

Employer Mandate Penalties: Letter 226J

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Questions: I work for an Applicable Large Employer (ALE) and we just received a Letter 226J from the IRS stating that we owe an Employer Shared Responsibility payment. We offered minimum essential coverage (MEC) to all of our full-time employees and their dependents. The coverage provides minimum value and is affordable, too. Can you explain why we were assessed a penalty? How does the penalty process work? What should our next steps be?

Summary:

On June 17, 2021, the U.S. Supreme Court rejected a lawsuit that would have called the constitutionality of the Employer Shared Responsibility provisions of the Affordable Care Act (ACA) into question. As such, all provisions of the Employer Shared Responsibility mandate remain in place.

Several years ago, the IRS began sending "Letters 226J" to enforce the Employer Shared Responsibility rules. Under the Employer Shared Responsibility provisions, Applicable Large Employers (ALEs) are required to offer minimum essential

coverage (MEC) to substantially all (at least 95%) of their full-time employees and their dependents or else they may be subject to the 4980H(a) penalty. ALEs are also required to offer minimum value, affordable coverage to full-time employees. If this requirement is not met, the ALE may be subject to the Section 4980H(b) penalty. Penalties under Section 4980H are triggered by employees who receive subsidized coverage on an Exchange by way of a premium tax credit (PTC).

The ACA requires ALEs to offer affordable, minimum value health coverage to their full-time employees and dependents or else pay a penalty.



Detail:

4980H Overview:

The ACA requires ALEs to offer affordable, minimum value health coverage to their full-time employees and dependents or else pay a penalty. ALEs are those employers that employ, on average, at least 50 full-time employees (FTs), including full-time equivalent employees (FTEs) during the preceding calendar year. Remember that ALE status is determined on a related employer basis which encompasses controlled groups, affiliated service groups and employers under common control. In the context of reporting, the term used for related employers is “Aggregated ALE.” Whether or not a particular employer is subject to an assessable penalty and the amount of that penalty, however, is determined on an ALE member by member basis. The liability for and the amount of the Employer Shared Responsibility penalty takes into account whether each ALE member offered the required coverage.

Employer Shared Responsibility penalties are triggered if (and only if) one or more full-time employee obtains a subsidy through an Exchange. To be eligible for a subsidy an employee’s household income must be between 100% and 400% of the federal poverty level (FPL). Those employees who apply for subsidies will also be screened for Medicaid and the state children’s health insurance program (CHIP) eligibility and if found to be eligible for those programs they will be enrolled in those programs and will not be eligible for Exchange subsidies. Individuals who are offered employer sponsored coverage can only obtain subsidies for Exchange coverage if, in addition to other criteria above, they are not enrolled in their employer’s coverage and their employer’s coverage is either unaffordable or does not provide minimum value.

There are two potential penalties under the Employer Shared Responsibility provisions of the ACA: the Section 4980H(a) penalty and the Section 4980H(b) penalty. The good news is that only one of those penalties will apply for an ALE in a particular situation-both cannot apply at the same time to the same ALE. Both of the penalties are assessed on a monthly basis.

The (a) penalty: An ALE will be subject to the Section 4980H(a) penalty if it doesn’t offer coverage to substantially all full-time employees and dependents and any of those full-time employees who did not receive an offer of coverage receives an Exchange subsidy. An ALE satisfies the “substantially all” requirement if it offers coverage to at least 95% of its full-time employees and dependents. The monthly penalty amount assessed on ALEs that do not offer coverage to substantially all full-time employees and dependents is equal to the ALE’s number of full time employees (minus 30) x 1/12 of \$2,000 for any applicable month (see below for penalty amounts adjusted by year). Employees who are in a limited non-assessment period are not included in the penalty calculation. The Section 4980H(a) penalty is indexed by the premium adjustment percentage for the calendar year. The adjusted Section 4980H(a) penalty amounts are as follows:

- \$2,080 for 2015
- \$2,160 for 2016
- \$2,260 for 2017
- \$2,320 for 2018
- \$2,500 for 2019
- \$2,570 for 2020
- \$2,700 for 2021
- \$2,750 for 2022

The (b) penalty: Even if an ALE offers coverage to substantially all full-time employees and their dependents, it may still be subject to the (b) penalty if at least one full-time employee received subsidized Exchange coverage either because 1) the ALE did not offer coverage to all full-time employees or 2) the ALE's coverage offered is unaffordable or does not provide minimum value.

An employer's coverage is considered affordable if the employee's required contribution for the lowest cost of self-only minimum value coverage does not exceed 9.5% (adjusted annually) of the employee's household income for the year. Household income is information that the employer will generally not have, so the employer will have to rely on one of three affordability safe harbors provided by the IRS: 1) the Form W-2 safe harbor, 2) the rate of pay safe harbor, or 3) the federal poverty line safe harbor. The contribution percentage on which affordability is based is adjusted annually for inflation. Here are the amounts as adjusted:

- 9.56% for 2015
- 9.66% for 2016
- 9.69% for 2017
- 9.56% for 2018
- 9.86% for 2019
- 9.78% for 2020
- 9.83% for 2021
- 9.61% for 2022

As to the minimum value determination, employer sponsored coverage will not be determined to provide minimum value if the plan's share of total costs of benefits provided under the plan is less than 60% of those costs and/or the plan doesn't provide coverage for in-patient hospitalization or physician services.

If an ALE member owes this penalty, the annual payment will be \$3,000 for each full-time employee who received the premium tax credit (see below for penalty amounts adjusted by year). This penalty is also assessed on a monthly basis, so the ALE member who owes the payment will pay 1/12 of the Section 4980H(b) penalty per month for each full-time employee who received the premium tax credit. Here are the penalty amounts, as adjusted for inflation:

- \$3,120 for 2015
- \$3,240 for 2016
- \$3,390 for 2017
- \$3,480 for 2018
- \$3,750 for 2019
- \$3,860 for 2020



- \$4,060 for 2021
- \$4,120 for 2022

Offer of Coverage:

Employees must be offered an effective opportunity to accept coverage or decline to enroll in coverage in order to be treated as having been offered the coverage for purposes of the Employer Shared Responsibility rules. This offer has to be made at least once per plan year. Employees must also have an effective opportunity to decline an offer of coverage that doesn't provide minimum value or isn't affordable. If an ALE fails to offer coverage to full time employees for any day of a calendar month during which the employee was employed, the employee is treated as not being offered coverage during that entire month.

Letter 226J

The general procedures the IRS will use to propose and assess the Employer Shared Responsibility penalties are described in the Letter 226J, issued to an ALE if the IRS determines that, for at least one month in the year, one or more of the ALE's full-time employees was enrolled under an Exchange for which a premium tax credit was allowed (and the ALE did not qualify for an affordability safe harbor or other relief for the employee).

ALEs will have an opportunity to respond to the letter before any Employer Shared Responsibility liability is assessed and notice and demand for payment is made. The Letter 226J will provide instructions for how the ALE should respond in writing, either agreeing with the proposed Employer Shared Responsibility penalty or disagreeing with part or all of the proposed amount.

If the ALE responds to the letter, the IRS will acknowledge the ALE's response with an appropriate version of Letter 227 – a series of five different letters that acknowledge the ALE's response to the Letter 226J, provide for a full dismissal or adjustment of penalties, 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 penalty, the ALE 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, *Your Appeal Rights and How To Prepare a Protest if You Don't Agree*, 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 Employer Shared Responsibility penalty and issue a notice and demand for payment—Notice CP 220J. At this point in time, interest will begin to run if the penalty is not paid in full immediately.

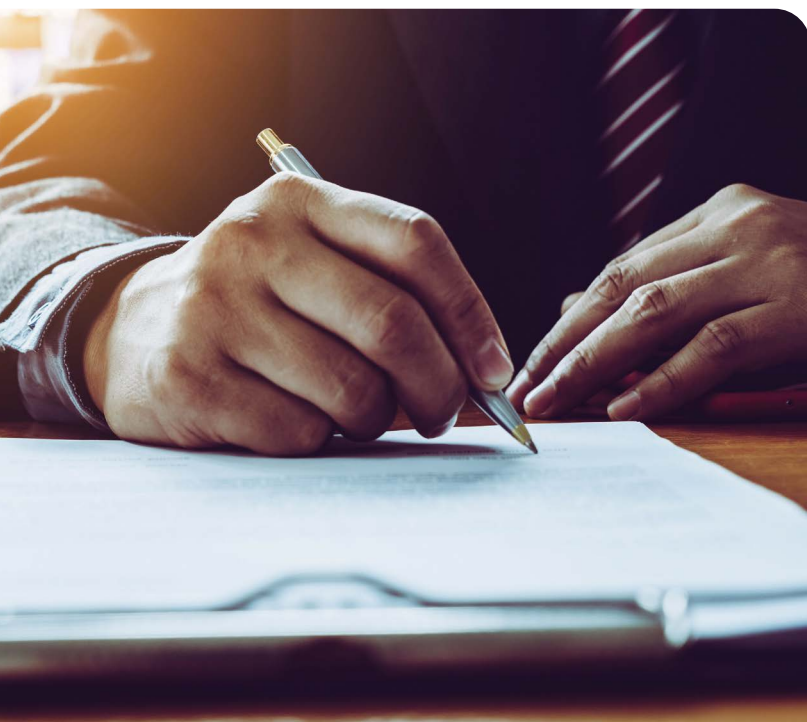
Responding to Letter 226J

ALEs are required to respond within 30 days from the date of the Letter 226J. Because these letters can be easily misplaced or misdirected and take a while to land in the right hands within an organization, appropriate personnel should be designated to be on the lookout for these letters and it might be prudent reach out immediately to the IRS to get an extension upon receipt.

Many times these penalties are related to simple clerical errors made when completing the IRS Forms 1094-C and 1095-C. Here are some recommendations and things to

consider as you review the Letter 226J and prepare your response:

1. Print off copy of Letter 226J and read the letter in its entirety— carefully review the ESRP Summary Table and Employee Premium Tax Credit (PTC) Listing.
2. Pull all copies of the filed Forms 1094-C and the 1095-C for each employee listed on the employee premium tax credit listing contained within the 226J Letter. The IRS does make mistakes and it is important to cross reference the original forms with the information set out on the ESRP Summary Table and Employee PTC Listing.
3. Get your team together to gather information you need to refute or disagree with the IRS. This will help to facilitate a quicker, more accurate response. Discuss the letter with your payroll vendor or employer reporting solution vendor who may have assisted with filings. There could be a disconnect between the information provided to the reporting vendor and the information the vendor reported to the IRS. It is also wise to contact your CPA or legal counsel immediately upon receipt of Letter 226J.
4. On Form 1094-C, look for the following common errors:
 - Did you mark **Yes** or **No** under Part III, Column (a) MEC Indicator Offer, Lines 23-35? If you answered **No**, double check that you indeed did offer MEC to 95% of full-time employees and their dependents. We are seeing **No** under this MEC indicator as a common mistake when offers really were made to 95% all 12 months or part of non-calendar year.
 - Did you submit one authoritative transmittal for each EIN? See Line 19 (page 6 of the 2015 instructions).
 - Did you mark **Yes** or **No** on line 21, indicating that you either are or are not part of an Aggregated ALE group? If you did mark **Yes**, check to be sure Part IV of Form 1094-C was completed and all members of the Aggregated ALE group were listed.
 - Did you accurately report your full time employees in Column (b) Part III? This is only full time per the ACA standard of 130 hours per month and is a key part of IRS penalty calculation. Full-time employees must be identified using either the monthly measurement or look back measurement method. An ALE should not include employees in a limited non-assessment period in this calculation (waiting period, or measurement period determining full-time status for a variable hour employee).
5. On the Form 1095-C for any employee receiving a premium tax credit:



- Review each code not highlighted in yellow on the PTC listing of employees for accuracy. Compare the PTC listing to the Forms 1095-C submitted to the IRS.
 - Was the employee enrolled in coverage? We have seen some employees receive a PTC even though enrolled in the employer sponsored coverage.
 - If the employee was not enrolled in coverage was an offer made that met one of the three affordability safe harbors? It is a common mistake is to leave Line 16 blank when the offer was declined, which indicates to the IRS that an offer may not have been affordable.
 - If an offer was not made, was the employee in a waiting period, or not employed for that month? A common mistake is to leave Line 16 blank when an offer is not made.
6. If assessed an (a) penalty, take a look at the allocated reduction provided by the IRS. There is an allowed reduction of 30 full time employees. If the employer is an Aggregated ALE, that reduction is allocated to each ALE member based on the number of full-time employees employed by each ALE member during a calendar month.
 7. If you agree with the proposed penalty assessed, complete Form 14764, ESRP Form, and submit the payment in full.
 8. If you disagree with proposed ESRP, take the following steps:
 - Step 1: Complete Form 14764, ESRP Form and indicate that you disagree with part or all of the proposed assessment.
 - Step 2: Prepare a written statement providing detailed clarifying information as to why the penalty should not apply. Include information about both Section 4980H(a) and (b) if penalties are assessed under both. Address the situation relating to each and every employee set out on the Form 14765, Employee

Premium Tax Credit Listing.

Step 3: Include supporting documentation, such as proof of declination of offer of coverage or payroll reports showing that employee was not full-time for the months in question.

Step 4: Make corrections on Form 14765, Employee Premium Tax Credit Listing. You should correct any incorrect 1095-C codes as well as fill in any appropriate missing codes for any months where a penalty is being assessed. Note that the Letter 226J states that the client should describe any appropriate changes to the Form 1094-C in its written statement but not to file the corrected Forms with the IRS.

9. Sign the Form 14764 and be sure to keep copies of everything submitted to the IRS as part of your Letter 226J response.
10. Check your other Forms 1094-C and 1095-C to see if you repeated the same mistakes. If so, consider correcting those now before another penalty is levied.

Paying a Penalty:

If, after correspondence between the ALE and the IRS (or a conference with the IRS Office of Appeals), the IRS or IRS Office of Appeals determines that an ALE is liable for an Employer Shared Responsibility penalty, the IRS will assess the Employer Shared Responsibility penalty and issue a notice and demand for payment (Notice CP 220J). Notice CP 220J will include a summary of the Employer Shared Responsibility penalty and reflect any payments made, credits applied and the balance due, if any; and instruct the ALE how to make a payment, if any. For payment options, such as entering into an installment agreement, ALEs should refer to Publication 594, The IRS Collection Process.

Conclusion:

With only 30 days to respond to a Letter 226J, ALEs must act quickly and those who receive a Letter 226J may want to consider calling the IRS to request an extension. ALEs should contact any reporting vendor and benefits consultant who assisted with the employer reporting process.



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