How to Respond to IRS Penalty Letter 226J

Lisa C. Allen
Vice President, Regulatory Affairs
Relph Benefit Advisors, an ALERA Group Company
Fairport, New York
Ever Changing!!

This seminar is a periodic seminar presented by Relph Benefit Advisors and should not be construed as legal advice or legal opinion on any specific facts or circumstances.

Legislation and Regulations are ever changing and evolving. The contents are intended for general information purposes only.

You are urged to consult your own advisor concerning your situation and any specific legal questions you may have.
Pay or Play Penalty Assessments

• In late November 2017, the IRS began notifying applicable large employers (ALEs) of proposed assessments of the pay or play penalty (Employer Shared Responsibility Payments or ESRP)

• These notifications came in the form of IRS Letter 226J

• Most proposed assessments are the result of reporting errors, not failure to comply with the pay or play penalty
Form 1094-C, Line 22

• Failing to check the Section 4980H Transition Relief Indicator Box
• Your organization could check this box if it is between 50-99 full-time/equivalent employees & meets certain maintenance requirements, you would not be subject to any Section 4980H penalties
• If your organization has 100 or more full time/equivalent employees, it could still check this box to apply a 70% instead of 95% threshold for offer compliance.
Plainly, some vendors who did the 2015 reporting did not understand either of these two forms of transition relief or left it to the client to figure it out and the client did not understand how to invoke the transition relief.

The fix for this issue is easy. Inform the IRS that the penalty was incurred because you forgot to check the applicable box. You will need to complete the ESRP Response (Form 14764) along with your signed statement supporting it. (To the extent your organization is seeking the 50-99 full time/time equivalent transition relief, your organization will want to specify that it met the eligibility requirements in the ESRP Response along with your supporting signed statement.)
Form 1094-C, Part III

- Is the MEC box checked Yes?
- Are your full time and all employee #’s correct?
- If line 21 is Yes, is the Aggregated Group Indicator box checked Yes?
- If line 21 box C is Yes, is column e completed with either “a” or “b” (a = transitional relief 50-99 and b = over 100?)
Check Line 22 and Part III

- Did you offer MEC to at least 70% of your full time employees/dependents in 2015 for all 12?
- If you did, make sure you checked the “yes” box in line 23 for “All 12 Months”
- *Best practice, if your employee counts vary by month, check Yes in box 24-35 instead of all 12 months
## Penalties

<table>
<thead>
<tr>
<th>Penalty Type</th>
<th>“No Coverage” Coverage not offered to 95%** of full-time employees</th>
<th>“Unaffordability” Coverage offered, but unaffordable or is not minimum value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
<td>Coverage not offered to 95%** of full-time employees</td>
<td>Coverage offered, but unaffordable or is not minimum value</td>
</tr>
<tr>
<td>2018</td>
<td>$2,320</td>
<td>$3,480</td>
</tr>
<tr>
<td>2017</td>
<td>$2,260</td>
<td>$3,390</td>
</tr>
<tr>
<td>2016</td>
<td>$2,160</td>
<td>$3,240</td>
</tr>
<tr>
<td>2015 **70%</td>
<td>$2,080</td>
<td>$3,120</td>
</tr>
<tr>
<td>2014** no ESRP</td>
<td>$2,200</td>
<td>$3,000</td>
</tr>
</tbody>
</table>
You Will Receive . . .

- Letter **226J**—ESRP reason and amount
- Form **14764**—ESRP Response
- Form **14765**—Premium Tax Credit Listing
- Notice **609**—Privacy Act Notice
- Publication **1**—The Taxpayer Bill of Rights
6 Things to Do—First

• Have your Forms 1094-C and 1095-C handy and evaluate how long you will need to respond. Employers only have 30 days to respond. Depending on if you agree or not with the IRS assessment of your liability, you may need more than 30 days to review all of your data. The IRS guidance states that if you request an extension within the original 30 days, they may grant additional time to respond. The response time may be difficult to meet, depending on the number of individuals listed on the PTC listing.

• Reach out to the IRS auditor on the 226J letter.
6 Things to Do—Second

- Strategize!!
- Responding to letter 226J should not be handled by your HR or benefits departments alone. Include in the conversation your chief counsel, CFO and any internal ACA experts.
- Depending on your organization, the assessment amount and PTC listing, it may be a good idea to seek legal counsel.
6 Things to Do—Third

- Assess your liability.
- While the current letters 226J refer to ESRP for 2015, the penalty process may not be limited to just that year.
- Work with your internal experts and external resources to fully understand the scope of any ESRP payment or penalties you may owe for 2016 and 2017. Make a determination on correction, if applicable.
6 Things to Do—Fourth

- Review Forms 1094-C and 1095-C.
- After your review of Letter 226J you may disagree in whole or in part with the IRS assessment. Inaccurate reporting on Forms 1094-C and 1095-C are most likely the cause of incorrect penalty assessments. The Forms 1094-C and 1095-C are the forms the IRS uses to calculate ESRP assessments.
- If you need to make corrections to your filings, the IRS specifically states not to submit corrected Forms 1094-C or 1095-C. You can make corrections in your response letter and the PTC listing by correcting codes.
6 Things to Do—Fifth

• Craft your response, carefully!
• Fill out Form 14764 to indicate whether you agree or disagree with the assessment. If you agree, you can include payment with your response.
• If you disagree, you will need to provide a full explanation for any discrepancies. Make sure to request a pre-assessment meeting in your letter if the IRS disagrees with your response. This is where counsel will be important.
• You may also appeal the “B” penalty by correcting any coding errors on Form 14765.
6 Things to Do—Sixth

• Sit tight and wait for the IRS to issue Letter 227.

• **Letter 227K**: *WINNER!*. It means your case has been resolved to your organization’s satisfaction. Letter 227K acknowledges that the information in the Letter 226J response was accepted and the IRS inquiry has closed. You do not owe an ESRP.

• **Letter 227L**: While not as thrilling as receiving Letter 227K, receiving this version of Letter 227 is very positive. It is sent when the IRS agrees with the information your organization provided in response to Letter 226J making the case for a reduced ESRP. The organization still needs to make a payment, but for an amount the organization cannot defend, but smaller than the originally proposed amount.
6 Things to Do—Sixth

- **Letter 227M**: It’s not so great to receive a Letter 227M. That’s the version in which the IRS disagrees with your organization’s Letter 226J response and simply reiterates its original proposed penalty.
- There are still two other versions of Letter 227 (N and O).
- For example, the IRS may partially disagree with the recalculated ESRP your organization provided and offers a revised, and hopefully lower, ESRP. The IRS may seek clarification of the information provided by your organization, which may necessitate providing supporting documentation before the IRS is willing to reconsider its original proposed penalty.
Pay or Play Penalty Assessments

- IRS Letters 226J originate from two IRS locations:
  - Florence, KY (Cincinnati, OH)
  - Ogden, UT
- Letter from Florence, KY
  - A specific IRS agent is assigned, with contact information (telephone and fax numbers)
  - Generally respond to telephone inquiries within 24 hours
  - Generally answer written response to proposed assessment within 30-45 days
Pay or Play Penalty Assessments

• Letter from Ogden, UT
  – No specific agent assigned (general 800 number)
  – Generally answers written response to proposed assessment in 60+ days
IRS Letter 226J

- Tax Year (2015) means the calendar year in which the proposed assessment relates
- Contact name (4980H Response Unit) is a department reference (vs. an assigned agent)
- Contact telephone and fax numbers are also generic
- Response date is 30 days from the date of the letter, not the date the letter is received
- Proposed assessment: $1,329,120 (ouch)
- NOTE: 226J letter will be addressed to the individual on the Business Master File within IRS and not the contact listed on the 1094-C
IRS Letter 226

About the Form 14954, Employee PTC Listing

The Employee PTC Listing shows the same and occupational social security number of each full-time employee for whom you filed a Form 1099-C. 

- The employee was allowed a PTC on his or her individual income tax return for one or more months of the tax year shown on the face of the form.

- You did not report an affordability rule violation or other violation from the ESRP on the employee’s Form 1095-C for one or more of the months the employee was allowed a PTC.

Employees are external to or associated full-time employers. Each monthly box on the Employee PTC Listing has instructions. The first row under the column, if any, that were attended on line 14 and line 15 of the employee’s Form 1095-C for each month. The each employee’s Form 1095-C, if the result is not highlighted, the employee is an individual full-time employee for that month. If the result is highlighted, the employee is not an individual full-time employee for the month.

Employees who are considered associated full-time employees for one full-time months of the tax year because the employee was not allowed a PTC for any month in the calendar year or a debt holder or other person providing relief was assigned as Form 1095-C, for each month the employee was allowed a PTC are not included on the Employee PTC Listing.

Specific Instructions for making changes to the Employee PTC Listing:

- If the information reported on an associated full-time employee’s Form 1095-C was inaccurate or incomplete, you may make changes to the Employee PTC Listing using the applicable indicator codes for lines 14 and 15 that are described in the instructions for Forms 1099-C and 1095-C. Make any changes for each employee, as necessary, including other rows on the 2nd row of each employee row.

- When making changes, enter the indicator code for line 14 and enter the indicator code for line 15. Separate the two codes with a slash (/). (H1H0)

- If the indicated code applies for all 12 months of the calendar year, enter that code in the “All 12 Months” column, and do not enter any of the other months.

- If any of the above additional information about the changes for each employee, enter a check in the column labeled “Additional Information Available.” Otherwise, leave the column blank.

NOTES: If more than one indicator code could apply for a month, enter only one code for that month on the Employee PTC Listing. Do not enter additional indicator codes for the employee’s Form 1095-C, for the applicable months and the additional indicator codes for each month.

We will review what you submit and will contact you.

Please revise the signed statement and all documents submitted to include the tax year and your employer ID number in the top right corner.

If we don't hear from you

If you do not respond to the Response Date on the first page of this letter, we will send you a Notice and Demand for the ESRP that was proposed and assessed. This ESRP will be subject to IRS late and penalty assessment anytime. Interest will accrue on the date of the Notice and Demand and continue until you pay the total ESRP balance due.

Letter 226 (09-2017)
Catalog Number 37404C
Minimum essential coverage offer indicator offered to at least 70% is marked “No.” This means:

- Employer did not offer coverage to “substantially all” of its full-time employees in any month of 2015; or
- Employer mistakenly checked this box in Part III, column (a) as “No”; or
- Employer mistakenly omitted checking any box in Part III, column (a); or
- There was some other transmission error.

Regardless of the source of the mistake, the IRS proposed a penalty under § 4980H(a), which is $2,080 per full-time employee ($173.33 per month).

This is the same penalty as if the employer failed to offer health coverage (“paid”).
Explanation of the EHSI Summary Table

The EHSI summary table includes the following information:

Column (a): Hourly EHSI C.I.P. (Part II). EHSI data is available to taxpayers if the EHSI was determined in a prior year (at least for the current year).

Column (b): Column (a) minus column (c) minus an adjustment for the prior year.

Column (c): For use in cases where the EHSI is determined in a prior year (at least for the current year).

Column (d): For use in cases where the EHSI is determined in a prior year (at least for the current year).

Note: Columns (a) and (b) are adjusted for the prior year.

Calculation of the EHSI

The EHSI is calculated as follows:

Column (a) = Hourly EHSI C.I.P. (Part II).

Column (b) = Column (a) - Column (c) - Adjustment for the prior year.

Note: The adjustment for the prior year is based on the EHSI from the prior year.

Example:

If the EHSI for the prior year was $100,000 and the EHSI for the current year is $150,000, the adjustment for the prior year would be $50,000.

The total EHSI for the current year would be $150,000 - $50,000 = $100,000.

Calculation of the EHSI for the current year

The EHSI for the current year is calculated as follows:

Column (a) = Hourly EHSI C.I.P. (Part II).

Column (b) = Column (a) - Column (c) - Adjustment for the prior year.

Note: The adjustment for the prior year is based on the EHSI from the prior year.

Example:

If the EHSI for the prior year was $100,000 and the EHSI for the current year is $150,000, the adjustment for the prior year would be $50,000.

The total EHSI for the current year would be $150,000 - $50,000 = $100,000.

Calculation of the EHSI for the current year

The EHSI for the current year is calculated as follows:

Column (a) = Hourly EHSI C.I.P. (Part II).

Column (b) = Column (a) - Column (c) - Adjustment for the prior year.

Note: The adjustment for the prior year is based on the EHSI from the prior year.

Example:

If the EHSI for the prior year was $100,000 and the EHSI for the current year is $150,000, the adjustment for the prior year would be $50,000.

The total EHSI for the current year would be $150,000 - $50,000 = $100,000.
Form 14764

- Do you consent to the assessment and collection of the proposed assessment?
- Do you disagree with part or all of the assessment of the ESRP?
- Are you enclosing a payment?
Form 14764

- Written authorization to permit a third-party (in addition to the authorized officer) to discuss the proposed assessment with the IRS
- If an Attorney, CPA or Enrolled Agent is representing an employer before the IRS regarding the proposed assessment, an IRS Form 2848 “Authorization and Declaration of Representative” can be used instead.
Power of Attorney

- The IRS may require Form 2848 depending on the facts and circumstances.
- This would be for an attorney/CPA you would like to have the authorization to speak to the IRS on your behalf.
Form 14765

- Form 14765 explains the calculation of any § 4980H(b) penalty.
- Every employee listed on Form 14765:
  - Was a full-time employee in at least one month of the year;
  - Received a premium tax credit in at least one month of the year; and
  - Had a Form 1095-C prepared for the year.
- Form 14765 uses the codes from lines 14 and 16 from the employee’s Form 1095-C.
Form 14765

Employee Premium Tax Credit (PTC) Listing

Any month not highlighted is a month that the employee received a PTC and no safe harbor or other relief from the ESRP was applicable. The employee is an as-separate full-time employee for that month.

<table>
<thead>
<tr>
<th>Employer Name</th>
<th>RSIN (tax 4 digits)</th>
<th>All 13-month Indicator Codes (from 1095-T, lines 14 and 15 combined)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Jan</td>
<td>Feb</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
<tr>
<td></td>
<td>First row - as filed</td>
<td>Second row - for corrections</td>
</tr>
<tr>
<td></td>
<td>1E/2H</td>
<td>1E/2H</td>
</tr>
</tbody>
</table>
Lessons Learned

• If you receive a Letter 226J, hope that it’s from Florence, KY

• Thus far, the IRS has accepted a written attestation as to the reason an employer is not subject to a pay or play penalty (vs. requiring substantiation)

• The IRS appears flexible:
  – Late responses
  – Multiple efforts to resolve issues before advancing matter to formal IRS controversy (appeals, litigation)

• No ALE is immune—attorney firms, non-profits and public school districts for example
Statistics/ Updates

- IRS has moved on to processing 226Js for more complicated cases
- IRS is not processing 226Js for aggregated group filers
- Expects to move on to 2016 in August/September
- Both “A” and “B” penalties are now being worked on
- Name on Business Master File not name on 1094-C
- IRS states that 30K+ 226J letters have gone out so far totaling $4.4 billion in assessments
Statistics/ Updates

• Paper filers beware, SCRIPPS program not scanning properly into the AIR system, paper filer letters will be going out
• New TIN Discovery Service, hopeful to eliminate “accepted with errors” in the next filing season
• IRS identified 49,259 potential liable employers who did not offer coverage at all or the offer was unaffordable
• IRS has spent $2.3 million on system upgrades to proceed with review and issuance of 226J letters, it’s not going away any time soon!

3A-30
## 2018 Reporting

### DRAFT AS OF JUNE 11, 2018
**DO NOT FILE**

**1095-C**

Employer-Provided Health Insurance Offer and Coverage

1. Name of employee (first name, middle initial, last name)
2. Social Security number (SSN)
3. Street address (including apartment number)
4. City or town
5. State or province
6. Country and other foreign work code
7. City of work
8. State of work
9. Country and other foreign work code

### Part I
Employee Offer of Coverage

<table>
<thead>
<tr>
<th>Start Month</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
</tr>
</tbody>
</table>

### Part II
Covered Individuals

- Employee provided self-insured coverage, check the box and enter the information for each individual enrolled in coverage, including the employee.

<table>
<thead>
<tr>
<th>Name of covered individual</th>
<th>SSN or other TIN</th>
<th>ID number of issuer or sponsor of the plan</th>
<th>Month(s) of Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Jan</td>
</tr>
<tr>
<td>17</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>21</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 9268M

Form 1095-C 2018
Continue to Watch Your Codes!

• Watch out for months with the following line 14 codes:
  – Blank or 1H—No offers of coverage
  – 1B, 1D, 1F—Inadequate offers of coverage

• Watch out for months without any line 16 code:
  – 2C—Enrollment in employer’s group health plan
  – 2A, 2B—Indicates a non-full-time employee
  – 2D, 2E, 2I—Various forms of relief
  – 2F, 2G, 2H—Affordability safe harbors
2019 Future

• Electronic filing proposal: The 250 limit for filing electronically would be changed in 2019 to adding all forms 1095-B, 1095-C, 1099 and W-2 together.

• An employer that produces 200 1095-Cs and 200 W-2s would now have a total of 400 and would be required to file electronically.

Stay tuned!
2019 Future

• Continue with 1095-B reporting?
• Continue with 1095-C Part III?
• 2 states enacted individual mandate for their state. States want to “piggy-back” on reporting of coverage via the 1095-C
• We will have to see what the future brings!
Questions?