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LEGAL ALERT

IRS Updates Employer Mandate FAQs: Indicates that Penalty Letters are Imminent

The Internal Revenue Service (IRS) has updated its list of [frequently asked questions](#) (FAQs) on the Affordable Care Act's employer shared responsibility provisions – also known as the “pay or play” mandate. In particular, [questions 55 through 58](#) provide guidance for employers who may be subject to shared responsibility payments. The FAQs indicate that the IRS will begin sending penalty letters to applicable large employers (ALEs) that owe penalties for calendar year 2015 “in late 2017.” Around this time last year, the IRS had indicated that penalty letters for 2015 would be coming “in early 2017;” however, those letters never materialized. Based on the latest update to its FAQs, it appears that the IRS has worked out the kinks in its systems and is prepared to begin sending penalty letters.

Background

Starting in 2015, the ACA requires ALEs to either “play” by offering affordable health coverage to their full-time employees, or “pay” a penalty if the employer fails to provide affordable health coverage and at least one full-time employee receives a premium tax credit to help purchase coverage through the Health Insurance Marketplace. ALEs are generally those with 50 or more full-time employees, including full-time equivalent employees. Transitional relief was available for 2015 (and, for non-calendar year plans, any portion of the 2015 plan year that fell in 2016) for ALEs with fewer than 100 full-time employees that satisfied the conditions of such transitional relief.

In general, there are two potential penalties (both non-deductible for tax purposes) that could be imposed on an ALE for failure to satisfy the mandate. The first penalty, known as the “no coverage” penalty, is based on whether an ALE fails to offer group health plan coverage to at least 95% (70% during 2015 plus, for non-calendar year plans, any calendar months of 2016 that fell within the 2015 plan year) of its full-time employees. In this case, the annual penalty is \$2,000 per full-time employee minus 30 (minus 80 for 2015, plus any calendar months of 2016 that fell within the 2015 plan year) full-time employees if at least one employee receives a premium tax credit for Marketplace coverage. The second penalty, known as the “unaffordability” penalty, applies when an employer offers coverage that fails to meet certain affordability and minimum value requirements. In that case, the annual penalty is \$3,000 for each full-time employee who receives a premium tax credit for Marketplace coverage, but no more than what the “no coverage” penalty would be if it applied. As noted above, several types of transition relief applied for 2015 (for non-calendar-year plans, some aspects of the relief continued for months of the 2015 plan year that fell in the 2016 calendar year). This transition relief delayed application

of the penalties for certain ALE members and reduced the penalty amount for others. This transition relief has now expired.

The annual penalties are prorated on a monthly basis and are indexed each year for inflation, as shown in the following table:

Penalty Type	“No Coverage”	“Unaffordability”
Description	Coverage not offered to 95%** of full-time employees	Coverage offered, but unaffordable or is not minimum value
2018	\$2,320	\$3,480
2017	\$2,260	\$3,390
2016	\$2,160	\$3,240
2015	\$2,080	\$3,120
2014*	\$2,000	\$3,000

*No employer shared responsibility penalties will be assessed for 2014.

** 70% during 2015 (plus, for non-calendar year plans, any calendar months of 2016 that fell within the 2015 plan year)

The IRS’ Penalty Process

The FAQs indicate that the IRS will use Letter 226J to propose and assess penalties. Letter 226J will be issued if the IRS determines that, for at least one month in the year, at least one of the ALE’s full-time employees was enrolled in subsidized coverage through the Marketplace and the ALE did not qualify for an affordability safe harbor (or other relief for the employee). The letter will include, among other things, the following:

- a brief explanation of the pay-or-play provisions;
- a table itemizing the proposed penalty by month and whether the liability is under the “no coverage” provision, the “unaffordability” provision or neither;
- an employer shared responsibility response form (Form 14764 – ESRP Response);
- a list of full-time employees who received subsidized Marketplace coverage each month (Form 14765 – Employee Premium Tax Credit List) and for whom the ALE did not qualify for an affordability safe harbor or other relief;
- a description of the actions the ALE should take if it agrees or disagrees with the proposed payment amount in Letter 226J; and
- a description of the actions the IRS will take if the ALE does not respond timely.

The response to Letter 226J will be due by the response date shown on that letter, which generally will be 30 days from the date of Letter 226J. The letter will contain the name and contact information of a specific IRS employee that the ALE should contact if it has questions about the letter. At this time, a copy of Letter 226J is not available on the IRS website.

Employer Response

ALEs will have an opportunity to contest any proposed penalty notices. ALEs that receive a Letter 226J may respond to the IRS about the proposed payment, including requesting a pre-assessment conference with the IRS Office of Appeals. The letter will provide instructions for how the ALE should respond in writing, either agreeing with the proposed penalty amount or disagreeing with all or a portion of it.

If the ALE responds to Letter 226J, the IRS will acknowledge the ALE’s response with one of five versions of Letter 227 (which, in general, acknowledge the ALE’s response and describe further actions the ALE may need to take). If, after

receipt of Letter 227, the ALE disagrees with the proposed or revised employer shared responsibility payment amount, it may request a pre-assessment conference with the IRS Office of Appeals. The ALE should follow the instructions provided in Letter 227 and [Publication 5](#) for requesting a conference with the IRS Office of Appeals. A conference should be requested in writing by the response date shown on Letter 227, which generally will be 30 days from the date of Letter 227.

If the ALE does not respond to either Letter 226J or Letter 227, the IRS will assess the amount of the proposed penalty and issue a notice and demand for payment (Notice CP 220J). Notice CP 220J will include a summary of the ALE's payment responsibility and will reflect payments made, credits applied, and the balance due, if any. The notice will instruct the ALE how to make payment, if any. ALEs will not be required to include the employer shared responsibility payment on any tax return that they file or to make payment before notice and demand for payment. ALEs may have the ability to make installment payments, as described in [Publication 594](#).

Next Steps

There were numerous legislative efforts by the Trump administration earlier this year to repeal and replace the ACA, including retroactively eliminating the individual and employer shared responsibility mandates. Recently, there have been discussions that Republicans may again try to repeal those mandates as part of their tax reform bill. However, to date, no such repeal bills have passed, and the most recent proposed tax reform bill does not include a repeal of the mandates. In the absence of a repeal, employers should be prepared to respond to any IRS penalty letters and continue to prepare for 2017 reporting (in 2018).

The IRS will be determining penalty responsibility based on an employer's ACA reporting (Forms 1094-C and 1095-C), along with information regarding an individual's receipt of a premium tax credit. ALEs who have been offering affordable, minimum value coverage to full-time employees should ensure that they have all information necessary to appeal any proposed penalty assessments, including payroll records and documentation regarding how offers of coverage are made. While the IRS FAQs indicate that the IRS plans to issue Letter 226J for the 2015 calendar year (which generally applied to ALEs with 100 or more full-time employees), it is a good time for ALEs in later years to start reviewing and gathering information that they may need to respond to Letter 226J as well.

Employers that receive Letter 226J should review it carefully and consider whether there is a basis to pursue an appeal, including whether the employee was full-time for ACA purposes in each month for which a penalty is assessed. For example, employers may need to demonstrate to the IRS that they were using permissible measurement and stability periods and that the employee in question qualified as a "variable hour employee," if the employer is claiming that an employee who worked 130 hours in a particular month was not full-time for ACA purposes. ***Employers who receive Letter 226J should be mindful of the response deadline, which will generally be 30 days from the issuance date appearing on the letter, and should consider taking steps now (such as working with human resources, legal, benefits, payroll, and finance departments as well as outside vendors housing your ACA data) to set up a process to ensure timely review and response to any Letter 226J. Depending on mailing delays and internal routing, an employer may have a very short timeframe before the due date to respond, so advanced planning is critical.***

Employers that receive subsidy notification letters from the Marketplace during the year should consider appealing them when there is a basis to do so. In many cases, employers receive Marketplace subsidy letters for individuals who are not full-time for ACA purposes, and thus there is no basis for an appeal. In other words, an employer would not appeal a premium subsidy notice for a part-time employee to whom the employer did not offer coverage (that person would be a prime candidate for subsidized coverage).

Employers should also be reminded that the ACA Section 1558 prohibits retaliation against employees who receive premium tax credits. Among other things, employers are prohibited from discharging or discriminating against an

employee because the employee received a premium tax credit. Employers violating Section 1558 may be required to reinstate the employee to his or her former position (and provide back pay) and may be subject to compensatory damages, costs and expenses (including attorneys' fees) incurred by the employee in connection with the bringing of a complaint.

Employers that have questions regarding Letter 226J or IRS response letters should consult with qualified benefits counsel so that the relevant facts and circumstances can be reviewed.

About the Authors. This alert was prepared for TRUEbenefits, LLC by Marathas Barrow Weatherhead Lent LLP, a national law firm with recognized experts on the Affordable Care Act. Contact Peter Marathas or Stacy Barrow at pmarathas@marbarlaw.com or sbarrow@marbarlaw.com.



Stacy Barrow, Esq.

Compliance Director

This alert was prepared by Stacy Barrow. Mr. Barrow is a nationally recognized expert on the Affordable Care Act and BAN's Compliance Director. His firm, Marathas Barrow Weatherhead Lent LLP, is a premier employee benefits, executive compensation and employment law firm. He can be reached at

sbarrow@marbarlaw.com.

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