MARSH & McLENNAN AGENCY

REFORM UPDATE

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December 11, 2017

IRS ASSESSING PENALTIES FOR THE 2015 "PAY OR PLAY" MANDATE

The IRS recently updated the Questions and Answers section of their website which addressed the employer shared responsibility requirements of the Affordable Care Act (ACA). These requirements are commonly referred to as the "pay or play" mandate.

Beginning in 2015, the ACA required Applicable Large Employers (ALEs) to offer full-time employees (i.e., those regularly expected to work at least 30 hours per week) health coverage or face potential penalties. An ALE is basically an employer with 50 or more full-time and full-time equivalent employees.

Two potential, mutually exclusive penalties could be applied to employers for 2015:

A. **No Coverage -** $2,080 per full-time employee excluding the first 30 full-time employees. This penalty applies if the employer fails to offer substantially all of its full-time employees and their dependent children minimum essential coverage (MEC), and at least one full-time employee purchases subsidized coverage in the Marketplace.

B. **No Minimum Value or Unaffordable Coverage** - $3,120 for each full-time employee who receives a premium tax credit for Marketplace coverage. This penalty only applies if the employer failed to offer the employee and dependent children minimum value / affordable coverage, and that employee subsequently purchased subsidized coverage in the Marketplace.

The exposure under the "no coverage" penalty is significantly greater to most employers because the penalty is applied to all full-time employees less the first 30 (80 in 2015). The other penalty applies only to the individual full-time employees who purchased subsidized coverage in the Marketplace.

The IRS has indicated that penalty letters will be sent in 2017. The penalty process will include the following steps:

1. Issuance of the penalty letter, called Letter 226J. It will include two additional forms:
   a. Form 14765 – A table that indicates all full-time employees who purchased subsidized coverage in the Marketplace.
   b. Form 14764 – The employer response form. This allows employers to affirm or dispute the penalties being assessed. Employers have 30 days to respond to Letter 226J.
2. If an ALE disputes the applicability of specific penalties and submits Form 14764, they will receive a response Letter 227 from the IRS. There will be several versions of Letter 227 that will indicate if the IRS agrees with the employer on the penalty applicability.
3. If the ALE still does not agree with the IRS assessment included in Letter 227, they can follow the instructions provided in Letter 227 and Publication 5 to request a pre-assessment 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.

4. If the employer fails to respond to Letter 226J or any Letter 227, the IRS will assess the amount of the proposed penalty. The IRS will issue a notice and demand for payment (Notice CP 220J). This Notice will include a summary of the penalty, and will reflect payments made, credits applied, and the balance due, if any. The Notice will instruct the ALE on the process to make a payment. ALEs are not required to include the penalty on any tax returns or to make payment before receiving the notice and demand for payment. In addition, ALEs may have the ability to make installment payments, as described in Publication 594.

Employers need to keep an eye out for Letter 226J. It will likely be sent to the contact listed on the 2015 Form 1094-C submitted in 2016. This Reform Update will discuss the penalty process in more detail.

LETTER 226J

A full sample copy of Letter 226J can be found at https://www.irs.gov/pub/notices/ltr226j.pdf.

The first page will look like this:

IRS

Department of the Treasury
Internal Revenue Service
Group 2219
7300 Turfway Road, Suite 410
Florence, KY 41042

Tax year:

Letter date:

Employer ID number:

Contact name:

Contact ID number:

Contact telephone number:

Contact e-fax number:

Response date:

Dear

We have made a preliminary calculation of the Employer Shared Responsibility Payment (ESRP) that you owe.

Proposed ESRP $ [XXXXXX]

Our records show that you filed one or more Forms 1095-C, Employer-Provided Health Insurance Offer and Coverage, and one or more Forms 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, with the IRS. Our records also show that for one or more months of the year at least one of the full-time employees you identified on Form 1095-C was allowed the premium tax credit (PTC) on his or her individual income tax return filed with the IRS. Based on this information, we are proposing that you owe an ESRP for one or more months of the year.

The Proposed ESRP will be the most important part of this page. This is the penalty related to the 2015 ACA shared responsibility requirements. The letter provides a description of both potential penalties that can be assessed. It also explains the Forms 14765 and 14764 which will be included with the letter.

The letter recommends that you have access to the Forms 1094-C and 1095-C, filed for 2015, to use for reference when you review the letter and the accompanying forms.

The letter then provides instructions:

If you agree with the proposed ESRP

- Complete, sign, and date the enclosed Form 14764, ESRP Response, and return it to us by the Response date on the first page of this letter.
- Include your payment of [XXXXXX]. If you're enrolled in the Electronic Federal Tax Payment System (EFTPS), you can pay electronically instead of by check or money order.
- If you don't pay the entire agreed-upon ESRP, you will receive a Notice and Demand (your "bill") for the balance due. For additional payment options, refer to Publication 594, The IRS Collection Process, or call the telephone number on your bill. We will begin the collection process if you do not make payments in full and on time after you receive your bill.

If you agree, indicate that on Form 14764. You may include payment with that form when you return it to the IRS. If you don't pay the entire amount, you will receive a bill in the form of a notice and demand for payment. You can look to Publication 594 for a description of the payment options.

If you disagree with the proposed ESRP

- Complete, sign, and date the enclosed Form 14764, ESRP Response, and send it to us so we receive it by the Response date on the first page of this letter.
  - Include a signed statement explaining why you disagree with part or all of the proposed ESRP. You may include documentation supporting your statement.
  - Make sure your statement describes changes, if any, you want to make to the information reported on your Form(s) 1094-C or Forms 1095-C. Do not file a corrected Form 1094-C with the IRS to report any changes you want to make to your Form 1094-C filed for the tax year shown on the first page of this letter.
  - Make changes, if any, on the **Employee PTC Listing** using the indicator codes in the Instructions for Forms 1094-C and 1095-C for the tax year shown on the first page of this letter. Do not file corrected Forms 1095-C with the IRS to report requested changes to the Employee PTC Listing; and
  - Include your revised Employee PTC Listing, if necessary, and any additional documentation supporting your changes with your Form 14764, ESRP Response, and signed statement.

Letter 226J (10-2017)
Catalog Number 67905G

If you don't agree with all or part of the assessed penalty, you must use Form 14764 to indicate this. You should include a signed statement that explains why you disagree with all or a portion of the penalty. If you need to make corrections to the Employee PTC listing (Form 14765), explain the changes you are making in your signed statement. Also, make the changes directly on the Employee PTC listing, by using the indicator codes you would use on a Form 1094-C or 1095-C. You are not required to file corrected statements with the IRS; simply include the corrections on the Employee PTC listing and your statement with the Form 14764 that you return to the IRS.

Letter 226J will also include a table called the ESRP Summary Table:

ESRP Summary Table

	Information Reported to IRS						
Month	**a.** **Form 1094-C, Part III, Col (a)** **Minimum essential coverage offer indicator offered to at least (70% or 95%)**	**b.** **Form 1094-C, Part III, Col (b)** **Full-time employee count for ALE member**	**c.** **Allocated reduction of full-time employee count for IRC Section 4980H(a)**	**d.** **Count of assessable full-time employees with a PTC for IRC Section 4980H(a)**	**e.** **Count of assessable full-time employees with a PTC for IRC Section 4980H(b)**	**f.** **Applicable IRC Section 4980H provision**	**g.** **Monthly ESRP amount**
Jan	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Feb	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
March	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Apr	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
May	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
June	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
July	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Aug	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Sep	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Oct	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Nov	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
Dec	[Yes/No]	[xxx]	[xx]	[x]	[x]	[4980H(a)/4980H(b)	[$xx,xxx]
						Total Proposed ESRP	[$xxx,xxx]

This shows employers the months where penalties apply and explains the derivation of the penalties. Is the penalty amount in column G related to the A penalty (no coverage) or the B penalty (no minimum value/affordable coverage)?

Letter 226J provides a detailed explanation of each column in the summary table to help employers understand how the penalty amounts were calculated.

The letter will include a number of references to IRS publications to aid employers in understanding the penalty determination.

FORM 14765

Every Letter 226J should include Form 14765. A sample of Form 14765 can be found at https://www.irs.gov/pub/irs-pdf/f14765.pdf.

This form is called the Employee Premium Tax Credit Listing:

Form **14765** (April 2017)

Department of the Treasury - Internal Revenue Service

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 assessable full-time employee for that month.

Employer name	Employer ID number	Tax year

Employee Name *(last, first)*	SSN *(last 4 digits)*	All 12 months Indicator Codes *(Form 1095-C, lines 14 and 16 combined)*	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Additional Information Attached
															☐
															☐
															☐
															☐
															☐
															☐

It will include all full-time employees who received a tax credit to purchase subsidized coverage in the Marketplace, whose Form 1095-C did not include a safe harbor code or other relief code from the tax penalty.

The Letter 226J includes instructions on how to make changes to the Employee PTC listing:

Specific instructions for making changes to the Employee PTC Listing

- If the information reported on an assessable 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 16 that are described in the Instructions for Forms 1094-C and 1095-C. Make any changes, for each employee, as necessary, by entering new codes on the 2nd row of each monthly box.
- When making changes, first enter the indicator code for line 14 and then enter the indicator code for line 16. Separate the two codes with a slash (e.g., 1H/2A).
- If the same indicator code applies for all 12 months of the calendar year, enter that code in the "All 12 Months" column, and do not make entries for any of the months.
- If you are providing additional information about the changes for an employee, enter a check in the column titled "Additional Information Attached." Otherwise, leave this column blank.

NOTE: If more than one indicator code could apply for a month, enter only one code for that month on the Employee PTC Listing. Note any additional indicator codes that could apply for the affected employee in your signed statement. Include the employee's name, the applicable months and the additional indicator codes for each month.

We will review what you submit and will contact you.

Letter 226J (X-2017)
Catalog Number 67905G

If you need to make any changes to the codes indicated on Form 14765, use the codes available for lines 14 and 16 on Form 1095-C. You can indicate changes for the months that need correcting on the second row that applies to the employee. You should include both the line 14 and line 16 codes, with a slash in between. For example, if you need to correct the code for an individual who was not offered coverage because he was in a waiting period, enter 1H/2A on the second row related to that employee. Code 1H indicates no offer of coverage and Code 2A means the individual was not employed during that month or in a limited non-assessment period. If you are including additional information to support the changes you are making, check the box in the far right column and include the information with Form 14764.

The IRS reminds you to ensure your statement is signed and the documents are submitted. You also need to make sure the tax year and your EIN are entered at the top of this form.

FORM 14764

All Letters 226J should include Form 14764. A sample of the Form 14764 can be found at https://www.irs.gov/pub/irs-pdf/f14764.pdf.

Employers should complete the ESRP Form, even if they agree with the proposed penalty being assessed:

Form **14764** (April 2017)

Department of the Treasury - Internal Revenue Service

ESRP Response

Complete both sides of this form and return it to the address below so that we receive it by [MM/DD/YYYY]. An envelope has been enclosed for your convenience. To request more time to respond, call us at 1-[XXX-XXX-XXXX].

Return form to: Department of the Treasury
Internal Revenue Service
Group 2219
7300 Turfway Road, Suite 410
Florence, KY 41042

Provide Your Contact Information

Name

Address *(if you changed your address, make the changes below)*

Primary telephone number	Best time to call

Secondary telephone number	Best time to call

Indicate Your Agreement or Disagreement

Agreement with proposed assessment

☐ I consent to the assessment and collection of the of the proposed assessment of the ESRP in the amount of [$0.00]

The first part of this form includes the due date of the response. If an employer needs more time to respond, they may call the IRS to request additional time. Include the contact information of the individual who should be contacted about any disagreement with the penalty amount, and the best time to reach that individual. This is also where the employer should indicate if they agree or disagree with all or part of the proposed penalty.

If an employer disagrees with the penalty amount, they should include the following when returning the form to the IRS:

- A signed statement explaining why you disagree with all or a portion of the penalty.
- Any additional documentation that supports your contention that penalties should not apply.
- If you made corrections to the Employee PTC listing (Form 14765), explain the changes you are making in your signed statement.

The Form also permits you to pay all or part of the proposed penalty. You can select "no payment," and the IRS will issue a demand for payment if there is agreement that at least a portion of the penalty applies.

Indicate Your Payment Option *(check all that apply)*

- ☐ Full payment using EFTPS on
- ☐ Partial payment using EFTPS on
- ☐ Enclosed full payment of $
- ☐ Enclosed partial payment of $
- ☐ No payment

- Write your employer ID number ([NN-NNNNNNN]), the tax year [(2015)] and ESRP on your payment and any correspondence.
- Make your check or money order payable to the United States Treasury.

Finally, this form allows you designate another authorized contact on page 2:

Authorization *(optional)*

If you would like to authorize someone, in addition to you, to contact the IRS concerning this proposed ESRP matter, please include the person's information, your signature, and the date.

The authority granted is limited as indicated by the statement above the signature line. The contact may not sign returns, enter into agreements, or otherwise represent you before the IRS. If you want to have a designee with expanded authorization, see IRS Publication 947, Practice Before the IRS and Power of Attorney.

Full name of authorized person			
Address			
City	State	Country	Zip code
Primary telephone number		Best time to call	

This part is optional. You may want to designate an additional contact if your primary contract is difficult to reach via phone.

LETTER 227

At this point, the IRS has not released any samples of Letter 227. However, the Questions and Answers on their website indicate that there will be at least five versions of this letter. It will provide a response to the employer who disagreed with any penalty assessed. It may request more information that supports the employer's position.

Letter 227 may also disagree with the employer's response and indicate that the IRS intends to levy the penalty.

REQUEST FOR CONFERENCE

If the IRS disagrees, yet the employer maintains the position that the penalty should not apply, the employer can request a pre-assessment conference with the IRS Office of Appeals.

Letter 227 will include instructions for requesting a conference. The employer can also reference IRS Publication 5 for more details, which is found at https://www.irs.gov/pub/irs-pdf/p5.pdf.

Employers will have 30 days from the date of Letter 227 to request the conference with the Office of Appeals.

CONCLUDING THOUGHTS

These penalty notices could not come at a worse time for most employers. Many are working through open enrollment issues, getting ready to issue W-2s and 1095-Cs, and preparing for the holidays.

It is critical that you address this letter shortly after receiving one. Timing is tight. You will have only 30 days to respond, and you may need that time to make specific arguments as to why a certain penalty amount may not apply.

It is also important to remember that a significant amount of transitional relief was available in 2015. It is not clear if the IRS will take this into consideration when proposing penalties. However, the employer can reference the transitional relief when challenging the penalty determination. Transitional relief available in 2015 is summarized on the next two pages.

Be prepared to respond to IRS Letter 226J. The IRS did not provide any further details on when these letters would be mailed, other than in late 2017. You may want to make sure you have access to the Forms 1094-C and 1095-C submitted to the IRS in 2016. You will likely need these forms to investigate any proposed penalties.

2015 TRANSITIONAL RELIEF

- ***Penalties Delayed for Employers (50-99 employees) -*** A number of provisions had to be met for an employer to qualify for this delay. The following summarizes the requirements:
  - The 50-99 determination was based on IRS controlled group rules.
  - The 50-99 determination was made in the same manner as the 50 or more determination for an ALE. Both full-time employees and full-time equivalent employees were counted.
  - To be eligible for this delay, the employer had to certify that it met the following conditions:
    - **Limited Workforce Size** – Certify that your full-time employees and equivalents fell between 50-99.
    - **Maintenance of Workforce and Aggregate Hours of Service** – From February 9, 2014 to December 31, 2014, the employer did not reduce the size of their workforce or overall hours of service worked in order to qualify for transitional relief. A reduction was permitted only if it was the result of a bona fide business reason.
    - **Maintenance of Previously Offered Health Coverage** - From February 9, 2014 to December 31, 2015, the employer did not eliminate or materially reduce health care coverage that was offered as of February 9, 2014. For non-calendar year plans, the reduction in health care coverage could not occur before the last day of the 2015 plan year. An employer would not be treated as eliminating or reducing coverage if:
      - It continued to offer employer funding for coverage that was at least 95 percent of the employer contribution on February 9, 2014, or the employer offered the same contribution percentage.
      - If benefits were modified, the plan retained minimum value after any benefit changes.
      - The employer did not alter the terms of eligibility for the group health plan to narrow or reduce the class of employees or dependents offered coverage under the plan as of February 9, 2014.
- ***Reduced "Substantially All" Threshold for Employers with 100 or More Employees -*** To avoid the "no coverage" penalty, an employer had to offer "substantially all" full-time employees and their children MEC. "Substantially all" was defined as 95 percent of full-time employees. However, for 2015, it was reduced to 70 percent of full-time employees. The no minimum value/affordable coverage penalty can still apply if any of the remaining 30 percent of full-time employees, not offered coverage, purchases subsidized coverage through the Marketplace.
- ***Non-Calendar Year Plan Transitional Guidance -*** As long as certain conditions are met, non-calendar year plans could comply with "pay or play" on their plan year. This relief applied to non-calendar year plans as of December 27, 2012 and only if the plan year was not modified after December 27, 2012. In order to be eligible to delay compliance to the first day of the plan year, employers had to meet one of the following two tests:

  A. Did the plan offer coverage to at least 33 percent of all employees at the most recent open enrollment period before February 9, 2014?

  OR

  B. Did the plan *cover* at least 25 percent of all employees? For this test, employers can use enrollment as of any date between February 10, 2013 and February 9, 2014.

2015 TRANSITIONAL RELIEF, CONT.

The final regulations allow employers to conduct these tests on full-time employees only; however, different percentages apply:

A. Did the plan offer coverage to at least **50 percent of all full-time employees** at the most recent open enrollment period before February 9, 2014?

OR

B. Did the plan *cover* at least **33 percent of all full-time employees?** For this test, employers can use enrollment as of any date between February 10, 2013 and February 9, 2014.

- ***Increased the exclusion under the no coverage penalty.*** For 2015, it is the number of full-time employees less the first 80. The “first 80” applies to all members of the IRS control group. If part of an IRS control group, then that 80 is pro-rated amongst all members of the control group.
- ***Transitional relief for plans that did not offer coverage to dependent children* –** More time was provided to employers if their plan:
  1. Did not offer coverage to dependent children.
  2. Offered coverage to some, but not all, dependent children.

The transitional relief did not apply if the employer offered dependent child coverage in either the 2013 or 2014 plan years. If an employer did not offer coverage to all dependent children or only to some dependent children, they had extra time to add coverage for these children. As long as employers were taking steps in 2014 and 2015 to cover the children that were not offered coverage in 2013 and 2014, then the employer had until 2016 to provide access to this coverage.