



ACA Audit Letter Best Practices

This guide provides general information and best practices for certain ACA audits.

Mineral® does not provide specific Affordable Care Act (ACA) audit support. This guide provides general information and best practices for certain ACA audits. Employers should seek guidance from legal counsel in the event of an audit.

The ACA's employer shared responsibility provision, often referred to as the "employer mandate" or "play or pay," generally applies only to applicable large employers (ALEs) under Internal Revenue Code § 4980H. An ALE is an entity that employed an average of 50 or more full-time equivalent employees in the prior calendar year. Any employer large enough to be an ALE, whether a private business, a governmental entity such as a city or public school district, a nonprofit organization, or a church, is affected by the ACA play or pay rules.

The ACA does not require employers to offer or provide health coverage, but an ALE that fails to offer coverage to its full-time employees may be exposed to a penalty levied by the IRS. The IRS has been issuing penalty letters from tax year 2015 to present. An IRS penalty assessment is only an estimate; it is an employer's responsibility to review the audit and provide statements refuting the assessed penalty.

Audit Letter 226J

Penalties are triggered under § 4980H when one full-time employee receives a premium tax credit and purchases an individual insurance policy from a public Marketplace (Exchange). Employer shared responsibility penalties are imposed when either of the following situations occur:

- The ALE did not offer minimum essential coverage to at least 95% of its full-time employees and their dependents (IRS does not include spouses in the definition of dependent); or
- The minimum essential coverage is not affordable or does not provide minimum value.

If both situations are found, the IRS will assess the penalty for the higher of the two, not both.

A 226J audit letter will contain an explanation of the employer shared responsibility provisions in § 4980H, an Employer Shared Responsibility Penalty (ESRP) Summary Table itemizing the proposed ESRP by month with an explanation, Form 14764, *ESRP Response*, and Form 14765, *Employee Premium Tax Credit (PTC) Listing*. The first page of the audit letter contains the tax year being audited, the deadline (generally 30 days) for responding to the letter, and IRS contact information.

When preparing a 226J response, the owner or an officer of the business may call the IRS and request an extension of time (typically 30 days) to respond. During that time, an employer should:

- Retrieve copies of Forms 1094 and 1095 for the tax year being audited.
- Notify the vendor used (if applicable) to complete the filing.

The audit letter will provide which section of the ESRP is proposed and how to respond. Not responding to the audit letter allows the IRS to assume agreement with the assessed penalty. The PTC listing will list the employees who received a tax credit. It is important to review each employee's records to determine the response. For example, an employee who was not full time should not incur a penalty assessment.



Review each employee on the PTC listing against the records to determine whether the penalty per employee and per month is accurately listed.

An employer should determine the following information for each employee:

- Was the employee full time for any month of the year?
- Was the employee offered coverage for any month of the year?
- Did the employee enroll or sign a waiver of coverage?
- Were the appropriate codes applied to lines 14 and 16 of Form 1095-C?
- Was the contribution value on line 15 of the filed Form 1095-C calculated accurately, and did it meet affordability?

The PTC listing provides spaces to correct inaccurate coding. For example, a noneligible part-time employee had an incorrect code on line 16 of 2E instead of 2B, which designates the employee as part time. The employer would use this space to make the correction.



To disagree with the IRS assessment, prepare a cover letter summarizing your reasons for disagreement, and:

- Include the employer's federal tax ID number on the top right corner of every response page.
- Fax the response to the IRS using the fax number on page one of the 226J letter.
- Obtain a fax confirmation documenting a successful fax transmission.
- Compile all pages of the audit letter and response and retain it indefinitely.

A precursor to a 226J letter was generally a letter from the applicable Marketplace when an employee obtained a PTC. An employer may respond to the Marketplace letter. A typical response to a Marketplace letter requires providing documentation of the following:

- Whether the named employee was full time;
- Whether benefits were offered, enrolled, or waived;
- Whether the plan provided minimum essential coverage and minimum value; and
- Whether the contribution amount provided to the employee was affordable.

The Marketplace does not decide on penalty assessments or employer responsibility. They are responsible for referring cases to the IRS. An employer's response to the Marketplace letter does not eliminate the potential for an IRS audit letter.

Appealing a Marketplace letter does not eliminate the potential for an IRS audit and is a good indicator that a 226J letter is forthcoming (generally within a year or longer).

Audit Letter 5699

Penalties may be assessed if ACA reporting, as required under Internal Revenue Code § 6055 and § 6056, is not filed by applicable employers or forms furnished to employees by the IRS annual deadlines. The IRS generally reviews other employer filings to estimate whether an employer is an ALE.

For example, an employer filed 200 Forms W-2 for the tax year 2021. The IRS may review whether ACA reporting was completed based on the number of W-2s. The IRS may compare other employer filings as well.

When the IRS assumes that an employer should have completed ACA reporting based on other filings indicating the number of employees or other reasons and does not have a filing record, they will notify the employer using Audit Letter 5699. Letter 5699 requests additional information from an employer to confirm whether an employer should have filed.

It is possible for an employer that completed a timely filing to receive a Letter 5699. To respond to the inquiry, provide the IRS with proof of filing. Electronic filers generally receive an IRS confirmation number upon successful transmission.

For example, an employer with 200 employees may not be an ALE if the majority of its employees are part time and work minimal hours per month. An employer in this circumstance may consider performing a full-time equivalency test.

Page two of Letter 5699 provides selections using check boxes for an employer to complete and return. A fax number is generally provided on page one of the letter for returning the response.



To respond to a 5699 letter, prepare a letter summarizing your response, and:

- Include the employer's federal tax ID number on the top right corner of every response page.
- Fax the response to the IRS using the fax number on page one of Letter 5699.
- Obtain a fax confirmation documenting a successful fax transmission.
- Compile all pages of the audit letter and response and retain it indefinitely.

The penalty assessment is generally calculated using the number of Forms W-2 filed in the tax year of the audit.

Employers receiving an IRS letter regarding ACA should consult with their ACA vendor and legal counsel to ensure timely and accurate response.