be provided to the State and Federal Exchanges. For this reason, we will include a review of the protection of taxpayer data by organizations outside of the IRS in our planned audit of ACA data security.

The Exchanges will use the income and family size information received from the IRS as well as information provided by the applicant and other data sources in finalizing the income amounts and family size. The Exchanges will provide these final amounts to the IRS to calculate the Maximum Advanced Premium Tax Credit. The Exchanges will prepare an Advanced Premium Tax Credit request and forward it to the IRS for processing. TIGTA will be initiating an audit to review the accuracy of the data that the IRS provides to the HHS for use in enrolling individuals and calculating the Advanced Premium Tax Credit, and plans to issue a report in Fiscal Year 2014.

The IRS developed the Advanced Premium Tax Credit application and calculator to determine each applicant's eligibility for the Maximum Advanced Premium Tax Credit. The applicant chooses the amount of Advanced Premium Tax Credit desired up to the maximum amount provided by the IRS and selects and purchases a health insurance plan.

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[6] TIGTA, Ref. No. 2013-23-034, *Affordable Care Act: The Income and Family Size Verification Project: Improvements Could Strengthen the Internal Revenue Service's New Systems Development Process* (Mar. 2013).

The flow of data for the Income and Family Size Verification Project and the calculation of the Advanced Premium Tax Credit are summarized in Appendix 2.

The Department of the Treasury is notified by the Exchanges of the Advanced Premium Tax Credit amount selected and will forward a check in the approved amount directly to the insurer. During each filing season, the IRS will reconcile the Advanced Premium Tax Credit originally claimed against the actual income and family size reported on individuals' tax returns. If the Credit amount is too low, the IRS will refund the remaining Credit to the taxpayer when the taxpayer files his or her tax return. If it is too high, the IRS will assess the additional Credit on the taxpayer's account and attempt to collect it.

There could be many reasons why the Credit is different when the tax return is filed. For example, the taxpayer's income could have changed from the prior year when the taxpayer applied for health coverage, or the taxpayer's family size may have increased or decreased from the prior year. TIGTA is concerned that the potential for refund fraud and related schemes could increase as a result of processing ACA Premium Tax Credits unless the IRS builds, implements, updates, and embeds ACA predictive analytical fraud models into the tax filing process.

Health insurance premium data and other ACA information will flow to the IRS directly from individuals, employers, and insurance providers before each tax filing season and will contain the critical data needed for processing tax returns and determining the actual Premium Tax Credit for applicable individuals and businesses. Beginning in Calendar Year 2014, State Exchanges and the Federal Exchange will transmit data to the IRS on a monthly basis. The data will identify all taxpayers and dependents covered by qualified health plans and will contain details on the Advanced Premium Tax Credit paid to insurers on behalf of the taxpayer for each month, as well as additional health insurance information. These data will be retained by the IRS for use during the tax filing season.

TIGTA is currently conducting an audit of the IRS's application development and testing for the Advanced Premium Tax Credit application and calculator and will finalize the report before the beginning of the October 2013 open enrollment period.[7]

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[7] TIGTA, Audit No. 201320312, *Review of Systems Development Activities for the Premium Tax Credit Project Under the Affordable Care Act Program*, report planned for September 2013.

TIGTA's understanding of the flow of ACA tax information is summarized in Appendix 3.

Security and Protection of Taxpayer Data

The Federal tax data provided to the HHS and the Exchanges will be protected through the IRS's Safeguard Review Program. The Internal Revenue Code authorizes the IRS to disclose Federal tax information to various Federal, State, and local entities. However, before agencies receive Federal tax information, they must submit a formal report called the *Safeguard Procedures Report* that describes how the agency will protect and safeguard the data. In addition, agencies are required to annually submit a *Safeguards Activity Report* to describe any changes to the Safeguard Program, advise on future actions, and certify that they are protecting the data. The Safeguard office also conducts on-site reviews of each agency that receives Federal tax Information.

TIGTA is currently conducting an audit of the IRS's Safeguard Program and will issue a report on its operations in Fiscal Year 2014.[8] TIGTA has concerns that the Safeguard Program may lack sufficient staffing or funding to adequately expand its operations to include the addition of the Federal and State Exchanges. We plan to assess the protection of Federal tax data provided by the Program in the future.

Protection Against Fraudulent ACA Tax Return Processing

The IRS has also developed a plan for the prevention, detection, and resolution of fraud and abuse during ACA tax return processing. The plan, when fully developed and implemented, is designed to leverage third-party reporting from the Exchanges and new computer analytical capability built into the Return Review Program.[9] The plan calls for the development of the ACA Validation Service which will be used to identify improper ACA-related refunds. The ACA Validation Service will be designed to perform screening for improper refunds and will also identify fraudulent schemes that include multiple returns. The IRS plans to rely on the Electronic Fraud Detection System and/or the new Return Review Program to provide the systems to identify and prevent ACA-related refund fraud.

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[8] TIGTA, Audit No. 201320029, *Review of the Internal Revenue Service's Office of Safeguards*, report planned for February 2014.

[9] The Return Review Program is the key automated component of the IRS's pre-refund initiative and will implement the IRS's new business model for a coordinated criminal and civil tax noncompliance approach to prevent, detect, and resolve tax refund fraud.

The applications for processing electronic and paper tax returns will need to be modified before January 2015 to be able to use the new ACA Validation Service to determine if a taxpayer claiming the Premium Tax Credit also purchased insurance through the Exchanges or received an Advanced Premium Tax Credit in 2014, and if any math errors exist.

TIGTA is currently performing a system development audit of the Return Review Program that will include the development and design of ACA fraud and abuse provisions.[10] We have concerns that the Return Review Program may not be operational in sufficient time to identify ACA-related refund fraud and that the IRS's existing fraud detection systems may not be capable of identifying ACA refund fraud or schemes prior to the issuance of tax return refunds.

In addition, TIGTA plans to conduct several audits of ACA processing and operations for the 2014 and 2015 filing seasons. These will address the IRS's processing of various tax returns and evaluate whether taxpayers are eligible for the ACA tax provisions claimed on tax returns. The need for the IRS's systems to be fully operational before the next filing season begins is critical to Federal tax administration. The IRS will need to ensure that tax returns accurately claim the various applicable ACA provisions, and, above all, that taxpayers are treated fairly.

Interagency Testing of ACA Systems

The HHS and the IRS have jointly developed an Interagency Test Plan for the 2013 open enrollment period that documents the test design and management activities they have agreed upon. The Interagency Test Plan establishes how the systems supporting the open enrollment will be tested to ensure operational communication, functionality, and interoperability.[11] The HHS systems involved in this testing include the Federal Exchange, which provides interface capability for citizens to apply for health care coverage. In addition, the HHS Data Services Hub will provide telecommunications support to enable the various Federal agency systems to share data for ACA purposes.

From the IRS perspective, the Plan includes the capabilities of the Income and Family Size Verification Project and the Advanced Premium Tax Credit application. The

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[10] TIGTA, Audit No. 201220011, *Return Review Program Transition State 1 Systems Development Activities*, report planned for September 2013.
[11] The ability of two or more systems or components to exchange information and to use the information that has been exchanged.

HHS Data Services Hub is connected to the IRS through the Transactional Portal Environment. The IRS and the HHS plan to jointly capture and manage test results, including tracking and monitoring any reported issues until they are resolved. However, TIGTA is concerned that final integration testing for all of the various agency systems, communications, and the Federal and State Exchanges will be difficult to complete before the start of the enrollment process in October 2013. The lack of adequate testing could result in significant delays and errors in accepting and processing ACA applications for health insurance coverage.

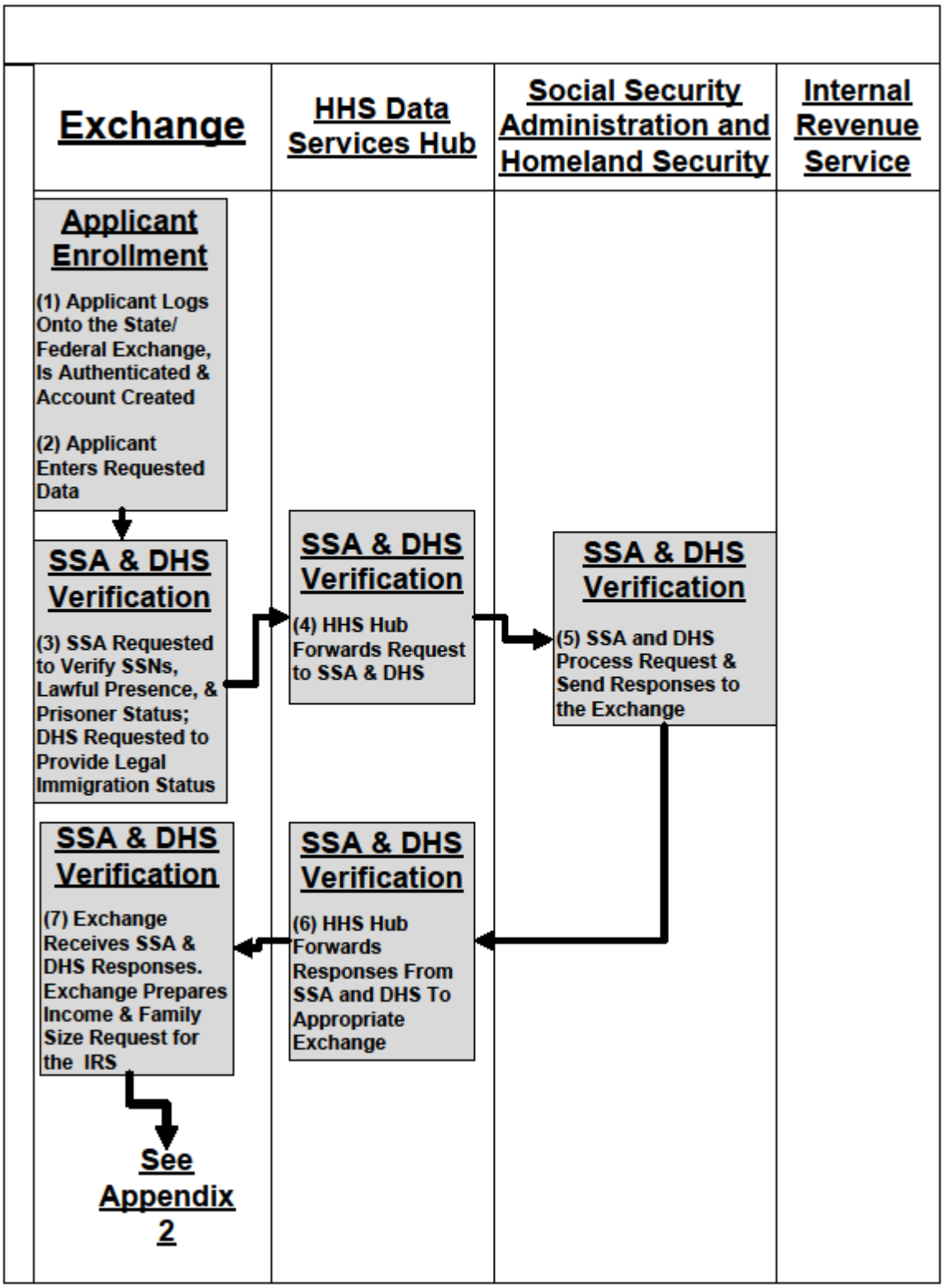
TIGTA plans to review the testing results and where possible will observe the testing and include our assessment in upcoming reports. We will also closely coordinate with the HHS' Office of Inspector General to ensure that all aspects of the systems are reviewed. TIGTA plans to conduct a comprehensive audit of the security over Health Insurance Exchange information maintained both by the IRS and the Exchanges where Federal tax data has been provided. TIGTA also plans to review the implementation of statutorily-mandated data protection of Federal tax data and will evaluate the adequacy of data security, disaster recovery, availability, reliability, operational readiness, and testing of new systems.

TIGTA's ACA Oversight Strategy

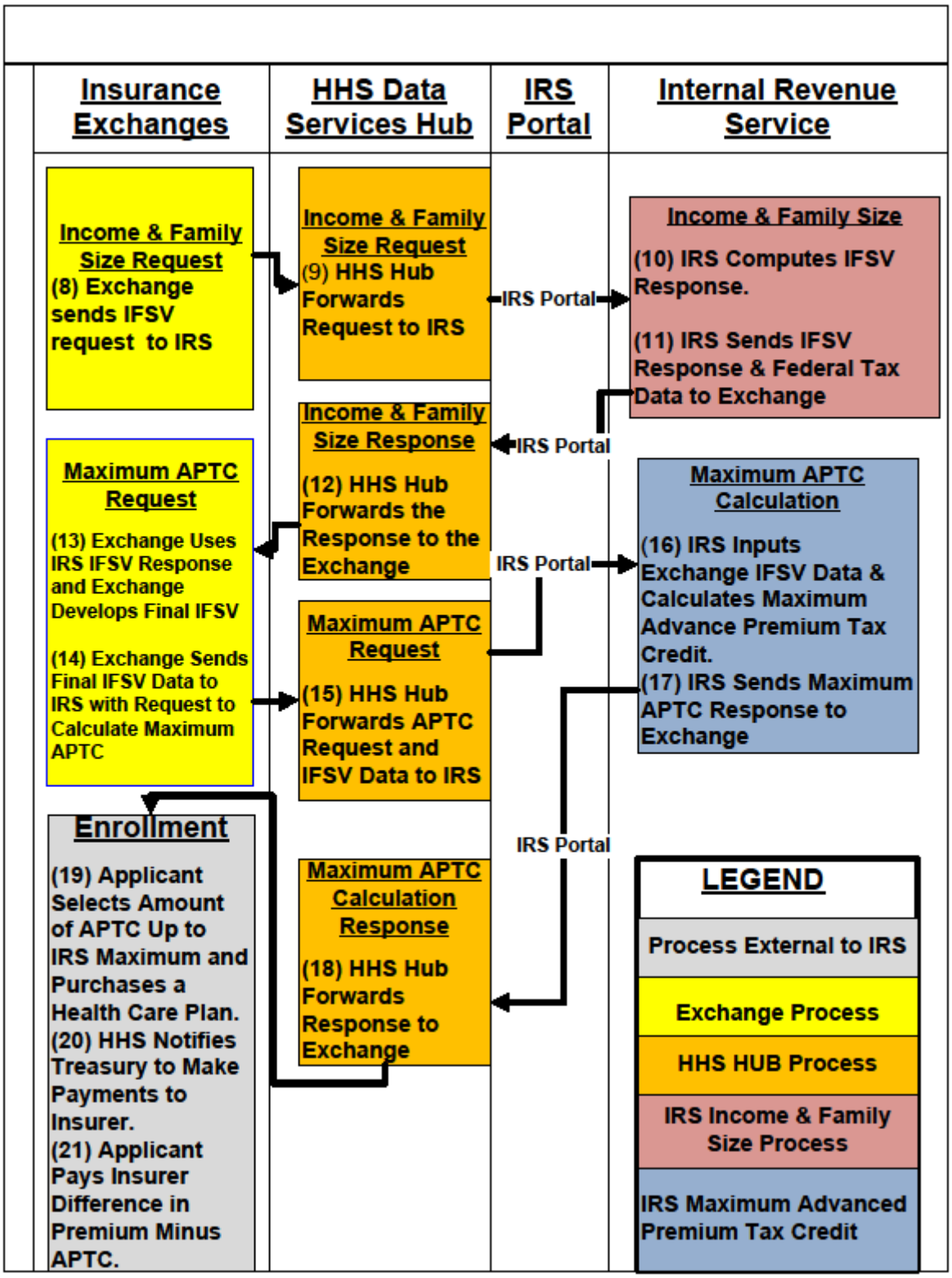
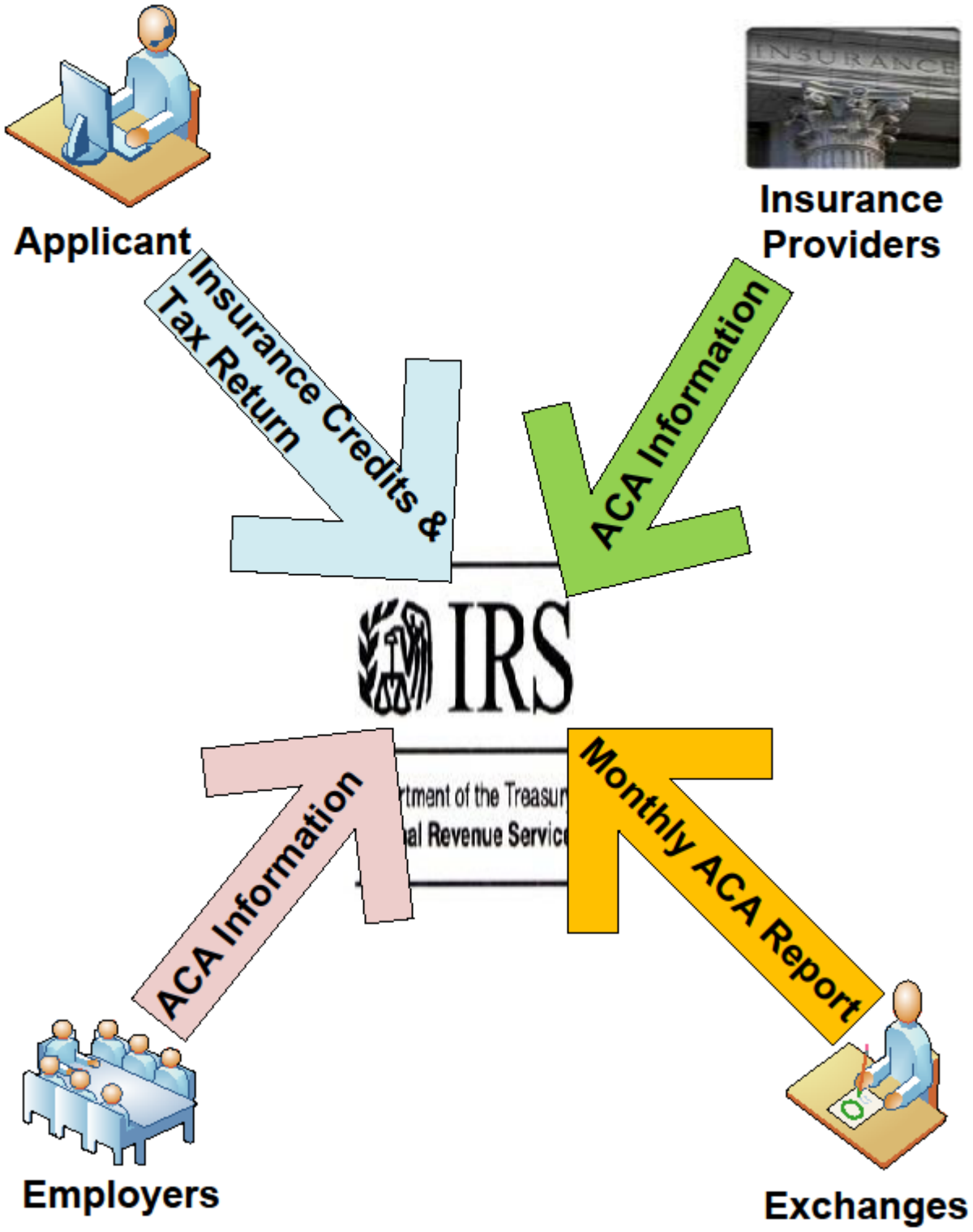
Several key ACA provisions will become effective in Fiscal Year 2014, making Fiscal Year 2014 and Calendar Year 2015 a significant period for ACA oversight. In addition, many provisions that previously became effective will require continued oversight to ensure that appropriate corrective actions are taken by the IRS. Because of the extensive changes to numerous tax code provisions, our concerns related to the development and implementation of new ACA systems, and the extensive coordination required between all of the stakeholders to effectively administer the ACA, TIGTA has implemented a multi-year oversight strategy that includes audits, evaluations, and investigative resources to assess the IRS's implementation of the ACA. This strategy includes coordination with other agencies, including the HHS Office of Inspector General.

Chairman Lankford, Chairman Meehan, Ranking Member Speier, Ranking Member Clarke, and Members of the Subcommittees, thank you for the opportunity to share my views and observations.

Appendix 1 – Applicant Enrollment Process



Appendix 2 - Affordable Care Act Exchange Data Flows



Appendix 3 – Flow of ACA Tax Information