

The Baldwin Regulatory Compliance Collaborative

ACA Information Reporting Responding to IRS Letter 226-J



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Evaluating and Responding to ACA-related Compliance Deficiencies Alleged in an IRS Letter 226-J

*Part One: Introduction to IRS Letter 226-J & ACA “Pay or Play” Penalty Assessments**

Pursuant to compliance requirements contained within the Affordable Care Act (the “ACA”), applicable large employers (“ALEs”) are required to offer affordable, minimum essential coverage that provides minimum value to at least 95% of their full-time employees; otherwise, the ALE may be subject to monetary penalties, as detailed in IRC Section 4980H (specifically, the Employer Shared Responsibility Provisions of the ACA). In order to satisfy the ACA’s enforcement expectations arising with respect to the ACA’s coverage obligations, the IRS utilizes Letter 226-J to advise ALEs of alleged compliance deficiencies which may ultimately result in an assessment of monetary penalties. Specifically, to the extent the following conditions exist (or existed) respecting an ALE, the employer may be subject to an assessment of monetary penalties:

- ***Respecting at least one month within any calendar year:***
 - 1) **One or more of the ALE’s employees was enrolled in a qualified health plan (“QHP”) not sponsored by the ALE;**
 - 2) **Respecting such enrollment, a premium tax credit was granted or issued to the benefit of such employee; and,**
 - 3) **The ALE did not qualify for an exception to the employer shared responsibility penalty assessment respecting such months of qualifying enrollment by the employee or employees; wherefore,**
 - 4) **The ALE may be subject certain monetary penalties, assessed by the IRS in accordance with the applicable limits imposed under the provisions of IRC Section 4980H of the ACA, and as may be communicated to the employer via an IRS Letter 226-J.**

**Note: There are different types of letters the IRS issues in relation to the “Pay or Play” Employer Mandate and its underlying employer information reporting requirements; however, this employer tool kit focuses solely on IRS Letter 226-J. Additional employer resources are included in the final section hereof.*

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IRS Letter 226-J is the initial communication from the agency to an allegedly non-compliant ALE (that is, to the extent the agency has made an initial assessment that the ALE may not have complied with the individual requirements of the employer mandate relative to the quality, affordability, or scope of coverage available under the ALE’s GHP). Remember, Letter 226-J is merely an initial assessment, rather than an actionable and enforceable monetary penalty respecting such employer. In other words, think of the Letter 226-J as the starting point for evaluation, negotiation, and potentially, settlement of alleged ACA-related employer monetary penalties.

**TABLE ONE:
Unpacking Letter 226-J – Components of a Proposed ESRP Assessment**

Item:	Overview:
(1) Penalty Explanation	An explanation of the Employer Shared Responsibility Penalty (“ESRP”) proposed by the IRS with respect to alleged ACA-related compliance failures, as detailed by the IRS in the Letter.
(2) ESRP Summary Table	An ESRP summary table itemizing the monetary penalties proposed by the IRS on a month-by-month / employee-by-employee basis respecting the evaluation of such calendar year.
(3) Form 14764, ESRP Response	An IRS Form 14764, ESRP Response is also included with the Letter 226-J which provides the employer with the procedural means for responding to the proposed penalty assessment.
(4) Form 14765, EPT Listing	An IRS Form 14765, Employee Premium Tax Credit (“PTC”) Listing, providing an inventory of the full-time employees who claimed a premium tax credit for one or more months, respecting such year.
(5) Responsive Communications	Instructions for responding to Letter 226-J, including details on how, when, and where to send the ALE’s responsive communications.
(6) Overview of Penalty Enforcement and Collection	An overview of the agency’s enforcement authority and the range of potential opportunities consistent with which the agency may collect any such final non-compliance penalty assessment.

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Part Two: Understanding Why an ALE Receives a Letter 226-J

Utilizing the information provided by an ALE on Forms 1094 and 1095-C, as well as the agency's cross-referencing of other tax forms filed by the employer and the employee (*i.e.*, IRS Forms 1040, 1099, etc.), the IRS makes initial evaluations respecting an ALE's potential ESRPs. Then, the IRS communicates these proposed ESRPs to the applicable ALE via the Letter 226-J communication. Consequently, an ALE's receipt of a Letter 226-J was predicated upon the information the ALE and its employees provided to the agency in compliance with ACA related information reporting requirements.

Thus, despite its formal appearance and the finality of language utilized by the IRS in Letters 226-J, an ALE receiving such a Letter should deem the letter as merely opening the door for the ALE to provide the IRS with different types of responsive communications (generally, provided to the agency via Form 14764, the ESRP Response), either agreeing with, or objecting to, the agency's proposed ESRPs.

Part Three: Understanding Calculation of a Proposed ESRP

There are two distinct types of ESRPs for which the IRS may seek enforcement and collection. Referred to as "Part A" and "Part B" penalties, the following sections break down these agency-assessed penalty types:

- 1) The proposed ESRP detailed in the Letter 226-J is calculated according to a basic equation. The first part of the inquiry focuses on whether the ALE offered minimum essential coverage to at least 95% of its full-time employees ("FTEs") and their dependents (referred to as the "substantially all" standard). This information is generally reported by the ALE in Part III, column (a) of Form 1094-C. If any month was checked "no" in the original filing, this reporting will trigger a "Part A" proposed ESRP, respecting the ALE's failure to satisfy the "substantially all" standard. The "Part A" penalty is also sometimes referred to as the "sledgehammer penalty" because this penalty is assessed by evaluating the total count of an ALE's FTEs (minus the first thirty FTEs), calculated without regard to the total number of employees that received a premium tax credit.

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(continued from previous page)

Consequently, it only takes one full-time employee obtaining subsidized coverage from a federal or state health insurance marketplace to trigger a “Part A” penalty for an ALE.

- 2) If an ALE offered minimum essential coverage to at least 95% of its full-time employees and dependents, a penalty may still be triggered if the coverage offered by the ALE was not “affordable” (consistent with the standards imposed under the ACA’s Employer Shared Responsibility Provisions) or if the coverage was not valuable enough. In such instances, a “Part B” penalty is assessed respecting each FTE that obtained subsidized coverage from a federal or state health insurance marketplace. The “Part B” penalty differs from a “Part A” penalty in that a “Part B” penalty is calculated on an employee-by-employee. Thus, the Part B penalty is assessed based on the number of full-time employees that received a premium tax credit, rather than the ALE’s entire FTE population. For this reason, the “Part B” penalty is also referred to as the “tack hammer penalty.”

Note: Refer to Column (f) in the ESRP Summary Table of Letter 226-J to find an inventory of assessed penalties. This inventory will indicate whether an ALE’s assessed penalties arise from non-compliance with IRS Section 4980H(a) (which give rise to “Part A” sledgehammer penalties) or from non-compliance with IRS Section 4980H(b) (which give rise to “Part B” tack hammer penalties). The incorporated inventory also bifurcates the assessed penalties on a month-by-month accrual basis.

Part Four: Responding to the Letter 226-J

While there are multiple responses an ALE may offer the IRS upon receipt of a Letter 226-J, there are only a handful of responsive communications an ALE may offer the IRS respecting its receipt of a proposed ESRP. Notwithstanding performance of one of these generally accepted types of responsive communications, the IRS will not typically offer substantive responses to any other types of communications offered by employers in receipt of a Letter 226-J (excepting notices of representation, as may be filed by legal and/or tax advocates engaged to represent an individual taxpayer respecting its defense against a proposed ESRP).

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Following, Table Two outlines generally accepted responsive communication techniques an ALE may employ in responding to the IRS upon receipt of a Letter 226-J proposing an ESRP:

**TABLE TWO:
Letter 226-J Responsive Communication Opportunities & Strategies**

Response:	Summary:
(1) No Response	No response is absolutely a response. If an ALE fails to respond to Letter 226-J in any form whatsoever, the IRS will deem the ALE's failure to respond as the ALE's agreement with the proposed ESRP, converting its proposed ESRP into a final ESRP, initiating enforcement and collection opportunities available to the agency respecting the collection of same.
(2) Assent & Full Payment	The employer may elect to respond to the Letter 226-J by providing the IRS with payment in full respecting the proposed ESRP outlined in the Letter 226-J. Such response will, upon the agency's receipt and crediting of such payment, extinguish additional agency enforcement activities respecting such calendar year.
(3) Extension Request	The employer may request an extension of time from the IRS in order to prepare and submit its Form 14764, generally not to exceed thirty (30) days from the date of the deadline provided under the terms of the original Letter 226-J. Also, note that any deadline extension must be received by the IRS prior to the expiration of the response deadline provided under the terms of the original Letter 226-J.
(4) Partial Assent / Partial Objection with Payment	The employer may partially agree and partially object to the proposed ESRP based on particularized facts and circumstances unique to the employer. Here, the ALE should look to employ Letter 226-J's incorporated Form 14764, ESRP Response, as its avenue for defending any proposed ESRPs.
(5) Fully Object	The employer may fully object to the proposed ESRP based on particularized facts and circumstances unique to the employer. Here, the ALE should look to employ Letter 226-J's incorporated Form 14764, ESRP Response, as its avenue for defending any proposed ESRPs.

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An ALE must respond to Letter 226-J by the response date set out on page 1 of the letter in the top right-hand section (generally 30 days from the date of the letter). If more time is needed, the IRS may provide an extension. The ALE should contact the IRS at the telephone number listed at the top of page 1 of the letter or send a fax to the number listed at the top of page 1 of the letter requesting more time (generally, an additional 30 days to respond may be granted).

Part Five: Preparing the Form 14746, ESRP Response

Generally, an ALE with either agree or disagree with the terms of the ESRP contained within the Letter 226-J.

- 1) To the extent the ALE agrees with the terms of the proposed ESRP contained with the Letter 226-J, the employer should perform the following operations:
 - a) Complete, sign, and date the enclosed Form 14764, ESRP Response, and return it to the IRS by the response date provided on the first page of the Letter;
 - b) Include the payment amount demanded in the Letter. If the ALE is enrolled in the Electronic Federal Tax Payment System (EFTPS), they may pay electronically instead of by check or money order.
 - c) If the ALE elects not to pay the demanded amount in full, they will receive a Notice and Demand for the balance due.
 - d) For additional payment options, refer to Publication 594, The IRS Collection Process, or call the telephone number on the final bill.
 - e) The IRS will begin the collection process if the ALE does not make payment in full and on time after receiving the final bill.
- 2) To the extent the ALE disagrees with the terms of the proposed ESRP contained with the Letter 226-J, the employer should perform the following operations:
 - a) Complete, sign, and date the enclosed Form 14764, ESRP Response, and return it to the IRS by the response provided on the first page of the Letter.

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- b) Include a signed statement explaining the employer’s disagreement with part or all of the proposed ESRP. The employer should include documentation supporting its statement.
- c) The ALE’s written statement should describe modifications, if any, necessary respecting the information reported in Form(s) 1094-C or 1095-C.
 - i. Do not file a corrected Form 1094-C with the IRS to report any modifications required to Form 1094-C filed for the tax year shown on the first page of the Letter; instead, make any required modifications 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 the Letter.
 - ii. Do not file corrected Forms 1095-C with the IRS to report requested modifications to the Employee PTC Listing; instead, include a revised Employee PTC Listing, if necessary, and any additional documentation supporting the employer’s modifications with its Form 14764, ESRP Response, and signed statement.

Following receipt of the employer’s Form 14764, there are five (5) different responsive communications the IRS may send to the reporting employer. Referred to as “227 Letters,” these letters are not bills; rather, they are demands for payment are made by the IRS using Notice CP 220J.

The following Table Three lists and explains the purpose of each type of 227 Letter the IRS may provide to an ALEs upon receipt of the ALE’s Form 14764:

(see Table Three on next page)

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**TABLE THREE:
IRS Letter 227 Responsive Communications**

No.	Communication:
227-J	This letter is sent to acknowledge receipt of the ALE's response and that the penalty will be assessed. The case will be closed, and no further response is required.
227-K	This letter is sent to acknowledge receipt of information provided by the ALE and that the IRS has reduced the ESRP to zero. The case will be closed, and no further response is required.
227-L	This letter is sent to acknowledge receipt of the information provided by the ALE and shows that the ESRP has been revised (and includes an updated PTC Listing and calculation table). The ALE can agree or request a meeting with the manager and/or appeals.
227-M	This letter is sent to acknowledge receipt of the information provided by the ALE and that the ESRP has not changed (and includes an updated PTC Listing and calculation table). The ALE can agree or request a meeting with the manager and/or appeals.
227-N	This letter acknowledges the decision reached in appeals and shows the ESRP based on the appeals review. After issuance of a Letter 227-N, the case will be closed, and no further response is required.

Following, in Part Six, links to additional resources are provided to assist ALE's in meeting their ACA-obligations arising in connection with the ESRP process.

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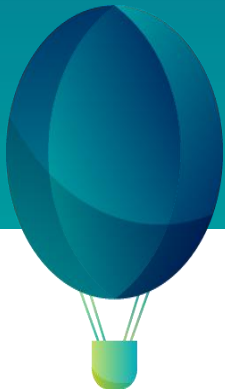
Part : Additional Information Reporting Resources for Employers

A variety of public and private informational resources are readily available to assist employers with evaluation and settlement of ESRP assessments from the IRS arising in connection employer obligations under Sections 4980H(a) and 4980H(b) of the Internal Revenue Code. To that end, in the following Table Three, please find links navigating to resources published and maintained by the IRS for the purpose of guiding employers in their performance of these complex legal and regulatory requirements:

**TABLE FOUR:
IRS Letter 226-J and Related ESRP Resources**

Resource Topic:	Internet Address:
IRS Publication – Understanding Your Letter 226-J	https://www.irs.gov/individuals/understanding-your-letter-226-j
IRS Publication – Questions & Answers on the ERSP of the ACA	https://www.irs.gov/affordable-care-act/employers/questions-and-answers-on-employer-shared-responsibility-provisions-under-the-affordable-care-act
IRS Publication – Overview of the Employer Shared Responsibility Provisions	https://www.irs.gov/affordable-care-act/employers/employer-shared-responsibility-provisions
IRS Publication – Information Reporting by Applicable Large Employers	https://www.irs.gov/affordable-care-act/employers/information-reporting-by-applicable-large-employers
Sample IRS Letter 226-J	https://www.irs.gov/pub/notices/ltr226-J.pdf
IRS Publication 5 – Appeal Rights and How to Protest if you Disagree	https://www.irs.gov/pub/irs-pdf/p5.pdf

Performance Notes and Summary of Administration



NOTES

MEET THE BALDWIN REGULATORY COMPLIANCE COLLABORATIVE



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QUESTIONS, COMMENTS & ADDITIONAL INFORMATION



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