

CHECKLIST | Responding to a Pay-or-Play Penalty Assessment (IRS Letter 226-J)

Presented by Parrott Benefit Group

The Affordable Care Act (ACA) requires applicable large employers (ALEs) to offer affordable, minimum-value health coverage to their full-time employees (and dependents) or potentially pay a penalty to the IRS. These penalties are commonly referred to as “pay-or-play” penalties.

The IRS issues [Letter 226-J](#) to an ALE if it determines that, for at least one month in the year, one or more of the ALE’s full-time employees enrolled in health coverage through an ACA Exchange and received a premium tax credit. The IRS’ determinations of whether an ALE may be liable for a penalty and the amount of the proposed penalty are based on information from Forms [1094-C](#) and [1095-C](#) filed by the ALE and the individual income tax returns filed by the ALE’s employees.

Letter 226-J is only an initial notification that an ALE may be liable for a pay-or-play penalty and not a tax bill; however, ALEs that receive these letters should take them seriously and start preparing a response to help minimize their penalty exposure.

This checklist outlines the key steps ALEs should take to respond to a pay-or-play penalty assessment (Letter 226-J).

Step 1: Understanding Letter 226-J

Carefully Review Letter 226-J	Complete
<p>Read Letter 226-J and its attachments carefully.</p> <p>Letter 226-J includes:</p> <ul style="list-style-type: none">• An explanation of the ACA’s pay-or-play rules;• A table itemizing the proposed penalty by month;• Form 14764, Employer Shared Responsibility Payment (ESRP) Response;• Form 14765, Employee Premium Tax Credit (PTC) List, which lists, by month, the ALE’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) and the indicator codes, if any, the ALE reported on lines 14 and 16 of each assessable full-time employee’s Form 1095-C;• A description of the actions the ALE should take if it agrees or disagrees with the proposed pay-or-play penalty in Letter 226-J; and• A deadline for responding to the IRS and a description of the actions the IRS will take if the ALE does not respond to Letter 226-J on time.	<input type="checkbox"/>

Step 2: Developing a Response Strategy

Understanding Letter 226-J	Complete
<p>Identify the deadline for responding to the IRS.</p> <p>The response to Letter 226-J is due by the deadline shown on the first page of the letter, which generally will be 30 days from the date of the Letter 226-J. If the ALE does not respond by the response deadline, the IRS will send a notice and demand for the penalty that was proposed and assessed. The penalty will be subject to IRS lien and levy enforcement actions. Interest will accrue from the date of the notice and demand and continue until the ALE pays the total penalty.</p>	<input type="checkbox"/>
<p>Gather information about the health coverage offered to full-time employees.</p> <p>To determine if a pay-or-play penalty is actually owed, ALEs should review the health coverage offered to full-time employees for the tax year covered by Letter 226-J. Full-time employees who are offered affordable, minimum-value health coverage do not trigger penalties for an ALE.</p> <p>ALEs should have their Forms 1094-C and 1095-C that they filed with the IRS for the applicable tax year to review the IRS' proposed penalty assessment. ALEs should confirm that the information filed with the IRS was accurate because the IRS uses this information to compute pay-or-play penalties.</p>	<input type="checkbox"/>
<p>Develop a comprehensive response to the IRS' proposed penalty assessment.</p> <p>ALEs must respond to Letter 226-J, either agreeing with the proposed penalty or disagreeing with part or all of the proposed amount. Depending on their organization, ALEs may want to consult with external experts, including legal counsel, to prepare a response.</p>	<input type="checkbox"/>
<p>Keep a copy of Letter 226-J and any documents submitted with the response.</p>	<input type="checkbox"/>

Step 3: Agreeing or Disagreeing With Proposed Penalty Amount

If the ALE:	Action Items	Complete	N/A
Agrees with the proposed penalty amount:	<p>Complete, sign and date Form 14764, ESRP Response, and return it to the IRS by the response deadline on the first page of Letter 226-J.</p>	<input type="checkbox"/>	<input type="checkbox"/>
	<p>Include the required payment amount for the penalty due.</p>	<input type="checkbox"/>	<input type="checkbox"/>

	<p>If the ALE is enrolled in the Electronic Federal Tax Payment System, it can pay electronically instead of by check or money order.</p> <p>If the ALE does not pay the entire agreed-upon penalty, it will receive a notice and demand (or bill) for the balance due. For additional payment options, refer to Publication 594, The IRS Collection Process, or call the telephone number on the bill. The IRS will begin the collection process if the ALE does not make payment in full and on time after it receives a bill.</p>		
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If the ALE:	Action Steps	Complete	N/A
<p>Disagrees with the proposed penalty amount:</p>	<p>Complete, sign and date Form 14764, ESRP Response, and return it to the IRS by the deadline on the first page of Letter 226-J.</p>	<input type="checkbox"/>	<input type="checkbox"/>
	<p>Include a signed statement explaining why the ALE disagrees with part or all of the proposed penalty.</p> <p>The ALE should include documentation supporting its statement, if appropriate.</p>	<input type="checkbox"/>	<input type="checkbox"/>
	<p>Make sure the statement describes changes, if any, the ALE wants to make to the information reported on its Forms 1094-C or 1095-C.</p> <p>Do not file a corrected Form 1094-C with the IRS to report any changes the ALE wants to make to its Form 1094-C; rather, these changes should be described in the ALE’s response to Letter 226-J.</p>	<input type="checkbox"/>	<input type="checkbox"/>
	<p>Make changes, if any, on the Employee PTC List using the indicator codes in the instructions for Forms 1094-C and 1095-C.</p>	<input type="checkbox"/>	<input type="checkbox"/>
	<p>Include a revised Employee PTC List, if necessary, and any additional documentation supporting the changes with Form 14764, ESRP Response, and signed statement.</p>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Specific Instructions for Making Changes to Employee PTC List:</p> <p>If the information reported on a full-time employee’s Form 1095-C was inaccurate or incomplete, an ALE may make changes to the Employee PTC Listing using the applicable indicator codes for lines 14</p>			

and 16 that are described in the [Instructions for Forms 1094-C and 1095-C](#). ALEs should make any necessary changes for each employee by entering new codes in the second 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; and
- 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 to the affected employee in your signed statement. Include the employee’s name, the applicable months and the additional indicator codes for each month.

Step 4: Understanding the IRS’ Response (Letter 227)

When an ALE responds to Letter 226-J, the IRS will acknowledge the ALE’s response with an appropriate version of Letter 227, which is a series of five different letters that, in general, acknowledge the ALE’s response to Letter 226-J and describe further actions the ALE may need to take. An ALE should read Letter 227 and attachments carefully, as they will explain the next steps available and provide information on how the case will be resolved.

Letter 227 Series	Provided to:	Description
Letter 227-J	ALEs that agreed with the IRS’ proposed penalty assessment	This letter acknowledges receipt of the ALE’s agreement to the proposed penalty. After the issuance of this letter, the case will be closed. No response is required.
Letter 227-K	ALEs that disagreed with the IRS’ proposed penalty assessment if the IRS agrees no penalty is owed based on information provided by the ALE	This letter acknowledges receipt of the information provided by the ALE disputing the proposed penalty and shows the penalty amount has been reduced to zero. After the issuance of this letter, the case will be closed. No response is required.
Letter 227-L	ALEs that disagreed with the IRS’ proposed penalty assessment if the IRS revises the proposed penalty amount based on information provided by the ALE.	This letter acknowledges receipt of the information provided by the ALE and shows the penalty has been revised. An ALE must respond to this letter. The ALE can agree to the penalty or request a meeting with a supervisor or the appeals office. If the ALE does not respond by the response deadline, the IRS will send a

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		notice and demand for payment of the penalty.
Letter 227-M	ALEs that disagreed with the IRS' proposed penalty assessment if the IRS does not revise the proposed penalty amount based on information provided by the ALE	This letter acknowledges receipt of the information provided by the ALE and shows the penalty has NOT been revised. An ALE must respond to this letter. The ALE can agree with the penalty or request a meeting with a supervisor or the appeals office. If the ALE does not respond by the response deadline, the IRS will send a notice and demand for payment of the penalty.
Letter 227-N	ALEs that disagreed with the IRS' proposed penalty assessment, received a Letter 227-L or 227-M, and requested an appeals conference in a timely manner	This letter acknowledges the decision reached in the appeals process and shows the penalty amount based on the appeals review. After the issuance of this letter, the case will be closed. No response is required.