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WHAT YOU NEED TO KNOW

Potential Employer Penalties under the ACA

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Employers that do not meet the requirements of the Patient Protection and Affordable Care Act (ACA) need to be concerned about several potential penalties. Two significant penalties include the excise tax, which can be as much as $100 per affected individual per day, and the penalties that larger employers must pay if they do not meet their employer shared responsibility / play-or-pay obligations.

Excise Tax Penalties

The excise tax penalties apply to all plans regardless of size. Since 2010, the IRS indicated that employers and plan administrators should self-report any failure to comply with various group health plan requirements, including requirements related to COBRA, HIPAA, Mental Health Parity, and the comparable contribution requirement for health savings accounts (HSAs), using IRS Form 8928. Under the ACA, numerous additional compliance responsibilities apply. Employers and plan administrators are expected to self-report these compliance failures, too, using Form 8928. Historically enforcement of the filing requirement and collection of the excise tax has been light, but the IRS is indicating that it expects employers to report failures and pay fines as applicable.

The excise tax is imposed on the plan sponsor, which generally is the employer. In the case of a multiemployer plan, the plan sponsor may be the employee organization, board of trustees, or committee. With COBRA and some ACA violations, the tax may instead be imposed on the third-party administrator or insurer responsible for the failure.

Potential COBRA, HIPAA, and related violations, which come with an excise tax of $100 per day per affected individual, include the failure to:

- Offer continuation (COBRA) coverage to a qualified beneficiary;
- Provide the required level of pediatric vaccine coverage;
- Comply with special enrollment requirements (and previously with the limitations on preexisting condition exclusions and the requirement to issue certificates of creditable coverage);

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- Provide the required 48-hour and 96-hour hospital length of stay in connection with childbirth for mothers and newborns; and
- Provide parity in mental health and substance use disorder benefits.

Potential ACA violations, which also come with an excise tax of $100 per day per affected individual, include:

- Preexisting condition exclusions
- Providing employer contributions for individual medical plans
- Discrimination against participants and beneficiaries based on health status
- Discrimination in coverage for services from certain health care providers
- Cost-sharing limitations on essential health benefits
- Eligibility waiting periods in excess of 90 days
- Failure to provide coverage for individuals participating in approved clinical trials
- Imposing lifetime or annual dollar limits on essential health benefits
- Most rescissions of coverage
- Failure to provide first-dollar coverage for preventive health services
- Failure to extend dependent coverage until age 26
- Summary of benefits and coverage failures
- Failure to meet health plan reporting requirements
- Failure to offer required health plan claim and appeals protections
- Failure to provide required patient protections relating to the selection of a primary care provider, coverage of emergency services, and access to pediatric, obstetrical and gynecological care providers

If the HSA comparable contribution rules are violated, the tax is generally 35 percent of the aggregate amount contributed by the employer for the calendar year to the HSAs of all employees. Keep in mind that the comparable contributions requirements do not apply to employers that contribute to an HSA through a Section 125 plan.

The excise tax for violations of any of the group health plan (COBRA, HIPAA, ACA, etc.) rules other than the comparable contribution requirements for HSAs often can be avoided.

- First, no excise tax is imposed during the period when the employer did not know, or when exercising reasonable diligence would not have known, a plan failure existed.
- Second, once the failure is discovered, no excise tax will be imposed if the failure was due to reasonable cause and the failure is corrected within 30 days after the date on which the error became known or should have been known. For these purposes, “correction” means retroactively fixing the failure (to the extent possible) and putting any affected individual in the same financial position as he or she would have been if the failure had not occurred.

It is not entirely clear from the IRS instructions whether the form must be filed even if no tax is due because the failure was due to reasonable cause and corrected promptly. It is also unclear how to determine if a failure is due to reasonable cause.

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The deadline for reporting the failure and paying the tax generally is the deadline for filing the plan sponsor's federal income tax return. In the case of a multiemployer plan, the deadline is the last day of the seventh month following the close of the plan year. However, the deadline for reporting and paying the tax for violating the HSA comparable contributions requirements is the 15th day of the fourth month following the calendar year in which the non-comparable contributions were made. Plan sponsors may file Form 7004 to obtain an automatic six-month extension for filing the Form 8928, but this will not extend the deadline for payment of the excise taxes.

If a plan sponsor fails to report and pay excise taxes when due, the IRS may assess penalties and interest, unless the failure to file and pay is due to reasonable cause and not willful neglect. The penalty for filing Form 8928 late is 5 percent of the unpaid excise tax for each month the form is late, up to a maximum of 25 percent. A separate penalty calculation applies for late payment of the excise tax, assuming the form has been filed. In addition, if the IRS discovers the failure during an audit, minimum penalties are significantly increased.

This new reporting obligation makes compliance with group health plan requirements more important than ever. To avoid self-reporting and excise taxes, plan sponsors should have procedures and processes in place that are designed to ensure compliance. If plan failures occur, the employer and other responsible parties should take action to correct the violation within 30 days.

Employer Shared Responsibility / Play-or-Pay Penalties

Large employers will owe penalties if they do not meet the employer shared responsibility / play-or-pay requirements. The IRS issued a helpful Q & A that answers many questions about play-or-pay penalties.

To avoid penalties, beginning in 2015 large employers (generally those with 50 or more full-time or full-time-equivalent employees in their controlled group) must offer health benefits to employees who work an average of 30 or more hours per week, or 130 hours per month.

To avoid all penalties, a large employer's plan must meet these requirements in 2016 and beyond:

- Coverage must be offered to full-time employees (those who work an average of 30 or more hours per week). Existing coverage for dependent children must be maintained. Coverage does not have to be offered to spouses.
- The plan must provide minimal essential coverage and it must be offered to at least 95 percent of full-time employees and their dependent children. (In 2015 this requirement was 70 percent.) Minimum essential coverage is basic medical coverage – most plans will satisfy this requirement.
- The plan must provide minimum value. This means that the plan is expected to pay, on average, at least 60 percent of the cost of medical claims and include significant coverage for physicians and inpatient hospital services.
- The plan must be affordable to employees. Affordability is based upon the cost for single-only coverage under the lowest-cost plan that provides minimum value, regardless of what coverage the employee actually has. Affordability may be met under any of these safe harbor criteria:
  - The W-2 test, which requires that the employee's cost not exceed 9.5% (indexed to 9.56% in 2015, 9.66% in 2016, 9.69% in 2017, 9.56% in 2018, and 9.86% in 2019) of the employee's income as reported in Box 1 of the W-2;

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- The rate of pay method, which requires that the employee's cost not exceed 9.5% (indexed to 9.56% in 2015, 9.66% in 2016, 9.69% in 2017, 9.56% in 2018, and 9.86% in 2019) of the lowest hourly rate paid to the employee, multiplied by 130 hours per month;
- The federal poverty line test, which requires that the employee's cost not exceed 9.5% (indexed to 9.56% in 2015, 9.66% in 2016, 9.69% in 2017, 9.56% in 2018, and 9.86% in 2019) of the federal poverty rate.

Employers may owe one of the two penalties, but never both. The first penalty, often called the "A" penalty, is based on whether the employer offers "minimum essential" (basic) coverage. If a large employer does not offer minimum essential coverage to at least 95 percent of its full-time employees in 2018, the employer will owe a penalty of $193.33 per month ($2,320 per year) on **all** of its full-time employees – even those who were not offered coverage – less a certain number of excludable employees. The excludable number is set at 30 for 2016 and later.

The second penalty, often called the "B" penalty, is based on whether the large employer offers coverage that is both "affordable" and "minimum value." If a large employer does not offer affordable, minimum value coverage to all of its full-time employees in 2018, the employer will owe a penalty of $290 per month ($3,480 per year) for each full-time employee who receives an Advanced Premium Tax Credit for coverage through a public Marketplace. The B penalty will never be more than the amount that the A penalty, if any, would have been, to provide employers with an incentive to offer at least minimum essential coverage.

The penalty will be determined after the end of each calendar year, after employees have filed their federal tax returns.

In November 2017, the IRS indicated on its "Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act" webpage that it planned to issue Letter 226J to inform large employers of their potential liability for an employer shared responsibility payment for the 2015 calendar year. The IRS' determination of an employer's liability and potential payment is based on information reported to the IRS on Forms 1094-C and 1095-C and information about the employer's full-time employees that were allowed the premium tax credit.

The IRS will issue Letter 226J if it determines that, for at least one month in the year, one or more of a large employer's full-time employees was enrolled in a qualified health plan for which a premium tax credit was allowed (and the large employer did not qualify for an affordability safe harbor or other relief for the employee).

Letter 226J includes:

- A brief explanation of section 4980H.
- An employer shared responsibility payment summary table itemizing the proposed payment by month and indicating for each month if the liability is under section 4980H(a) ("Penalty A") or section 4980H(b) ("Penalty B") or neither.
- An explanation of the employer shared responsibility payment summary table.
- An employer shared responsibility payment response (ESRP) form (Form 14764, "ESRP Response").

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- An employee premium tax credit (PTC) list (Form 14765, "Employee Premium Tax Credit (PTC) List") which lists, by month, the employer's assessable full-time employees (individuals who for at least one month in the year were full-time employees allowed a premium tax credit and for whom the ALE did not qualify for an affordability safe harbor or other relief (see instructions for Forms 1094-C and 1095-C, Line 16), and the indicator codes, if any, the employer reported on lines 14 and 16 of each assessable full-time employee's Form 1095-C.
- A description of the actions the employer should take if it agrees or disagrees with the proposed employer shared responsibility payment in Letter 226J.
- A description of the actions the IRS will take if the employer does not respond timely to Letter 226J.
- A date by which the employer should respond to Letter 226J, which will generally be 30 days from the date of the letter.
- The name and contact of the IRS employee to contact with questions about the letter.

When an employer responds to Letter 226J, the IRS will acknowledge the response with a version of Letter 227 to describe the further actions that the employer can take:

- **Letter 227-J** acknowledges receipt of the signed agreement Form 14764, ESRP Response, and that the penalty will be assessed. After the IRS issues this letter, the case will be closed. No response is required.
- **Letter 227-K** acknowledges receipt of the information provided and shows the penalty has been reduced to zero. After the IRS issues this letter, the case will be closed. No response is required.
- **Letter 227-L** acknowledges receipt of the information provided and shows the penalty has been revised. The letter includes an updated Form 14765 and revised calculation table. The employer can agree or request a meeting with the manager and/or appeals.
- **Letter 227-M** acknowledges receipt of information provided and shows that the penalty did not change. The letter provides an updated Form 14765 and revised calculation table. The employer can agree or request a meeting with the manager and/or appeals.
- **Letter 227-N** acknowledges the decision reached in appeals and shows the penalty based on the appeals review. After the IRS issues this letter, the case will be closed. No response is required.

If, after receiving Letter 227, the employer agrees with the proposed penalty, then the employer would follow the instructions to sign the form and return it with full payment in the envelope provided.

If, after receiving Letter 227, the employer disagrees with the proposed or revised shared employer responsibility payment, the employer must provide an explanation of why it disagrees or indicate changes needed, or both, on Form 14765. Then the employer must return all documents as instructed in the letter by the response date. The employer may also request a pre-assessment conference with the IRS Office of Appeals within the response date listed within Letter 227, which will generally be 30 days from the date of the letter.

If the employer does not respond to either Letter 226J or Letter 227, the IRS will assess the amount of the proposed employer shared responsibility payment and issue a notice and demand for payment.

Although the penalty is calculated monthly, it will be paid annually. The penalty will not be included in any standard tax filing, but instead will be charged through a notice and demand for payment, Notice CP 220J, from the IRS.

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Notice CP 220J will include a summary of the employer shared responsibility payment, payments made, credits applied, and the balance due, if any. If a balance is due, Notice CP 220J will instruct employers on how to make payment. For payment options, such as an installment agreement, employers should refer to Publication 594 "The IRS Collection Process."

Employers are not required to make payment before receiving a notice and demand for payment.

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