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TAX REFUNDS AND AFFORDABLE CARE ACT RECONCILIATION

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March 31, 2015

ABSTRACT

People may purchase subsidized health insurance through the ACA exchanges with premiums based on projected future income. However, if actual income is higher than estimated, they may be required to repay part or all of the subsidy when they file tax returns. This “reconciliation” process could raise taxes substantially for many ACA participants. However, analysis of income tax return data suggests that for most lower-income filers, the reconciliation will reduce the refund they receive rather than require them to remit additional tax because their refunds exceed the reconciliation amount. We conclude by making suggestions to improve the reconciliation process.

We thank Stan Dorn, Elaine Maag, Tara Straw, and Eric Toder for helpful comments and advice.

The findings and conclusions contained within are those of the author and do not necessarily reflect positions or policies of the Tax Policy Center or its funders.

The Patient Protection and Affordable Care Act (ACA) subsidizes health insurance purchased through the newly created health insurance exchanges, or health insurance marketplaces, for low- and middle-income households who aren't offered qualifying health insurance plans through an employer. The subsidies, which are delivered in the form of tax credits, are based on income in the tax year in which the premiums are paid and calculated when the taxpayer files her income tax return. However, most participating households receive their tax credits in advance in the form of a reduction in the insurance premium they would otherwise pay. Calculation of this reduced premium is based on an estimate of income in the year of coverage. This estimated income is typically based on income reported on the last tax return filed prior to enrolling for the insurance.

Because annual income is highly variable, many families will either qualify for larger credits or be required to repay part or all of the advance credit when they file their tax return, based on whether actual income is higher or lower than projected. Some tax filers could owe a substantial amount of additional tax as part of this reconciliation process.

Health insurance purchased through the exchanges is subsidized for taxpayers with incomes up to 400 percent of the federal poverty level (FPL), which was \$46,680 for singles and \$95,400 for a family of four in 2014. (See Table 1.) The subsidies make coverage more affordable by capping spending on health insurance premiums as a share of income for consumers who buy a "benchmark" plan. Net premium contributions range from a low of 2 percent of income for families at the poverty threshold to 9.5 percent of income for families with incomes between 300 and 400 percent of poverty.¹ Families with incomes below the poverty threshold are not generally eligible for the premium tax credit (PTC)² although many are covered by Medicaid. In states that opted to expand Medicaid coverage in response to the ACA incentives, most individuals with incomes up to 138 percent of FPL are covered by Medicaid and thus ineligible for tax credits.³

The maximum premium contribution assumes that households purchase the second least expensive Silver plan among the menu of Bronze, Silver, Gold, and Platinum health insurance plans offered through the exchanges. People who buy less expensive plans generally have to contribute even less to premiums (although they may face substantially higher out-of-pocket

¹ Those percentages increase slightly after 2014 based on changes to premiums and income nationally. For 2015, for example, households with incomes below 133 percent of FPL pay 2.01 percent of income, rather than 2.0 percent; those at 133 percent FPL pay 3.02 percent, rather than 3.00 percent; etc. IRS, Rev. Proc. 2014-37 (26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability), July 24, 2014, <http://www.irs.gov/pub/irs-drop/rp-14-37.pdf>.

² The exception is certain legal immigrants who are not eligible for Medicaid by virtue of their immigration status are eligible for ACA subsidies. In addition, people who were determined eligible for the PTC and received an Advanced Premium Tax Credit for at least one month in 2014 before their income fell below the poverty threshold may continue to claim the credit for that year. See Center on Budget and Policy Priorities, "Premium Tax Credits: Answers to Frequently Asked Questions," July 2013. Available at: <http://www.cbpp.org/files/QA-on-Premium-Credits.pdf>.

³ See Henry J. Kaiser Family Foundation, "How Will the Uninsured Fare Under the Affordable Care Act?", April 7 2014. Available at <http://kff.org/health-reform/fact-sheet/how-will-the-uninsured-fare-under-the-affordable-care-act/>.

costs) and those who opt for more generous health insurance plans must cover a larger share of premiums.



TABLE 1. MAXIMUM PREMIUM CONTRIBUTION* (AFTER CREDITS) FOR SINGLES AND FAMILIES OF FOUR BY INCOME LEVEL IN 2014

Income as Percentage of Federal Poverty Level (FPL)	Premium as Percentage of Income	Single		Family of Four	
		Income in Dollars	Maximum Premium	Income in Dollars	Maximum Premium
100	2	11,670	233	23,850	477
133	3	15,521	466	31,721	952
150	4	17,505	700	35,775	1,431
200	6.3	23,340	1,470	47,700	3,005
250	8.05	29,175	2,349	59,625	4,800
300	9.5	35,010	3,326	71,550	6,797
399	9.5	46,563	4,424	95,162	9,040
400	no limit	46,680	No Limit	95,400	No Limit

**Based on purchase of second least expensive Silver plan offered through a health insurance exchange.*

The exact amount of PTC depends on the particular situation of the family—how large it is, the age of family members, and the cost of health insurance in their particular location. Families with older parents, for example, or who live in high-cost areas, face higher premiums and thus qualify for larger credits. Figure 1 illustrates the size of the premium credit for a family of four in Washington, DC, headed by 45- and 40-year old parents with two children under the age of 21. Before credits, the second least expensive Silver plan had a premium of \$10,272 per year in 2014.⁴ A family with income equal to 100 percent of the FPL would qualify for a tax credit of \$9,795 in DC. (In DC, this could apply only to a non-citizen family since others at this income level are eligible for Medicaid.) The PTC declines to \$1,209 for the family as its income approaches the 400 percent of FPL limit for credit eligibility.

As noted, families whose incomes or family composition change will generally qualify for a different tax credit than they claimed in advance. Families can limit discrepancies by updating their information with the health insurance exchange so that Advance Payment of Tax Credit (APTC) amounts change when incomes fluctuate. IRS researchers estimated that only 2 percent of households would see no change in their PTC if they claimed an advance credit based on prior

⁴ This is calculated based on the premiums listed on the DC Health Link website. The 45-year old faced a premium of \$292 per month; the 41-year old, \$242; and each child cost \$162. This yields a total monthly premium of \$856, or an annual premium of \$10,272. See http://dchealthlink.com/sites/default/files/forms/2014_SLCSP_Listing%28v3_2-28-14%29.pdf.

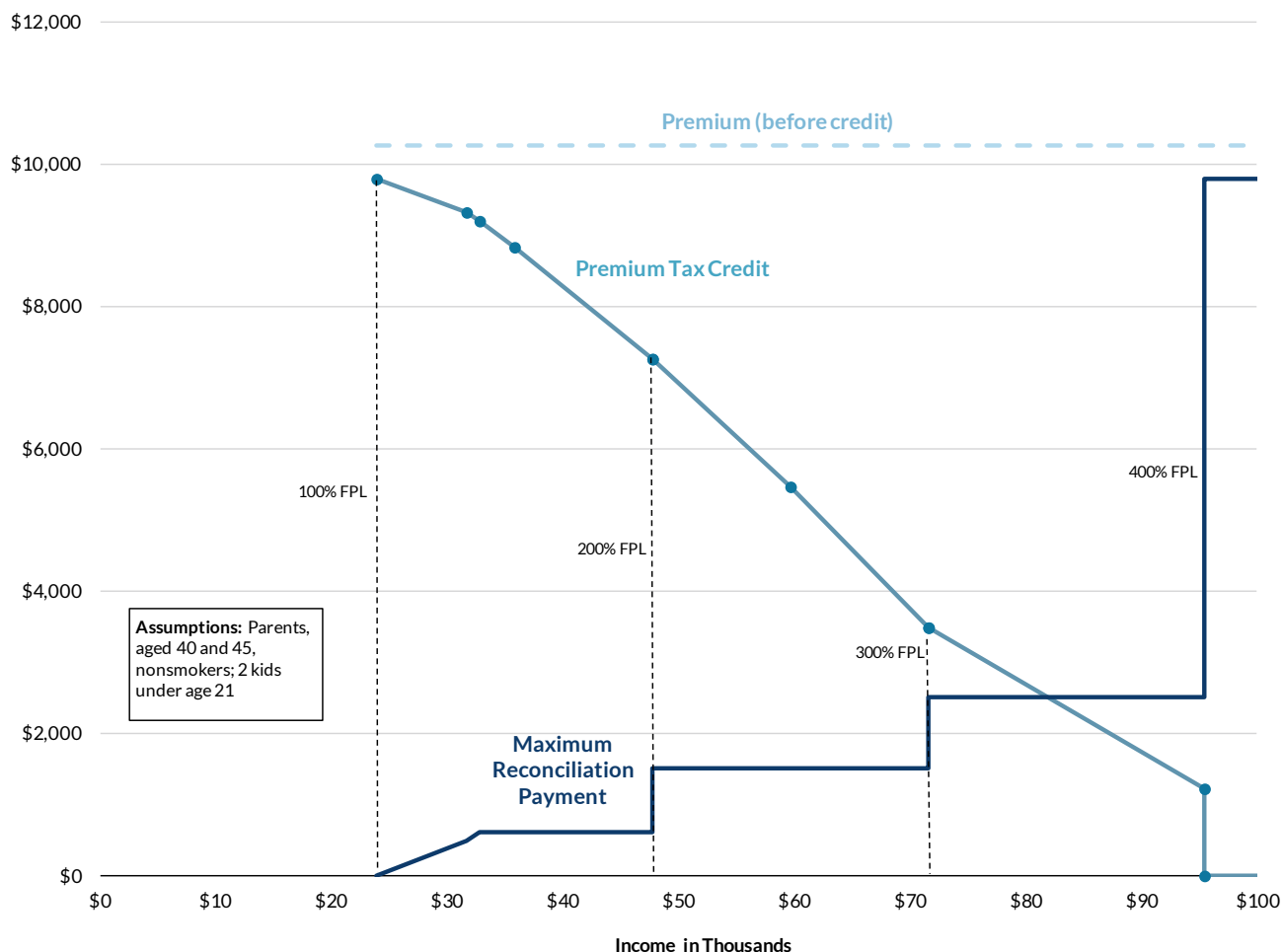
year's income (based on income data for 2010 and 2011).⁵ Half would have to repay part or all of the credit and slightly less than half (48 percent) would qualify for additional credits.

Ken Jacobs and coauthors used data from the Survey of Income and Program Participation calibrated to match the demographic characteristics of the population of households eligible for the PTC in California.⁶ The population of low- and middle-income households has very volatile incomes.

Nearly three-quarters (73.3 percent) of the predicted subsidy recipients were in families with [year to year] income changes of more than 10 percent... Of those recipients, 37.8 percent had large income increases, while 35.5 percent had large decreases. Thirty percent of recipients were in families whose income increased more than 20 percent, and 18.9 percent had income increases of more than 40 percent. (p. 1541)



FIGURE 1. PREMIUM TAX CREDIT AND MAXIMUM RECONCILIATION PAYMENT FOR HYPOTHETICAL FAMILY OF FOUR IN DC, BY INCOME, 2014



⁵ Brian Erard, Emily Heys, Brock Ramos, Layne Morrison, and Robert Mueller, "Return-Based Affordable Care Act Microsimulation Model: Projecting the Impact of ACA Tax Provisions on Taxpayers and the IRS," June 19, 2014. Available at <http://www.irs.gov/pub/irs-soi/14resconsession4.pdf> (p. 47).

⁶ Ken Jacobs, Dave Graham-Squire, Elise Gould, and Dylan Roby, 2013, "Large repayments of Premium Subsidies may be Owed to the IRS if Family Income Changes are not Promptly Reported," *Health Affairs*, 32(9):1538–1545.

Fortunately for most households with large income increases, the maximum reconciliation payment is limited. The maximum addition to tax is capped at \$300 in 2014 for single filers with incomes at or below 200 percent of FPL. (See Table 2.) As incomes rise, the maximum repayment amount increases: \$750 for families with incomes between 200 and 300 percent of FPL and \$1250 for those with incomes between 300 and 400 percent. The limits are twice as high for married filers and heads of household.

However, families whose incomes are above 400 percent of FPL must repay their entire APTC. In DC, a non-citizen immigrant family that expected to have income at 100 percent of FPL but actually had income over 400 percent could owe as much as \$9,795 in additional tax on their 2014 income tax return.⁷ A family whose projected income was 200 percent of FPL but whose actual income was above the 400 percent FPL eligibility threshold could owe \$7,267 (the tax credit for families at 200 percent of FPL).



**TABLE 2. AVERAGE TAX REFUND BY INCOME GROUP
COMPARED WITH MAXIMUM ACA RECONCILIATION**

Household Income as Percentage of Poverty Level	Maximum Reconciliation Payment (in Dollars)	Percentage of Returns with Refunds	Average Refund (in Dollars)	Percentage of Refunds Exceeding Limits
Non-single Filers				
Less than 200	600	92	4,434	86
200-299	1,500	86	3,240	62
300-399	2,500	83	3,436	42
400 and over	unlimited	71	7,644	N/A
Single Filers				
Less than 200	300	82	1,397	70
200-299	750	81	1,375	53
300-399	1,250	83	1,732	42
400 and over	unlimited	75	4,441	N/A

Source: Tax Policy Center computations based on the 2008 Internal Revenue Service Public Use File, inflated to \$2014 using the CPI

Jacobs, et al., estimated that 1 percent of credit-eligible families in California with income of 100 percent of FPL or less in 2018 would have incomes over 400 percent of FPL in 2019; 6 percent with incomes between 201 and 250 percent and 19 percent with incomes between 251 and 400 percent of FPL in 2018 would ultimately find themselves ineligible and be required to repay in full any APTC.

⁷ \$9,795 is the PTC assuming income at 100 percent of FPL. See Figure 1.

All told, Jacobs, et al., estimate that about 38 percent of people who qualify for advance credits would owe additional tax if they do not report changes in income or family status over the course of the year. This is less than the IRS estimate primarily because Jacobs, et al., assume that credit recipients will use the most recent income information available—not simply prior year tax returns—to project income when enrolling in an exchange. The percentage owing reconciliation payments would be even lower if families report income changes during the year.

The estimates from Jacobs and colleagues involve people who *qualify* for credits, not those who *receive* the APTC. To illustrate the difference, suppose that APTC take-up rates are highest among eligible households who qualify for the deepest subsidies because they have the lowest incomes when they apply for the APTC. Because such households are less likely than others to see their final annual incomes exceed 400 percent FPL, fewer APTC beneficiaries would owe large amounts than the percentages estimated by Jacobs and colleagues. We will not know actual reconciliation totals until long after tax filing season.

For the families who do not report income changes (and adjust premium subsidies), the additional tax arising from reconciliation could be a substantial hardship. However, most lower-income households are likely to have large enough income tax refunds to cover the maximum reconciliation payment. In 2008, the latest year for which a public use file is available from the IRS, 86 percent of married filing joint households with incomes below 200 percent of the FPL received refunds, which averaged almost \$4,500 in 2014\$. (See Table 2.) We estimate that 77 percent would have large enough refunds to cover the maximum reconciliation payment of \$600.⁸ Almost 80 percent of singles in that income category would have large enough refunds to cover reconciliation, should it occur.

The adequacy of refunds to cover reconciliation declines as income increases. About 60 percent of households with incomes between two and three times the FPL have a refund large enough to cover the maximum possible reconciliation payment, and less than half of those with incomes between three and four times FPL are in that situation. This is because the likelihood of having a refund falls as income rises and also because the average refund does not increase as fast as the maximum reconciliation payment (and indeed is somewhat smaller for families with incomes between 200 and 400 percent of poverty than for families with lower incomes). Fortunately, families with higher incomes are also more likely to have savings that they can use to pay an unexpected tax bill.

⁸ Note that these projections rest on a number of assumptions, including that refunds and incomes for those eligible for credits grow with the consumer price index, and that those who purchase insurance in exchanges do not have systematically higher or lower refunds than otherwise similar households who have other insurance coverage. One concern is that self-employed people might be especially likely to purchase health insurance through the exchanges. For example, if their estimated tax payments are lower than typical W-2 withholdings, they would have smaller refunds and be more likely to owe tax in excess of their reconciliation. Self-employed people might also have especially volatile incomes and thus be more likely to face a substantial reconciliation payment. Many self-employed people also qualify for additional assistance, since they can deduct from self-employment income any Qualified Health Plan premium payments that are not covered by PTC. For those reasons, these estimates should be considered illustrative.

However, it is likely that reconciliation will present a hardship for some families who claimed the APTC even if they do not have a net tax payment due. Many low-income households rely on refunds to meet pressing needs—treating their over-withholding of tax as a form of saving.⁹

Quincy, Kleimann, and Kingsley recommend a consumer education campaign to explain the possible consequences of reconciliation.¹⁰ In testing, they found that about half of participants would elect to take the tax credit on their income tax return rather than as an advance credit. (They also concluded that participation would be higher if more middle-income people knew that they might be eligible for credits.)

However, many low- and moderate-income uninsured who qualify for tax credits lack the room in household budgets needed to pay a year's insurance premiums, based on the expectation of financial assistance on their next tax return. Affordability appeared to be the most important factor limiting participation among uninsured consumers who examined Marketplace options in 2014 and chose not to sign up.¹¹

One option to address this problem would be to end reconciliation altogether for households whose incomes are higher than the good-faith projections that they made at the time of enrollment. This would make the ACA more comparable to other means-tested transfer programs where benefits are not rescinded retroactively when income rises between reporting periods. Medicare Parts B and D, federally-funded college student aid, and 2008 tax stimulus payments made to individuals through the tax code, all base current-year subsidies on prior-year incomes. If current income declines, beneficiaries can seek additional aid. If income rises, there is no “claw back” of current-year payments through reconciliation.¹² This approach provides certainty. However, changing the ACA's PTC to fit this more generous model would increase the cost of the program. A somewhat less expensive option would be to reduce the limits on repayment to the levels originally specified in the ACA—a flat \$250 for individuals and \$400 for families whose incomes remain below 400 percent of FPL.¹³

An even more modest option would be to allow tax filers who made a good-faith estimate of annual income at the time they claimed the APTC the option of doing monthly reconciliation

⁹ Ruby Mendenhall, Kathryn Edin, Susan Crowley, Jennifer Sykes, Laura Tach, Katrin Kriz, and Jeffrey R. Kling, “The Role of Earned Income Tax Credit in the Budgets of Low-Income Families,” *Social Service Review*, volume 86 issue 3, February 2012.

¹⁰ Lynn Quincy, Susan Kleimann, and Barbra Kingsley, “Helping Consumers Understand the New Premium Tax Credit,” Consumers Union, May 2013. Available at http://consumersunion.org/wp-content/uploads/2013/05/Understanding_The_Premium_Tax_Credit.pdf.

¹¹ Dorn, S., *Affordability of Marketplace Coverage: Challenges to Enrollment and State Options to Lower Consumer Costs*, December 2014, Washington, DC: Urban Institute, <http://www.urban.org/UploadedPDF/2000039-Affordability-of-Marketplace-Coverage.pdf>.

¹² Dorn, S., *Implementing National Health Reform: A Five-Part Strategy for Reaching the Eligible Uninsured*, May 2011, Washington, DC: Urban Institute, <http://www.urban.org/UploadedPDF/412335-Reaching-the-Eligible-Uninsured.pdf>; Dorn, S., *Express Lane Eligibility and Beyond: How Automated Enrollment Can Help Eligible Children Receive Medicaid and CHIP*, April 2009, Washington, DC: Urban Institute and National Academy for State Health Policy, http://www.urban.org/UploadedPDF/411879_eligible_children.pdf.

¹³ Both the Medicare and Medicaid Extenders Act of 2010 and the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayment Act of 2011 increased the limits on repayment of premium credits when income increases.

on their income tax returns if their incomes exceed projections. This would be somewhat complex as filers would have to compute income for every month in the tax year and compare monthly subsidies claimed to the amount to which they would be entitled based on their income in that month. This would especially help filers whose incomes unexpectedly rise at the end of the year because of a windfall (say, an award in a lawsuit or a bonus payment at work). A filer whose income increased dramatically at the end of the year might owe back the entire subsidy claimed in the last month or two, but would no longer face the risk of having to repay the entire year's subsidy.

These changes would require legislation, which seems unlikely given the current political impasse over the ACA. The IRS, however, could help some taxpayers to avoid large reconciliation payments by modifying the form W-4, which every employee is required to fill out at the start of employment, to encourage employees to report changes in income—and health insurance coverage status—to the ACA exchange. HR departments could also be advised to inform new employees that a new job may change their eligibility for subsidies under the ACA.



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