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Health Care

Christopher E. Condeluci and Alden J. Bianchi methodically walk through the ''process'' for assessing penalties under the ACA's ''employer mandate.'' They explain that the ACA statute and implementing regulations clearly state that an ACA Exchange must send a certification and notification to an employer as a pre-condition to the IRS assessing employer mandate penalties. Unfortunately, the Federally-facilitated Exchange and a majority of State-based Exchanges failed to send the required certification and notification for the 2015 calendar year, which—Chris and Alden argue—precludes the IRS from assessing penalties for 2015 unless and until the certification and notification process is exhausted.

Why the IRS May Be Unable to Assess ACA Employer Shared Responsibility Penalties for 2015

By Christopher E. Condeluci and Alden J. Bianchi

The Internal Revenue Service recently announced that it will start notifying employers with assessments for potential penalties under the Affordable Care Act's (ACA) ''employer mandate'' provision for the 2015 calendar year. Employers are reporting receipt of these assessment letters, and in many cases, the amount of the assessment has been described as ''eye-popping.''

In the spring of 2016, IRS officials announced that employer mandate assessment letters would be going out in the first quarter of 2017. However, in April 2017, the Treasury Department's Inspector General reported that the IRS was experiencing multiple technical challenges in implementing the systems and processes necessary to enforce the employer mandate, forcing further delay. It now appears that those issues have been resolved. As a result, the IRS is proceeding with enforcement actions. Despite the opening salvo of enforcement activity, it appears (to us at least) that the agency is not in a position to assess penalties. This apparent bar to enforcement is not a result of the IRS's own actions, but rather, as a consequence of the failure on the part of the Exchanges created under the ACA (an ''ACA Exchange'') to take certain steps required by the statute and implementing regulations.

Background

The ACA added Section 4980H to the Internal Revenue Code, setting forth two different penalties applicable to employers employing 50 or more ''full-time equivalent employees'' (an ''applicable large employer''):

> Under tax code Section 4980H(a)—known as the ''no coverage'' penalty—an applicable large employer that fails to offer ''minimum essential coverage'' to at least 95 percent of its ''full-time employees'' will be subject to a penalty if at least one full-time employee (1) enrolls in a health plan offered through an ACA Exchange and (2) receives a premium tax credit.
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> Under tax code Section 4980H(b)—known as the ''affordable/minimum value'' penalty—an applicable large employer that fails to offer a group health plan that is ''affordable'' or the plan does not provide ''minimum value'' will be subject to a penalty if one or more its full-time employees (1) enroll in a health plan offered through an ACA Exchange and (2) receive a premium tax credit.

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While tax code Section 4980H(a) and (b) differ in how penalties may be triggered, these two subsections contain the same pre-condition for assessing the penalties. Specifically, as a condition for assessing a penalty under tax code Section 4980H(a) *and* (b), an employer *must* receive a ''certification'' under ACA Section 1411 that one or more of the employer's full-time employees (1) enrolled in a health plan offered through an ACA Exchange and (2) received a premium tax credit (*see* tax code Section 4980H(a)(2) and 4980H(b)(1)(B); *see also* Treas. Regs. Sections 54-4980H-4(a) and 54-4980H-5(a)).

ACA Section 1411 directs the ACA Exchanges to make this certification through a notification process, which is established and implemented in 45 C.F.R. Section 155.310(h) (Health and Human Services Regulations). Section 155.310(h) provides that in the event an employee is determined eligible for a premium tax credit, and where the employee enrolls in a health plan sold through an Exchange and qualifies for a premium tax credit, *the Exchange must notify [the employee's] employer*.

The final employer mandate regulations explicitly recognize the Exchange certification and notification process, which it refers to as a ''Section 1411 Certification.'' In particular, the term ''Section 1411 Certification'' is defined to mean:

> [T]he certification received as part of the process *established by the Secretary of Health and Human Services* under which an employee is certified to the employer under section 1411 of the Affordable Care Act as having enrolled for a calendar month in a [health plan sold through an Exchange] with respect to which an applicable premium tax credit . . . is allowed . . . with respect to the employee (Treas. Regs. Section 54-4980H-1(a)(40)).

Final tax code Section 4980H regulations describe at length (and through examples) the role of the Exchange certification and notification in the assessment of employer mandate penalties. These regulations explain that the IRS will assess penalties on an employer that (1) fails to offer an ''affordable/minimum value'' plan *and* (2) receives a Section 1411 Certification (*see* Treas. Regs. Section 54-4980H-4(a)(f)). As such, we read this to mean that an employer's receipt of a Section 1411 Certification is a substantive pre-condition to assessing penalties. Or, put another way: No certification, no penalty.

The 1411 Certification and Notification Process

In a form letter that the IRS is currently sending to employers (Letter 226J), the agency makes the following statement:

> This letter certifies, under Section 1411 of the Affordable Care Act, that for at least one month in the year, one or more full-time employees was enrolled in a [health plan sold through an Exchange] for which a PTC [(i.e., a premium tax credit)] was allowed.

There appears to be no basis for this claim. As we explain above, tax code Section 4980H, its implementing regulations, and the ACA itself clearly state that a Section 1411 Certification *must* be furnished by an Exchange, *not* the IRS.

HHS regulations confirm this to be the case. In the preamble of original final regulations implementing the Exchanges—issued on March 27, 2012—HHS was asked to consider allowing the IRS to effectuate the Section 1411 Certification. The Department responded, stating:

> Section 1411(e)(4)(B)(iii) [of the ACA] provides that this notice must be provided to employers by Exchanges in connection with certain eligibility determinations. It is not within the discretion of the Secretary [of HHS] to shift responsibility for provisions of this notice to the IRS (*see* 77 Fed. Reg. 18310, 18357 (March 27, 2012)).

Subsequent regulations provide further evidence that the requirement to furnish employers with a Section 1411 Certification rests with the Exchanges. On July 15, 2013, HHS added to the body of the Exchange regulations a ''certification'' program that would be established by the IRS. In the preamble of those regulations, HHS explained that this IRS-established certification ''would be distinct from the notice to employers required by ACA Section 1411(e)(4)(B)(iii) of the Affordable Care Act and paragraph (h) of section 155.310'' (*see* 78 Fed. Reg. 42160, 42250 (July 15, 2013)).

On Aug. 30, 2013, when HHS added an appeals process (through which an employer may appeal eligibility determinations set forth in a Section 1411 Certification), the agency doubled-down on the position that a Section 1411 Certification must be furnished by an Exchange, and not the IRS. HHS was once again asked to coordinate the Section 1411 Certification with the IRS to reduce ''confusion for employers and unnecessary administrative burden on the Exchange[s].'' The agency responded:

> We maintain the existing language in § 155.310(h), which specifies that when an employee has been determined eligible for a premium tax credit. . .the Exchange will notify the employee's employer, in accordance with section 1411(e)(4)(B)(iii) of the Affordable Care Act (*see* 78 Fed. Reg. 54070, 54113 (Aug. 30, 2013)).

On March 8, 2016, HHS further clarified that an Exchange ''must notify employers within a reasonable timeframe following any month an employee was determined eligible for. . .Exchange financial assistance and enrolled in [a health plan sold through the Exchange], *with the goal to notify employers as soon as possible to provide the greatest benefit to enrollees* (*emphasis added*)'' (*see* 81 Fed. Reg. 12204, 12267 (March 8, 2016)).

In a series of Frequently Asked Questions (FAQs) issued on Sept. 18, 2015, HHS announced that the Federally-facilitated Exchange (the ''Federal Exchange'') would not send out Section 1411 Certifications for the 2015 calendar year. But in the same FAQs, HHS for the first time suggested—in clear conflict with HHS's own implementing Exchange regulations—that employers would still be liable for any potential penalties under tax code Section 4980H for 2015, even in the absence of receipt of a Section 1411 Certification. Specifically, HHS said: ''The IRS will independently determine any liability for an employer shared responsibility payment without regard to whether [the Federal Exchange] issued a notice. . .''

Anecdotal evidence suggests that out of the 13 State-based Exchanges (including the District of Columbia) operating in 2015, only Maryland, Connecticut, and Washington State were furnishing a Section 1411 Certification to at least some employers operating in those States.

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Conclusion

The IRS has a clear obligation to enforce the employer mandate, but it must do so in a manner consistent with tax code Section 4980H and ACA Section 1411, along with final Treasury and HHS regulations. Both the statute and the final regulations require that an Exchange *must* first furnish a Section 1411 Certification notifying an employer that one or more of its full-time employees received a premium tax credit. Since the Federal Exchange and a majority of the State-based Exchanges failed to furnish any Section 1411 Certifications for the 2015 calendar year, the process for assessing penalties clearly set forth in the statute and regulations has *not* been followed. Therefore, it appears to us that the IRS is precluded from enforcing employer mandate penalties for the 2015 calendar year until the required certification and notification process is exhausted.

We are mindful of the Supreme Court's admonition, in *King v. Burwell*, not to read the ACA too literally. There the Court upheld, as consistent with the statute, the outlay of premium tax credits to qualifying persons in all states despite the statute's explicit reference to an exchange established ''by a state.'' Had the Court read the ACA literally, the result would be different. We recognize that the IRS could cite this case to support the position that Congress did not really intend to make the Section 1411 Certification and notification process as a bar to enforcement, despite what appears to be explicit statutory language to the contrary. Under this approach, the IRS may contend that the agency's 226J assessment letter would serve as the Section 1411 Certification for the 2015 calendar year. However, even granting *King v. Burwell* its full due, this argument appears difficult to sustain. The statute and implementing regulations are clear—a Section 1411 Certification *must* come from an ACA Exchange, *not* the IRS.

There is of course another possibility: The IRS may urge that this process defect be ''cured'' by directing the Federal and State-based Exchanges to furnish a Section 1411 Certification for the 2015 calendar year. We agree. The Trump Administration could indeed direct the Exchanges to furnish the 2015 Section 1411 Certifications. This would further delay, but not derail, enforcement.

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