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Elimination of Good Faith Relief for ACA Reporting

by Karen K. Hartford on January 10, 2022

On November 22, 2021, the Internal Revenue Service (IRS) published proposed regulations that codify, among other things, an automatic extension of the deadline for furnishing IRS Forms 1095-C to employees. IRS Forms 1095-C are the annual information returns required by the Affordable Care Act (ACA) for reporting offers of minimum essential health coverage to employees. Specifically, the proposed regulations provide for a 30-day extension of this deadline from January 31 to March 2 (March 3 in a leap year).[1] With that welcome news, however, the IRS also eliminated the transitional good faith relief for employer ACA reporting. For the 2015 through 2020 tax years, the transitional good faith relief insulated employers from penalties assessed under Sections 6721 and 6722 of the Internal Revenue Code (Code) for furnishing or filing a Form 1095-C that contained mistakes or was missing information so long as employers filed timely and made reasonable efforts to complete Form 1095-C accurately (essentially, “do the best you can”).

Anecdotally, it has become apparent that some employers never fully understood what penalties the transitional good faith relief was intended to relieve and, consequently, do not now understand what elimination of the good faith relief may mean to them. This post is intended to clarify the potential consequences of the elimination of transitional good faith relief.

Since 2015, Applicable Large Employers (ALEs) (generally, those employers with at least 50 full-time employees) have been required to complete and furnish Forms 1095-C to all employees who worked full-time during any month of the tax year and to the IRS. The Forms reports codes denoting offers of coverage and affordability, and employment status, and provide details such as employee and employer names and addresses, taxpayer identification numbers (TINs), and the identity of covered dependents. Information reported on Form 1095-C is used to verify employer-provided health coverage and to determine eligibility for the premium tax credit when coverage is purchased on a government exchange. Form 1094-C is the transmittal form that accompanies an employer’s Forms 1095-C when the forms are filed with the IRS.

From the start, the accurate completion of Forms 1094-C and 1095-C has challenged employers. Not only were employers contending with accurate and complete reporting of basic information, such as names, addresses, and TINs, they struggled with the complexity of the fact-sensitive codes required by the ACA under Part II (Employer Offer of Coverage) of Form 1095-C. This is especially true when it comes to completing the forms for employees who change employment status during the year (full-time to part-time or vice versa, terminate and re-hire, COBRA continuants, etc.), which can require different codes to be reported under Part II of Form 1095-C.

Mistakes on Forms 1094-C and 1095-C— in particular, mistakes in the coding of offers of coverage and the relief available to employers —often lead to the assessment of proposed penalties under the ACA's Employer Shared Responsibility Payment (ESRP) provisions of Section 4980H of the Code, resulting in the employer's receipt of the dreaded IRS Letter 226-J (Notice of Proposed ESRP Penalty) assessing, in many cases, millions of dollars of proposed penalties under the ESRP regulations.[2] This is because reporting incorrect codes, or simply checking the wrong box on Forms 1094-C and 1095-C, can make it appear as though the employer is not offering ACA-required minimum essential coverage to at least 95% of its full-time employees, not providing affordable coverage, or is otherwise non-ACA-compliant. Fortunately, instructions that accompany Letter 226-J provide a process for disputing proposed ESRP penalties and for correcting mistakes. And this is where we have seen the confusion arise. It seems that because the good faith relief has been informally referred to as "ACA reporting relief," some employers have been under the mistaken impression that the good faith standard applied to the ESRP provisions and resulting penalties. To be clear, the transitional good faith relief never applied to ESRP penalty assessments. The ESRP penalties are separate and distinct penalties from the reporting penalties under Code Sections 6721 and 6722, which apply to the failure to file and furnish timely and accurate information returns. We assume that the process for responding to proposed ESRP penalties will remain the same, and mistakes appearing on Forms 1094 and 1095 that give rise to an ESRP penalty can continue to be corrected by following the steps that have been in place for the past six years, as described in the materials that accompany IRS Letter 226-J.

Employers penalized under Code Sections 6721 and 6722 for late, incorrect, or incomplete returns will receive an IRS Notice 972CG (Notice of Proposed Penalty for Late/Incorrect Information Return), not an IRS Letter 226-J. Employers that have been filing their Forms 1094-C and 1095-C on time and with good faith effort, have likely never received IRS Notice 972CG. For businesses with annual gross receipts of more than $5 million, the 2022 penalties under Sections 6721 and 6722 are $280 per return furnished to the employee and $280 for the same return filed with the IRS, for a potential total of $560 per return. Penalties under Code Sections 6721 and 6722 are capped at $3,426,000 per calendar year. The penalty amounts are indexed for inflation, typically on an annual basis. If mistakes in the information returns are discovered and corrected quickly, the general penalty may be reduced to as low as $50 per return (capped at $571,000) if corrected within 30 days of the due date, or $110 per return (capped at $1,713,000) if corrected more than 30 days after the due date but before August 1. On the other hand, if mistakes are intentionally disregarded, the 2022 penalty will be at least $570 per return, with no annual cap.

Notably, despite the elimination of the transitional good faith relief, the IRS stated in the preamble to the proposed regulations that Code Sections 6721 and 6722 penalty relief for “reasonable cause,” has always been, and will continue to be, available under Code Section 6724. Of course, reasonable cause is a higher standard than good faith. IRS Publication 1586 explains that to demonstrate reasonable cause, “filers must establish both that they acted in a responsible manner both before and after the failure occurred and that: there were significant mitigating factors with respect to the failure . . . or the failure was due to events beyond the filer’s control.” In addition, there is no guarantee that penalty relief will be granted.

In conclusion, to those who may be concerned that the process for reducing and eliminating ESRP penalties proposed via IRS Letter 226-J is becoming more unforgiving as a result of the end of the transitional good faith relief, there is some solace, because as far as we are aware, the process set forth in the instructions that accompany Letter 226-J for disputing proposed ESRP penalties and for correcting mistakes remains untouched. Soberingly, however, with the elimination of the transitional good faith relief, there is the possibility of an entirely different, potentially hefty, penalty under Code Sections 6721 and 6722 for filing late, incorrect, or incomplete Forms 1094 and 1095. If you are an employer that has dealt with the IRS in the past due to inaccurate Forms 1094-C and 1095-C and/or you have questions or concerns about the ability to produce accurate forms going forward, now is the time to reach out to your ACA reporting vendor or legal counsel to formulate a plan to support accuracy and avoid all types of penalties.

Please contact a member of Verrill’s Employee Benefits & Executive Compensation Group if you have any questions about ACA reporting.

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[1] The deadline for filing the forms with the IRS (February 28 for paper filers; March 31 for e-filers) was unaffected.

[2] Prior Client Advisories discussing IRS Letter 226-J in more detail are available here and here.

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