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#14****AFFORDABLE CARE ACT (ACA) – BUSINESS: The IRS Faces Challenges in Implementing the Employer Provisions of the ACA While Protecting Taxpayer Rights and Minimizing Burden****RESPONSIBLE OFFICIALS**

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**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*

**PROBLEM STATEMENT**

The IRS is charged with implementing complex Affordable Care Act (ACA) provisions that require updating information technology systems, issuing guidance, and collaborating with other federal agencies.<sup>2</sup> For tax years 2015 and beyond, certain provisions of the ACA impacting employers become effective.<sup>3</sup> For example, applicable large employers (ALEs) must offer minimum essential coverage (MEC) to their full-time employees.<sup>4</sup> Employers not in compliance with this provision may be subject to an assessable payment, referred to as the “employer shared responsibility payment” (ESRP). The IRS expects to receive 77 million new information returns once the business portions of the ACA become effective in 2015.<sup>5</sup>

The ACA also provides for a temporary small business health care tax credit (SBHCTC) designed to defray the costs of employers with 25 or fewer employees whose average annual wage is less than \$50,000.<sup>6</sup> Although many businesses will not meet the strict (and complex) criteria for claiming the SBHCTC, the IRS could do more to actively promote this credit to ensure that all eligible employers can take advantage of this subsidy.

The National Taxpayer Advocate is concerned that the IRS’s implementation of the ACA provisions for the 2016 filing season may burden both employers and employees if certain conditions and issues are not addressed. Through representation on the IRS ACA Executive Steering Committee and several joint

1 See Taxpayer Bill of Rights, available at [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

2 See Patient Protection and Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119 (Mar. 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

3 For a discussion of concerns expressed by the National Taxpayer Advocate regarding the IRS’s implementation of the components of the ACA that impact individual taxpayers, see Most Serious Problem: *Affordable Care Act (ACA) - Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *infra*. See also National Taxpayer Advocate FY 2016 Objectives Report to Congress 38 (Area of Focus: *The IRS’s Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen*); National Taxpayer Advocate 2014 Annual Report to Congress 67 (Most Serious Problem: *Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers*).

4 See Internal Revenue Code (IRC) § 4980H.

5 IRS response to TAS information request (Oct. 22, 2015).

6 See IRC § 45R(d); Treas. Reg. § 1.45R-2; IRS Notice 2010-44, available at [www.irs.gov/pub/irs-drop/n-10-44.pdf](http://www.irs.gov/pub/irs-drop/n-10-44.pdf).

implementation teams, the National Taxpayer Advocate and TAS have identified the following concerns with the implementation of ACA provisions that impact employers:

- Employees in the newly-established ACA Business Exam unit need to receive specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as ALE, MEC, and ESRP;
- The IRS should provide additional guidance to employers on how to calculate the number of full-time equivalents (FTEs) for purposes of meeting MEC requirements;
- The IRS lacks adequate testing of the accuracy of information-reporting data that would verify employer information before the filing season. This could lead to significant taxpayer burden that would subject employers to an unwarranted ESRP or require them to respond to unnecessary notices; and
- The IRS needs to increase active promotion of the availability of the SBHCTC to eligible employers.

Notwithstanding these concerns, we acknowledge the tremendous efforts made by the IRS to implement the health care provisions given their interdependency on decisions made by other federal agencies. Nonetheless, the IRS will be heavily scrutinized by individuals and employers for any ACA-related problems that arise in the context of return filing.

## ANALYSIS OF THE PROBLEM

### Background

#### *Applicable Large Employers*

Internal Revenue Code (IRC) § 4980H(a)(1) provides that an ALE must offer MEC to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or FTEs), or a combination of full-time and part-time employees that equals at least 50 FTEs.<sup>7</sup>

An employer calculates its FTEs based on each employee's hours of service. For purposes of the ESRP, an employee is considered full-time for a calendar month if he or she averages at least 30 hours of service per week. Under the final regulations, for purposes of determining full-time employee status, 130 hours of service in a calendar month is treated as the monthly equivalent of at least 30 hours of service per week.<sup>8</sup>

IRC § 4980H includes a provision stating that companies with a common owner (or that are otherwise related) generally are combined and treated as a single employer and therefore would be combined for purposes of determining whether or not they collectively employ at least 50 FTEs. If the combined total meets the threshold, then each separate company is subject to the ESRP, including those companies that individually do not employ enough employees to meet the 50 FTEs threshold.

#### *Employer Shared Responsibility Payment*

IRC § 4980H provides that ALEs will be subject to an ESRP if (1) it fails to offer its full-time employees the opportunity to enroll in MEC under an eligible employer-sponsored plan, and (2) a Premium Tax

<sup>7</sup> IRC § 4980H(c)(2).

<sup>8</sup> Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at [www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage](http://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage).

The National Taxpayer Advocate is concerned that the IRS has not yet firmed up its approach to selecting and working cases involving Affordable Care Act (ACA) business issues, even as the 2016 filing season is rapidly approaching.

Credit was paid to at least one full-time employee. The amount of the ESRP under IRC § 4980H(a) is \$2,000 per full-time employee per year (determined on a monthly basis).<sup>9</sup>

IRC § 4980H(b) requires ALEs to offer affordable MEC that provides minimum value. If an ALE offers MEC but it is not considered affordable, it will be assessed an ESRP of \$3,000 for each employee (determined on a monthly basis) that purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance.<sup>10</sup> While an employer may be subject to ESRP under both IRC § 4980H(a) and (b), the liability is limited to the amount under IRC § 4980H(a).<sup>11</sup>

The ESRP provisions generally are not effective until January 1, 2015, meaning that the ESRP will be first assessed during the 2016 filing season.<sup>12</sup> However, employers must take action during 2015 to avoid liability for ESRP assessed in 2016.

### *Minimum Essential Coverage, Minimum Value, and Affordability*

MEC, minimum value, and affordability are defined under IRC provisions other than IRC § 4980H but all relate to the determination of ESRP. MEC is defined in IRC § 5000A(f) and the regulations under that section and includes employer-provided health care coverage but not coverage providing only limited benefits, such as coverage only for vision or dental care. IRC § 36B(c)(2)(C)(ii) provides the definition of minimum value. An employer-sponsored health plan meets this standard if it is designed to pay at least 60 percent of the total cost of medical services for a standard population.

If an employee's share of the premium for employer-provided coverage would cost the employee more than 9.5 percent of that employee's annual household income (HHI), the coverage is not considered "affordable" for that employee.<sup>13</sup> Because employers generally will not know their employees' HHI, employers can take advantage of several affordability safe harbors set forth in the final regulations that are based on information the employer will have available.<sup>14</sup> If an employer meets the requirements of any of these safe harbors, the offer of coverage will be deemed affordable for purposes of the ESRP provisions regardless of whether it was actually affordable to the employee.

### *IRC § 4980D Excise Tax*

IRC § 4980D imposes an excise tax on employers who maintain a group health plan that fails to meet certain requirements. There is concern that certain flexible spending accounts, health reimbursement arrangements, and other arrangements that reimburse employee premiums for medical insurance purchased on the individual market are considered group health plans subject to the excise tax imposed by IRC § 4980D. By their nature, these arrangements fail to comply with the ACA market reforms that prohibit annual and lifetime dollar limits (Public Health Service Act § 2711) and require plans to provide cost-free

9 IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5).

10 IRS § 4980H(b)(1).

11 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at [www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage](http://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage).

12 IRS Notice 2013-45, available at [www.irs.gov/irb/2013-31\\_IRB/ar08.html](http://www.irs.gov/irb/2013-31_IRB/ar08.html).

13 IRC § 36B(c)(2)(B) and (C).

14 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at [www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage](http://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage).

preventive services (Public Health Service Act § 2713). As a result, it appears that such programs are subject to an excise tax of \$100 per affected individual, per day, under IRC § 4980D as plans that fail to satisfy ACA market reforms.<sup>15</sup>

On February 18, 2015, the IRS issued Notice 2015-17<sup>16</sup> providing temporary relief from the IRC § 4980D excise tax for employer programs that reimburse employees for the cost of health insurance coverage purchased individually (including coverage obtained through an Exchange). This excise tax will not be asserted for employers that are not ALEs for 2014 and for January through June 2015. After June 30, 2015, such employers may be liable for the IRC § 4980D excise tax. Understandably, this temporary relief is not all that comforting to small businesses that must decide whether to keep providing such a benefit to their employees at the risk of being assessed an excise tax of \$100 per day per employee.

### *Small Business Health Care Tax Credit*

Under IRC § 45R, eligible small employers can claim the SBHCTC for 2010 through 2013 and for two additional years beginning in 2014. A small employer is eligible for the credit if (a) it has fewer than 25 FTE employees, (b) the average annual wages of its employees are less than \$50,000 (adjusted for inflation beginning in 2014), and (c) it pays a uniform percentage for all employees equal to at least 50 percent of the premium cost of employee-only insurance coverage.

For 2010 through 2013, the maximum credit was 35 percent of premiums paid by eligible small businesses and 25 percent of premiums paid by eligible tax-exempt organizations. For 2014 and 2015, the maximum credit rate rises to 50 percent for small businesses and 35 percent for tax-exempt organizations.<sup>17</sup> Businesses that have already filed and later find that they qualified in 2013 or an earlier year can still claim the credit by filing an amended return for the affected years.

### **IRS Employees Need to Receive Training on the Parts of ACA Implementation That Impact Businesses, Including Training on Concepts Such as ALE, MEC, and ESRP**

The IRS must ensure that employees who work ACA-related issues, especially those in taxpayer-facing roles, are properly trained on the aspects of the ACA that impact business taxpayers. The IRS has designated that ESRP cases will be worked by a specialized unit out of the Ogden Service Center but does not yet know the grade or series of the examination employees selected to work these ESRP cases.<sup>18</sup> The IRS expects to develop procedures and roll out training for these employees before the ESRP cases are assigned but has not committed to a certain date. The National Taxpayer Advocate is concerned that the IRS has not yet firmed up its approach to selecting and working cases involving ACA business issues, even as the 2016 filing season is rapidly approaching.

Although the IRS developed and delivered a substantial amount of training in advance of the 2015 filing season, much of that training was focused on the components of the ACA that impacted individual taxpayers.<sup>19</sup> In 2015, the IRS expanded training to revenue agents, tax compliance officers, and technical advisors on IRC §§ 4980H, 6055, and 6056. Once the IRS has determined which group of employees

15 See IRS Notice 2013-54, available at [www.irs.gov/pub/irs-drop/n-13-54.pdf](http://www.irs.gov/pub/irs-drop/n-13-54.pdf).

16 Available at [www.irs.gov/pub/irs-drop/n-15-17.pdf](http://www.irs.gov/pub/irs-drop/n-15-17.pdf).

17 See Treas. Reg. § 1.45R, 79 FR 36640 (June 30, 2014), available at [www.federalregister.gov/articles/2014/06/30/2014-15262/tax-credit-for-employee-health-insurance-expenses-of-small-employers](http://www.federalregister.gov/articles/2014/06/30/2014-15262/tax-credit-for-employee-health-insurance-expenses-of-small-employers).

18 IRS response to TAS information request (Oct. 22, 2015).

19 See National Taxpayer Advocate 2014 Annual Report to Congress 71.

will focus on examining employers' compliance with the business aspects of the ACA, this new group of employees will require comprehensive and specialized training.<sup>20</sup>

### The IRS Should Provide Formal Guidance to Employers on the Calculation of FTEs for Purposes of Meeting MEC Requirements

IRS outreach and education should continue to focus on increasing awareness to employers of the ACA requirements that are effective beginning in tax year (TY) 2015. For example, the IRS Information Reporting Advisory Committee (IRPAC) reported that the ACA Information Center for Tax Professionals web page on the IRS website should be improved to provide clearer guidance for TY 2014 about what constitutes MEC.<sup>21</sup>

Employers not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the ESRP. On February 12, 2014, the IRS and Treasury issued final regulations on the ESRP provisions.<sup>22</sup> The guidance acknowledges that there are certain categories of employees whose hours of service will be particularly challenging to identify and track and advises their employers to use “a reasonable method of crediting hours of service that is consistent with section 4980H.” The preamble provides some examples of what may be considered a reasonable method in certain industries but is far from comprehensive.

In addition to the final regulations, the IRS provides clarification of the guidance in the form of an ESRP Q&A page and an ALE Information Center on [irs.gov](http://irs.gov).<sup>23</sup> While they contain helpful information, the limited Q&A page and ALE Information Center do not adequately address many questions about the calculation of FTEs for purposes of meeting the MEC requirements. Q&As are helpful, but they do not have the impact of formal guidance, which undergoes a notice and comment period. Furthermore, although informal guidance is better than no guidance, taxpayers may not rely on Q&As found on the IRS website for penalty defense purposes.

### The Inability of the IRS to Adequately Test the Accuracy of Information-Reporting Data Before the Filing Season Can Inhibit IRS Verification Efforts and May Cause Significant Taxpayer Burden

The IRS relies on information reports to verify data relevant to the ESRP liability and SBHCTC eligibility. Beginning in the 2016 filing season, the IRS will receive and process an estimated 77 million new information returns from employers.<sup>24</sup>

IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. IRC § 6056 requires annual information reporting by ALEs relating to the health insurance that the employer offers (or does not offer) to

20 The IRS did not provide specific course modules or training schedules for business-related ACA issues. See IRS response to TAS information request (Oct. 27, 2015).

21 See IRS, *2014 IRPAC Public Report: Employee Benefits and Payroll Subgroup*, available at [www.irs.gov/Tax-Professionals/IRPAC-Public-Report-Employee-Benefits-and-Payroll-Subgroup-2014](http://www.irs.gov/Tax-Professionals/IRPAC-Public-Report-Employee-Benefits-and-Payroll-Subgroup-2014).

22 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at [www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage](http://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage).

23 See IRS, *Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act*, available at [www.irs.gov/Affordable-Care-Act/Employers/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act](http://www.irs.gov/Affordable-Care-Act/Employers/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act) (last visited Dec. 1, 2015); IRS, *ACA Information Center for Applicable Large Employers (ALEs)*, available at [www.irs.gov/Affordable-Care-Act/Employers/ACA-Information-Center-for-Applicable-Large-Employers-ALEs](http://www.irs.gov/Affordable-Care-Act/Employers/ACA-Information-Center-for-Applicable-Large-Employers-ALEs) (last visited Dec. 1, 2015).

24 IRS response to TAS information request (Oct. 22, 2015).

its full-time employees. Below is a list of information returns the IRS created to meet these reporting requirements:

- Form 1095-B, *Health Coverage* (used by health insurance issuers and carriers to report information about individuals who are covered by MEC and therefore aren't liable for the individual shared responsibility payment; due by February 28 (or March 31 if filing electronically));<sup>25</sup>
- Form 1094-B, *Transmittal of Health Coverage* (used by health insurance issuers and carriers to submit Form 1095-B);
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance* (furnished by ALEs to any full-time employee for one or more months of the year; due by February 28 (or March 31 if filing electronically));<sup>26</sup> and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

**FIGURE 1.14.1, Projected Volume of Information Returns for ACA Exchange Provisions, Tax Years 2015–2017**<sup>27</sup>

	Tax Year 2015	Tax Year 2016	Tax Year 2017
Forms 1095-B	46 million	45 million	47 million
Forms 1095-C	77 million	77 million	78 million
<b>Total</b>	<b>123 million</b>	<b>122 million</b>	<b>125 million</b>

As noted above, the IRS expects to receive over 120 million information returns from health insurance providers and ALEs during the 2016 filing season. If this information is not furnished to the IRS timely, the IRS has little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers. As of the time of publication, the IRS has not been able to fully test the ability of its information technology systems to handle the expected volume of ACA information returns. Furthermore, the IRS has not expanded the taxpayer identification number (TIN) matching program to health insurers and self-insured employers that are required to file Form 1095-B, which may lead to mismatches and unnecessary notices.<sup>28</sup>

If the IRS receives incomplete or inaccurate data, taxpayers will be harmed.<sup>29</sup> For example, if the IRS cannot accurately verify coverage information, it will inhibit the IRS's ability to verify eligibility for the SBHCTC. Furthermore, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable and contains false positives. If the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRPs on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify.

25 IRS, *Instructions for Forms 1094-B and 1095-B* (2015), available at [www.irs.gov/pub/irs-pdf/i109495b.pdf](http://www.irs.gov/pub/irs-pdf/i109495b.pdf).

26 IRS, *Instructions for Forms 1094-C and 1095-C* (2015), available at [www.irs.gov/pub/irs-pdf/i109495c.pdf](http://www.irs.gov/pub/irs-pdf/i109495c.pdf).

27 IRS response to TAS information request (Oct. 22, 2015).

28 See Most Serious Problem: Affordable Care Act (ACA) - Individuals: *The IRS Is Compromising Taxpayers Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*, *infra*.

29 See National Taxpayer Advocate 2014 Annual Report to Congress 75-6 (discussing TIN matching for Form 1095-B; the IRS will use Form 1095-B to verify compliance with IRC § 5000A); Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*, *infra*.

### The IRS Should More Actively Promote the Availability of the SBHCTC to Eligible Employers

To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC.<sup>30</sup> This tool allows small businesses to estimate their credits (if any) and find out how any changes in circumstances will impact their eligibility. Since November 2012, the SBHCTC estimator has been available on the TAS Tax Toolkit,<sup>31</sup> where small businesses and tax professionals can access it easily, and TAS has continually promoted it through social media, including Twitter and Facebook.

Notwithstanding the efforts of TAS, the IRS should do more to promote the availability of the SBHCTC to eligible employers. Yet it is difficult for the IRS to actively promote this credit to small businesses when it has decimated its public outreach staff, such that as of the end of October 2015, 14 states (plus the District of Columbia) did not have a single outreach and education employee dedicated to small businesses located within their borders.<sup>32</sup>

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**The IRS expects to receive over 120 million information returns from health insurance providers and Applicable Large Employers (ALEs) during the 2016 filing season. If this information is not furnished to the IRS timely, the IRS has little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers.**

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### CONCLUSION

The 2016 filing season will be challenging as the IRS implements several ACA provisions that impact employers against the backdrop of historically low levels of taxpayer service. Although the IRS developed systems and procedures to administer components of the ACA impacting individual taxpayers in the 2015 filing season, the IRS will face new challenges in the 2016 filing season when business taxpayers file their TY 2015 returns and report ESRP liabilities. The IRS will receive and process a significant amount of new information returns from insurers and exchanges to identify errors and noncompliance. While the IRS has little control over some of the anticipated risks, such as delayed or inaccurate data reporting from the exchanges, it will be held publicly responsible when the associated problems surface during the tax return filing process.

Because of the increased risk of taxpayer harm this filing season, TAS will continue to address issues as they arise and identify systemic problems. TAS will continue to assign ACA Rapid Response team members to immediately address any potential ACA systemic issues that arise during the 2016 filing season. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System.<sup>33</sup>

30 To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC, *available at* [www.taxpayeradvocate.irs.gov/estimator/smallbusiness2014/](http://www.taxpayeradvocate.irs.gov/estimator/smallbusiness2014/).

31 The TAS Tax Toolkit is a website that contains useful tax information for individuals, businesses, tax professionals and media, including news and updates, ways TAS helps taxpayers, and important information about tax topics and rights and is available at <http://www.TaxpayerAdvocate.irs.gov>.

32 IRS Human Resources Reporting Center, *Report of SB/SE Job Series, Stakeholder Liaison Field Employees as of October 31, 2015* (Nov. 10, 2015). The 14 states are Alaska, Delaware, Hawaii, Iowa, Kentucky, Mississippi, Montana, Nebraska, New Hampshire, North Dakota, South Dakota, Vermont, West Virginia, and Wyoming. See also National Taxpayer Advocate 2014 Annual Report to Congress 31 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

33 Stakeholders can report suspected systemic issues at [www.irs.gov/sams](http://www.irs.gov/sams).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide additional guidance to employers and tax practitioners on how to calculate the number of FTEs for purposes of meeting the MEC requirements.
2. Publish regulations explaining how the IRC § 4980D excise tax may apply to certain flexible spending accounts and health reimbursement arrangements.
3. Establish a Rapid Response team to assist front-line IRS employees with issues, problems, or questions from employers or tax practitioners.
4. Provide employees in its newly-established ACA Business Exam unit with comprehensive and specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as ALE, MEC, and ESRP.