



ACA COMPLIANCE BULLETIN

AUDIT REVEALS PAY OR PLAY ENFORCEMENT ISSUES

OVERVIEW

On April 7, 2017, the Treasury Inspector General for Tax Administration (TIGTA) released the [results](#) of its audit to assess the Internal Revenue Service's (IRS) preparations for ensuring compliance with the employer shared responsibility rules and related reporting requirements under the Affordable Care Act (ACA).

The TIGTA audit revealed a number of major system and operational problems that have hindered or delayed the IRS' enforcement of these provisions. As a result, the IRS has been unable to identify the employers potentially subject to an employer shared responsibility penalty or to assess any penalties.

ACTION STEPS

Although no penalties have been assessed under the employer shared responsibility rules at this time, employers subject to these rules are still responsible for compliance.

The TIGTA report emphasized that the IRS' systems to enforce these provisions have not been canceled, and could be up and running as early as May 2017.

HIGHLIGHTS

- The Treasury audited the IRS' ability to enforce the employer shared responsibility rules.
- The audit revealed numerous system and operational problems.
- As a result, the IRS has been unable to identify the employers potentially subject to an employer shared responsibility penalty or to assess any penalties.

IMPORTANT DATES

April 7, 2017

The TIGTA released its audit results.

May 2017

The TIGTA report indicated that the IRS' systems to enforce the employer shared responsibility rules could be up and running as early as May 2017.

Provided By:
Sullivan Benefits

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Background

The ACA's employer shared responsibility rules require applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. These rules, also known as the "employer mandate" or "pay or play" rules, only apply to ALEs, which are employers with, on average, at least 50 full-time employees, including full-time equivalent employees (FTEs), during the preceding calendar year.

The employer shared responsibility rules took effect for most ALEs beginning on **Jan. 1, 2015**. However, some ALEs may have had additional time to comply with these requirements. An ALE may be subject to a penalty only if one or more full-time employees obtain an Exchange subsidy (either because the ALE does not offer health coverage, or offers coverage that is unaffordable or does not provide minimum value).

The ACA also imposes a **reporting requirement under Section 6056** for ALEs related to these employer shared responsibility rules. Section 6056 requires ALEs to annually file information returns (Forms 1094-C and 1095-C) with the IRS and provide related statements to their full-time employees about the health coverage they offered (or did not offer). The information on Forms 1094-C and 1095-C is intended to help the IRS verify the accuracy of reported offers of coverage and calculate any applicable employer shared responsibility penalty.

ALEs that file 250 or more information returns for a calendar year must electronically file through the ACA Information Returns (AIR) system, whereas ALEs filing fewer than 250 returns could choose to file on paper.

Future Enforcement

At this time, the IRS has been unable to identify the employers potentially subject to an employer shared responsibility penalty or to assess any penalties. To enforce these rules going forward, the IRS plans to mail a letter to ALEs informing them of their potential liability for a penalty. These letters will:

- ✓ Include the names of the employees who received a subsidy for the applicable tax year; and
- ✓ Provide ALEs with an opportunity to respond before any penalty liability is assessed or notice and demand for payment is made.

These letters are separate from the Section 1411 Certification sent by the Department of Health and Human Services (HHS) that employers began receiving in 2016. The Section 1411 Certifications are sent to all employers with employees who receive a subsidy to purchase coverage through an Exchange (including both ALEs and non-ALEs). Section 1411 Certifications do not trigger or assess any penalties for any employers.

The IRS previously [indicated](#) that it expected to begin sending letters in early 2017 informing ALEs that filed Forms 1094-C and 1095-C of their potential liability for an employer shared responsibility penalty for the 2015 calendar year (with reporting in 2016). **However, at this time, no letters have been sent to any ALEs.**

For future years, the IRS expects to begin issuing these letters in the latter part of each calendar year in which reporting was due (for example, in late 2018 for reporting in 2018 for coverage in 2017).

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Appeals Process

The IRS notice is expected to provide information on how to appeal any penalty assessment. **Although filing an appeal is not required, employer shared responsibility penalties will be assessed against any ALEs that received a letter and did not file an appeal (or whose appeal was not successful).**

If it is determined that an ALE is liable for an employer shared responsibility penalty following the IRS' initial contact, the IRS would send a second notice of the ALE's penalty liability and demand for payment. That notice would instruct the employer on how to make the payment. However, employers will not be required to include the penalty payment on any tax return that they file.

TIGTA Audit Report

The TIGTA audit was conducted to assess the status of the IRS' preparations for ensuring compliance with the employer shared responsibility rules and the related Section 6056 reporting requirements. According to the audit report, the IRS implemented processes and procedures in an effort to ensure that ALEs could comply with the Section 6056 reporting requirements.

However, through this audit, TIGTA found a number of major issues that hindered the IRS' enforcement of these provisions. According to the TIGTA audit report:

- ✓ System errors that prevented the IRS from having necessary data to identify noncompliant employers potentially subject to the employer shared responsibility penalty;
- ✓ Slow processing of paper information returns;
- ✓ Problems identifying validation errors on information returns; and
- ✓ Delayed or canceled development and implementation of key systems needed to identify noncompliant employers subject to an employer shared responsibility penalty.

Paper Returns Were Not Timely and Accurately Processed

The IRS experienced significant delays in processing paper Forms 1094-C and 1095-C. Despite a one-year delay in implementation of the employer shared responsibility rules and related reporting requirements, the TIGTA audit found that the most basic processes were not functioning as intended, such as:

- ✓ The ability to transfer scanned paper information returns to the AIR system for processing: As a result, some of the data was not accurate and complete for use to identify noncompliant ALEs potentially subject to an employer shared responsibility penalty. As of Oct. 28, 2016—almost five months after the May 31, 2016, filing deadline—the IRS estimated that 24 percent of the paper Forms 1094-C and 32 percent of the paper Forms 1095-C still had not been processed into the AIR system.
- ✓ IRS filing season priorities further delayed processing of paper Forms 1094-C and 1095-C: For example, the IRS suspended processing of paper information returns on March 17, 2016, and did not resume

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processing until the beginning of May 2016. Processing of paper returns was halted again in mid-May to divert resources to complete processing of individual tax returns for the tax filing season. IRS management indicated that they planned to have paper Forms 1094-C and 1095-C scanned into the system by Sept. 30, 2016. However, the IRS did not meet its planned September deadline.

- ✓ Errors in scanning paper Forms 1094-C and 1095-C resulted in missing or incorrect entries: According to IRS management, the majority of the errors were caused by employees failing to correct scanning errors during data verification. However, in other instances, the errors occurred because the scanner incorrectly read the form entry.

Processes to Accurately Identify Reporting Errors Were Not Always Working as Intended

While the IRS developed the AIR system to process and validate both e-filed and paper returns, the criteria used to identify and communicate validation errors in the submissions were not always working as intended. Specifically, the TIGTA audit found that:

- ✓ Some error codes generated when no error condition existed, and other error codes did not generate when an error condition existed. The TIGTA audit identified six error codes generated when no error condition existed. In addition, the audit found two error codes for Form 1094-C and four error codes for Form 1095-C that did not generate when required, related to verifying the employer and employee taxpayer identification numbers (TINs). In many of these cases, electronic returns were rejected when no error existed, or accepted without identifying inaccuracies or requiring correction. The IRS separately reported that, as of Aug. 25, 2016, 16 of the 141 total error codes for Forms 1094-C and 1095-C were not functioning correctly. The TIGTA audit noted that the IRS did not sufficiently test all error code programming to ensure that all error conditions were functioning as intended.
- ✓ The error message description caused confusion for ALEs attempting to identify and correct invalid or missing TINs on Forms 1094-C and 1095-C. Each of the 141 error codes developed by the IRS include a description of the error. For the TIN validation error code, the error description only detailed which Form 1094-C or Form 1095-C contained the TIN that was invalid, without identifying the specific TIN on the form that was invalid. As a result, ALEs had no way to know which TIN needed to be corrected. For 2017 filing (2016 forms), the IRS plans to improve the error messaging by adding additional detail to the error file that includes identifying which TIN(s) are invalid.
- ✓ Management reports used to monitor volumes and types of errors associated with the processing of information returns were inaccurate. The TIGTA audit identified that the volume and types of errors were inaccurately reflected on management reports. For example, one report showed that 6.2 million of the 7 million Forms 1095-C were rejected because the offer of coverage code was missing. However, the TIGTA review showed that this error condition only occurred 828 times, and that IRS criteria when identifying this error condition does not result in the rejection of a Form 1095-C. The IRS determined

that incorrect programming and labeling caused some of the inaccuracies in the management reports and initiated steps to correct these errors for the 2017 filing season.

Development and Implementation of Key Systems Needed to Identify Noncompliant ALEs Have Been Delayed, Not Initiated or Canceled

The IRS is developing new systems that will use information returns and other tax data to identify ALEs that are not compliant with the employer shared responsibility rules and may be subject to a penalty. For example, the IRS is developing the ACA Compliance Validation (ACV) system, which will be used to identify potentially noncompliant ALEs and calculate the proposed employer shared responsibility penalties.

The IRS began developing the ACV system in July 2015, with implementation scheduled for January 2017. However, implementation of the ACV system has been delayed to May 2017, as a result of the need to incorporate new requirements into ACV system development to address data inconsistencies (such as forms containing errors, missing entries and contradictory entries). Thus, the IRS has had to develop an automation tool outside of the ACA system in an attempt to identify the ALEs subject to penalties. The IRS also identified a lack of funding that has prevented the IRS from developing additional ACV capability (for example, the ability to identify ALEs that did not file Forms 1094-C and 1095-C as required).

A separate ACA Case Management system was also expected to be developed to allow IRS employees to create, manage and track the status of the employer shared responsibility penalty cases to ensure ALE compliance. However, on June 7, 2016, the IRS canceled the ACA Case Management system development effort in order to save funds and free up resources for other development efforts. The IRS had expended a total of \$7 million in development costs at the time the ACA Case Management system was canceled.