

Be Prepared to Respond to IRS Employer Shared Responsibility Payment Assessments

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Although it is the holiday season and people's thoughts have turned to vacation with family, eggnog, and gift giving — employers have something slightly less festive to contemplate.

The Internal Revenue Service (IRS) has started to send out letters to employers regarding potential Employer Shared Responsibility Payments (ESRP) (one of two types of penalties for failure to satisfy certain coverage rules) relating back to the 2015 plan year. This article describes the actions an employer should take if it receives a proposed ESRP assessment from the IRS.

What are the penalties at stake? Under the Internal Revenue Code (the "Code") Section 4980H rules, an Applicable Large Employer (ALE)¹ may be subject to an ESRP in two ways:

- **The A penalty.** If an ALE does not offer minimum essential coverage to "substantially all" (at least 70% in 2015 and 95% in years after 2015) of its full-time employees (and their dependents), and at least one of its full-time employees receives a premium tax credit on the Health Insurance Marketplace (the "Exchange"),² the ALE will owe an annualized ESRP equal to the number of full-time employees the ALE employed for the calendar year (minus up to 30 employees), multiplied by \$2000 (as adjusted each year). Depending on the size of the ALE, this penalty could be substantial, so it is often referred to as the "sledgehammer penalty."
- **The B penalty.** Even if an ALE offers coverage to substantially all of its full-time employees and their dependents, it may still have exposure to the "B" penalty, often called the "tack hammer penalty." If an ALE offers coverage to substantially all of its full-time employees and their dependents, but has one or more full-time employee who receives a premium tax credit on the Exchange, the ALE may face a B penalty payment. Generally, the amount of the payment for the impacted month equals the number of full-time employees who receive a premium tax credit for that month multiplied by 1/12 of \$3,000 (as adjusted). An example of how this might occur is if the ALE offered coverage to 95% of its full-time employees, but one of the 5% who did not receive an offer of coverage went out to the Exchange and qualified for a premium tax credit.

Note: The 2015 adjusted penalty amounts under the A penalty and B penalty are \$2,080 and \$3,120, respectively.

Certain transition relief is available for 2015. Understanding that the ESRP rules generally were first effective in 2015 and were a source of considerable confusion for employers, the IRS provided various forms of “transition relief” to employers for the 2015 year. Examples of this transition relief include, but are not limited to:

- If an employer had fewer than 100 full-time employees, including full-time equivalent employees, it was not assessed an ESRP for 2015. For all other years after 2015, an employer is considered an ALE subject to the ESRP rules if it has 50 or more full-time employees (including full-time equivalent employees).
- Generally, an ALE will owe the A penalty if it does not offer coverage to at least 95% of its full-time employees and their dependents. However, in 2015, an ALE could avoid the A penalty by offering coverage to at least 70% of its full-time employees and their dependents (a significantly relaxed standard).
- If an ALE is subject to the A penalty, the annual payment is generally \$2,000 for each full-time employee — adjusted for inflation — after excluding the first 30 full-time employees from the calculation. For 2015, if an ALE with 100 or more full-time employees (including full-time equivalent employees), is subject to an ESRP, the payment will be calculated by reducing the ALE’s full-time employees by 80, rather than 30.

Given the various forms of transition relief for 2015 (e.g., the 70% standard), it is our guess that a majority of the proposed assessments from the IRS relating to the 2015 plan year will relate to the B penalty and not the A penalty.

How will an employer know if it is subject to IRS penalties? An ALE will first receive notice that it is potentially subject to an ESRP when it receives a [Letter 226J](#) from the IRS. This Letter 226J will describe whether the IRS believes the employer owes the A penalty or the B penalty. The letter will also include various attachments that are described further below (i.e., the Employee Premium Tax Credit Listing, an ESRP Summary Table with accompanying explanation, and an ESRP Response Form).

What can an employer do upon receiving an assessment? Upon receiving the Letter 226J, the ALE should take the following steps:

- Read through the Letter 226J and its accompanying attachments carefully. The letter will include an “Employee Premium Tax Credit Listing” which lists the employees (by name) for whom the ALE may have ESRP exposure (i.e., those employees who received a premium tax credit while no safe harbor or other relief from the ESRP was available to the ALE). This Listing also includes the indicator codes that the ALE reported on lines 14 and 16 of each assessable full-time employee’s Form 1095-C (i.e., the codes describing whether an offer of coverage was made, and whether any safe-harbor or other relief was available from the ESRP).

In addition to the Employee Premium Tax Credit Listing, the Letter 226J also includes an ESRP Summary Table where the IRS describes the monthly ESRP amount that the IRS has proposed for the ALE. This Summary Table describes how the IRS calculated the proposed monthly ESRP amounts. When calculating the proposed assessment, the IRS uses such information as the data reported by the ALE on its Form 1094-C, Part III Columns (a) and (b). These columns report whether the ALE offered coverage to substantially all of its full-time employees (i.e., 95% (70% in 2015)), and the ALE's monthly full-time employee count.

Note, the IRS has issued a helpful guide titled "[Understanding your Letter 226J](#)" that an ALE may use when determining how to respond to the letter. The IRS also has issued [FAQs \(55–58\)](#) describing how to pay the ESRP.

- Act immediately. The ALE should educate its workforce that upon receiving a Letter 226J, they will need to forward it to the appropriate individuals (e.g., the ALE's reporting vendor, legal counsel, etc.) for analysis. Prompt action is necessary — the IRS has only provided a 30-day window to respond to the letter.
- Upon receiving a Letter 226J, the ALE will need to quickly determine whether it will be able to meet the 30-day deadline to respond to the IRS. The ALE may request more time to respond by calling the IRS using the telephone number listed on the ESRP Response Form.
- Review the Letter 226J to determine whether the information is accurate. The ALE should review the information reported on the letter and the accompanying attachments and compare them to such information as the ALE's enrollment and payroll records, as well as its copies of the Forms 1094-C and 1095-C that were filed with the IRS.
- If the ALE agrees with the IRS's proposed penalty, it will need to complete, sign and date the enclosed ESRP Response Form (i.e., the Form 14764), and return the Form to the IRS by the date listed on the first page of the Letter 226J. The ALE also will need to make payment by check or through the electronic federal tax payment system.
- If an ALE received a Letter 226J from the IRS, it should not automatically assume that it owes an ESRP. The IRS determination regarding whether an ALE owes an ESRP is based on the information reported by the ALE on its Forms 1094-C and 1095-C. 2015 was the first year that employers were required to complete ACA reporting, and there was considerable confusion (on the part of ALEs as well as the IRS) during this first year of reporting.³
 - The ALE should critically analyze the Letter 226J and attachments to determine whether it agrees with the information reported by the IRS in these documents. For example, does the ALE agree with the full-time employee counts listed in the ESRP Summary Table? Has it verified that the proper "allocated reduction of full-time employee count" for purposes of calculating the A penalty was used by the IRS (i.e., for 2015 — an 80 full-time employee reduction instead of 30)? Has the ALE confirmed that the employees listed in the Employee Premium Tax Credit Listing document were in fact full-time employees (and not part-time employees)? Are the employees listed by the IRS actually employees of the ALE? For each employee listed in the Employee Premium Tax Credit Listing, has the ALE confirmed that the employee(s) was truly not offered coverage, and that no safe-harbor or other relief was available from the ESRP?

- If an ALE disagrees with the information reported in the Letter 226J, it will need to complete an ESRP Response Form (Form 14764) stating that it disagrees with part or all of the proposed ESRP assessment. Further, the ALE will need to include a signed statement explaining why it disagrees with all or part of the proposed assessment. The ALE should include backup documentation supporting its statement (e.g., enrollment materials showing that an offer of coverage was made to the impacted full-time employee, etc.)
- If in the process of reviewing the Letter 226-J, the ALE realizes that the information the ALE reported on its Form 1094-C and/or 1095-C was inaccurate, the ALE's response to the IRS should include a statement (and updated Employee PTC Listing) describing any changes it wants to make to the information reported on its Forms 1094-C (the primary form the IRS uses to calculate the A penalty) and/or Forms 1095-C (the primary form the IRS uses to calculate the B penalty). Note: The accompanying instructions to Letter 226J state that the ALE should not file corrected Forms 1094-C or 1095-C to report the requested changes.

Further appeal rights available. Upon receiving the ALE's ESRP Response Form, the IRS will respond by providing the employer with a Letter 227. The Letter 227 will acknowledge the ALE's response and describe further actions the ALE may need to take. If after receiving the Letter 227, the employer still disagrees with the IRS proposed penalty, it will have the opportunity to have a pre-assessment conference with the IRS Office of Appeals.

If after the ALE has taken all of these steps, the IRS still determines that the ALE is subject to an ESRP, it will issue a notice and demand for payment. Note: An ESRP is not deductible by the ALE.

Conclusion. Given the quick deadline to respond to a proposed ESRP, an employer should make sure that it has ready access to the Forms 1094-C and 1095-C that were filed in 2015, as well to its applicable payroll and enrollment records. It is important that the employer proactively prepare. The employer cannot afford to ignore an IRS Letter 226J. The IRS has clarified that if the ALE does not respond within the 30-day deadline, the IRS will send a "Notice and Demand" for the penalty payment, and the employer could be subject to accrued interest until the employer pays the total penalty payment owed.

Also, as employers enter into another Form 1094-C/1095-C reporting season, it is more clear than ever that accurate Affordable Care Act reporting is critical. The IRS has confirmed that it is determining penalty assessments based on the information that the ALE reported on its IRS Forms 1094-C and 1095-C. An ALE should work to ensure that the information it is reporting is accurate (e.g., full-time employee counts are accurate, offers of coverage are appropriately reported, as well as safe-harbor relief, etc.), and that it is retaining all of the documents necessary to respond to the IRS if the ALE receives a proposed ESRP assessment.

Footnotes follow on next page

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- ¹ If an employer is part of an aggregated ALE group (i.e., the same Code section 414 control group), liability under the Code Section 4980H rules applies separately for each ALE member in the aggregated ALE group. Note: Each employer that is a member of an aggregated ALE group is referred to as an ALE member.
 - ² An employee may be eligible for a premium tax credit (i.e., a subsidy) if he or she declines the ALE offer of coverage and the ALE coverage offered was not affordable or failed to meet the minimum value standard.
 - ³ The Treasury Inspector General for Tax Administration published an audit report titled "Assessment of Efforts to Implement the Employer Shared Responsibility Provision" on April 7, 2017. This audit report found that the IRS did not sufficiently test its error code programming for processing Forms 1094-C and 1095-C for 2015 reporting. For example, error codes sometimes were erroneously generated when no error condition existed.

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