

**Office of Chief Counsel  
Internal Revenue Service**

# Memorandum

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subject: Application of Section 7611 to Letter 226-J.<sup>1</sup>

This memorandum should not be used or cited as precedent.

## Issue

Does the routine request exception in Treas. Reg. § 301.7611-1, Q&A-4 apply when the IRS sends Letter 226-J to a church applicable large employer?

## Conclusion

Yes. When sent to a church applicable large employer, Letter 226-J is a routine request within the meaning of Treas. Reg. § 301.7611-1, Q&A-4.

## Background and Applicable Law

### Section 4980H and Related Process Generally

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<sup>1</sup> Unless otherwise specified in this memorandum, all section references are references to the Internal Revenue Code.

Enacted as part of the Affordable Care Act, section 4980H generally provides that an applicable large employer (ALE) is subject to an assessable payment if either (1) the ALE fails to offer its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan for any month and at least one full-time employee is certified as having enrolled for such month in a qualified health plan for which a premium tax credit is allowed; or (2) the ALE offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage and one or more full-time employee is certified as having enrolled for such month in a qualified health plan for which a premium tax credit is allowed for that employee because the offered coverage did not provide minimum value or was not affordable, or the particular employee was not offered coverage. The assessable payment under section 4980H is commonly referred to as the employer shared responsibility payment (ESRP).

For purposes of section 4980H, ALEs generally are employers that employed on average 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year. ALEs use Forms 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, and 1095-C, Employer-Provided Health Insurance Offer and Coverage, to report information required under sections 6055 and 6056 about offers of health coverage to, and enrollment in health coverage by, their employees. The IRS uses the information contained in the Forms 1094-C and 1095-C, along with information in IRS records from the individual income tax returns filed by the ALE's full-time employees regarding whether any of the ALE's full-time employees is allowed a premium tax credit for enrolling in a qualified health plan, in preliminarily determining whether an ALE may owe an ESRP under section 4980H and calculating its amount. This is the only information used by the IRS in making this preliminary determination and calculation.

ALEs cannot proactively determine, calculate, or pay any amounts payable under section 4980H because they do not know whether their offer of coverage to their full-time employees is affordable based on the household income for their full-time employees.<sup>2</sup> The IRS, however, has information about the ALE's offer of coverage from the ALE's information return and information about the ALE's full-time employee's household income from that full-time employees' individual income tax returns. Therefore, for every ALE, the IRS generates a preliminary calculation of the ESRP based solely on the information contained in the ALE's Forms 1094-C and 1095-C and the ALE's full-time employees' tax returns. The IRS then informs each ALE of this preliminary calculation via Letter 226-J. ALEs must receive the preliminary calculation in the Letter 226-J and a notice and demand for payment from the IRS before they can pay any amounts.

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<sup>2</sup> Under section 4980H(d), ESRPs are assessed and collected in the same manner as an assessable penalty.

The Letter 226-J also affords ALEs an opportunity to provide information to clarify or correct the information from its Forms 1094-C and 1095-C that is contained in the letter and used to determine and calculate the ALE's ESRP, if any. Such clarification or correction may or may not reduce or eliminate the preliminary amount provided in the Letter 226-J. The IRS does not request books, records, or similar documents of any nature, including corporate and financial records regularly kept by an ALE, in connection with the Letter 226-J.

There are several ways that an ALE may respond to the issuance of the Letter 226-J:

1. The ALE may not respond at all to the Letter 226-J. If this occurs, the IRS sends a second substantially similar letter.<sup>3</sup> If the ALE does not respond to that letter, the IRS will begin assessment procedures for the amount listed in the Letter 226-J without initiating an examination.
2. The ALE may respond to the Letter 226-J by providing additional information to the IRS that clarifies or corrects the previously reported information from Forms 1094-C and 1095-C that is contained in the Letter 226-J. These corrections may either reduce or fully eliminate the preliminary calculation of the ESRP set forth in the Letter 226-J. If the ESRP is fully eliminated as a result of the clarified or corrected information, the IRS will not assess the preliminary ESRP in the Letter 226-J and no further action will be taken.
3. The ALE can agree with the preliminary calculation specified in the Letter 226-J, or a recalculated amount of the ESRP after the IRS takes into account any related clarification or correction. In such instances, the original preliminary amount listed in the Letter 226-J, or the recalculated amount, as the case may be, is assessed by the IRS without initiating an examination. The ALE may send payment with a response in agreement to Letter 226-J, but payment is not required until the ALE receives a notice and demand for payment.

If the IRS determines that an ALE still owes an ESRP after taking into account any response to Letter 226-J and the ALE disagrees with all or part of the ESRP amount listed, the ALE is afforded an opportunity to take the case to the IRS Independent Office of Appeals.

### Section 7611 Procedural Requirements

In 1984, Congress enacted section 7611 to expand the requirements relating to IRS interactions with churches to protect churches from undue interference while allowing the IRS to retain the ability to pursue individuals who inappropriately use the church form as a tax-avoidance device. Section 7611(a) permits the IRS to begin a church tax

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<sup>3</sup> This second letter is Letter 5040-J and includes a copy of the Letter 226-J. Letter 5040-J advises the taxpayer of the different responses they can make to the letter and advises the taxpayer that if it does not respond, a Notice of Assessment will be issued.

inquiry only upon a written, reasonable belief determination by an appropriate high-level Treasury official. Delegation Order 7-3 (Rev. 2) requires the Commissioner, Tax Exempt & Government Entities (TE/GE) to make all reasonable belief determinations under section 7611(a). Section 7611(a) also contains an inquiry notice requirement that requires the IRS to provide taxpayers subject to section 7611 specific information before it can begin a church tax inquiry. Current IRS procedures provide that the specific information required by the inquiry notice requirement is provided to church taxpayers using Letter 5307, Notice of Church Tax Inquiry. See, IRM 4.75.39.7.4.

Section 7611(h)(2) defines a church tax inquiry as any inquiry to a church (other than an examination) to serve as a basis for determining whether a church is exempt from tax under section 501(a) by reason of its status as a church, or is carrying on an unrelated trade or business (within the meaning of section 513) or otherwise engaged in activities which may be subject to taxation under title 26. The legislative history for section 7611 provides that “[T]he procedures also are not intended to apply to routine IRS inquiries to a church, including inquiries with respect to income tax withholding for church employees, social security taxes, and similar matters.” S. Rpt. No. 169 Vol. 1, 98<sup>th</sup> Cong. 2d Sess. (March 21, 1984). The Conference Agreement legislative history expands on the Senate amendment and provides that “The conferees further intend that routine IRS inquiries to a church will not be considered to commence a church tax inquiry and therefore will not trigger application of the church audit procedures. Routine questions for [the] purpose include (but are not limited to) questions regarding (1) the filing or failure to file any tax return or information return by the church, (2) compliance with income tax or FICA tax withholding responsibilities by the church, (3) any supplemental information needed to complete the mechanical processing of any incomplete or incorrect return filed by the church, (4) information necessary to process applications for exempt status, letter ruling requests, or employment tax exemption requests by the church, and information identifying a church that is used by the IRS to update its Cumulative List of Tax Exempt Organizations and other computer files, and (5) confirmation that a specific business is or is not owned and operated by a church. H.R. Rep. No. 861, 98<sup>th</sup> Cong. 2d Sess. (June 23, 1984).

Treas. Reg § 301.7611-1, Q&A-2 reiterates the statutory definition of a church tax inquiry, and further provides that a church tax inquiry does not include a routine request described in Treas. Reg § 301.7611-1, Q&A-4. Treas. Reg § 301.7611-1, Q&A-2 also provides that a church tax inquiry is considered to commence when the IRS requests information or materials from a church of a type contained in church records.

Treas. Reg § 301.7611-1, Q&A-4, which essentially repackages the legislative history, provides that routine requests to a church will not be considered to commence a church tax inquiry and will not necessitate application of the procedures set forth in section 7611. Routine requests for this purpose include (but are not limited to) questions regarding (1) the filing or failure to file any tax return or information return by the church; (2) compliance with income tax or FICA (social security) tax withholding responsibilities by the church; (3) any supplemental information needed to complete the mechanical

processing of any incomplete or incorrect return filed by the church; (4) information necessary to process applications for exempt status and letter ruling requests; (5) information necessary to process and update periodically a church's (i) registrations for tax-free transactions (excise tax), (ii) elections for exemption from windfall profit tax, or (iii) employment tax exemption requests; (6) information identifying a church that is used to update the Cumulative List of Tax Exempt Organizations (Publication No. 78) and other computer files; and (7) confirmation that a specific business is or is not owned or operated by a church.

### Cases Involving Sections 7611 and 4980H

All ALEs, including churches or convention or association of churches, are subject to section 4980H. Section 7611 generally applies to all cases involving a church, unless an exception applies.<sup>4</sup> In 2018, this office considered whether section 7611 applies to a section 4980H case that involves an ALE that is a church, taking into account the newness of the ESRP compliance program and its unique nature as compared to other compliance programs under which churches may ultimately owe a tax. After consideration of the law, the newness and distinctions of the compliance program, and the intent of section 7611 to provide additional procedural protections to churches, this office advised a cautious approach of applying section 7611 to the ESRP compliance program with respect to church taxpayers. Based on that advice, TE/GE has been applying section 7611 to communications issued to a church taxpayer under the ESRP compliance program, including Letter 226-J. Accordingly, each Letter 226-J has been reviewed by the Commissioner, TE/GE in accordance with section 7611(a) when the taxpayer is a church, and the Letter 226-J is sent as an attachment to the Notice of Church Tax Inquiry (designated as Letter 5307-A as opposed to Letter 5307 when issued with Letter 226-J attached).

After two years of administering the ESRP compliance program as applied to taxpayers that are churches, TE/GE's experience is that the vast majority of churches that receive Letter 226-J clarify or correct the information they previously reported to the IRS on Forms 1094-C and 1095-C, and that such clarification or correction usually results in elimination of the liability preliminarily calculated in the Letter 226-J.<sup>5</sup> Those church ALEs for which a response does not eliminate the preliminarily calculated ESRP either pay the ESRP and resolve the matter or receive additional correspondence from the IRS.

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<sup>4</sup> Section 7611(i) enumerates five exceptions to section 7611, including criminal tax cases and cases involving a willful attempt to defeat or evade tax. The exceptions enumerated in section 7611(i) are reiterated in Treas. Reg § 301.7611-1, Q&A-6. Additionally, Treas. Reg § 301.7611-1, Q&A-5, excepts information requests regarding third-party records and third-party record keepers from the application of section 7611. Section 7611(i) and Q&As-5 & 6 of Treas. Reg § 301.7611-1 are not relevant for purposes of this memorandum.

<sup>5</sup> Approximately 90% of the church ALEs that receive the Letter 226-J clarify or correct the information contained in the letter and are ultimately not assessed any ESRP.

Furthermore, treating Letter 226-J as a church inquiry subject to section 7611, and the associated necessity of obtaining approval of the high-level Treasury official, has resulted in substantial delays in providing Letters 226-J to church ALEs, as compared to ALEs that are not churches. This, in turn, delays resolution of a church ALE's reporting errors, potentially leading to repeated reporting errors in subsequent years. Thus, rather than providing extra protection for church taxpayers, as intended by section 7611, requiring approval of the high-level Treasury official and the associated delay result in less favorable treatment for church ALEs.

Further, Letter 226-J is a template letter generated solely based on the church ALE's own reporting and the tax returns of one or more of its full-time employees allowed a premium tax credit. It is a routine review of the same general fact pattern and identical legal issues involved.

Accordingly, our office reconsidered the 2018 advice in light of the information gained from operation of the ESRP program. In particular, the office further considered whether the Letter 226-J is best viewed as the beginning of a church tax inquiry subject to the reasonable belief and inquiry notice requirement in section 7611(a), or whether Letter 226-J, when sent to a church ALE, is better characterized as a routine request within the meaning of Treas. Reg § 301.7611-1, Q&A-2 and Treas. Reg § 301.7611-1, Q&A-4. As discussed below, we have determined that when sent to a church ALE, Letter 226-J is a routine request within the meaning of Treas. Reg. § 301.7611-1, Q&A-4.

## **Analysis**

In order to provide procedural safeguards to churches, section 7611 limits the ability of the IRS to begin church tax inquiries and examinations. Under section 7611, a church tax inquiry is any inquiry to a church that will serve as a basis for determining whether the church is exempt from tax under section 501(a), is carrying on an unrelated trade or business, or is otherwise engaged in activities which may be subject to taxation under title 26. Neither section 7611 nor 4980H addresses whether the requirement that a church ALE provide minimum essential coverage or owe an ESRP is an "activity which may be subject to taxation under title 26." Similarly, neither the legislative history nor the existing regulations under section 7611 address this issue.

Assuming section 7611 generally applies to the ESRP compliance program and that Letter 226-J would otherwise meet the definition of a church tax inquiry, we consider whether any exception applies.<sup>6</sup> Relevant for this analysis are Treas. Reg § 301.7611-1, Q&A-2 and Treas. Reg § 301.7611-1, Q&A-4, which as noted, are drawn from the discussion of the scope of the statute in the legislative history. Q&A-2 reiterates the statutory definition of a church tax inquiry, and further provides that, among other things,

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<sup>6</sup> While there are potential arguments that section 7611 does not apply to the ESRP compliance program or, more specifically, that Letter 226-J does not otherwise meet the definition of a church tax inquiry, for purposes of this memorandum we assume that Letter 226-J would otherwise be a church tax inquiry.

a church tax inquiry does not include routine requests for information. Q&A-2 references Q&A-4 for the description of a routine request. Q&A-4 provides that routine requests to a church will not be considered to commence a church tax inquiry and will not necessitate application of the procedures set forth in section 7611. The regulation further states that, routine requests for this purpose include **(but are not limited to)** questions regarding (1) the filing or failure to file any tax return or information return by the church; (2) compliance with income tax or FICA (social security) tax withholding responsibilities by the church; (3) any supplemental information needed to complete the mechanical processing of any incomplete or incorrect return filed by the church; (4) information necessary to process applications for exempt status and letter ruling requests; (5) information necessary to process and update periodically a church's (i) registrations for tax-free transactions (excise tax), (ii) elections for exemption from windfall profit tax, or (iii) employment tax exemption requests; (6) information identifying a church that is used to update the Cumulative List of Tax Exempt Organizations (Publication No. 78) and other computer files; and (7) confirmation that a specific business is or is not owned or operated by a church. (Emphasis added).<sup>7</sup> Although inquiries regarding compliance with section 4980H are not explicitly included in the seven examples provided in Treas. Reg. § 301.7611-1, Q&A-4 (and indeed could not have been since the regulations predate the passage of section 4980H), it is clear from the parenthetical in bold text above, that Q&A-4 sets forth a non-exhaustive list of what constitutes a routine request.

It is our view that Letter 226-J is rightfully characterized as a routine request for purposes of section 7611. Our view is based on the reasons described below.

1. **Letter 226-J is an initial communication with an ALE that is necessary in order for the ALE to know that they may have a tax obligation.** Letter 226-J is a necessary prerequisite communication that is issued to ALEs (including churches) to enable the ALE to correct information about its offers of coverage in order for the IRS to correctly determine whether the ALE owes an ESRP and, if so, the amount it owes. Prior to the issuance of the Letter 226-J, the ALE will not know the number of full-time employees that are certified as having enrolled for a particular month in a qualified health plan for which a premium tax credit is allowed and cannot calculate any potential ESRP obligation without this information. Accordingly, the ALE cannot unilaterally and proactively calculate or pay the ESRP, but instead must rely on the information communicated in the Letter 226-J. Thus, the calculation information provided to the ALE in the Letter 226-J is entirely routine in the context of the ESRP program, and the ESRP program would not function without this initial communication to an ALE.
2. **Letter 226-J provides a preliminary ESRP that is calculated from the ALE's own information reporting.** Letter 226-J is premised solely on information reported by the ALE on its Forms 1094-C and 1095-C and one or more of the

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<sup>7</sup> The section 7611 legislative history presents the list of routine request examples slightly differently, but the difference is not relevant for purposes of this memorandum.

ALE's full-time employee's being allowed a premium tax credit on the full-time employee's individual income tax return. The IRS does not use any other information to make this preliminary calculation of the ESRP. While Letter 226-J gives the church ALE an opportunity to clarify or correct its previously reported information or to state that any of the full-time employees referenced in the Letter 226-J as having been allowed a premium tax credit were not its employees for the relevant period or were in a limited non-assessment period, the Letter 226-J is not focused on obtaining additional information from the church.

3. **Letter 226-J is routine in nature as evidenced by its usual resolution.** If an ALE responds to Letter 226-J and clarifies or corrects its previously reported information, including information about the number of its full-time employees for each month, the IRS generally accepts the new information, resulting in an adjusted or eliminated ESRP.<sup>8</sup> In fact, over the course of the last two years in administering the ESRP program, the clarification or correction provided by the church ALE usually resulted in the church owing no ESRP. The fact that the proposed assessment is almost always resolved after an initial round of communication demonstrates the routine nature of the Letter 226-J.
4. **Letter 226-J is similar to other routine requests.** The Letter 226-J process shares similarities with the first three examples contained in the non-exhaustive list of routine requests in Treas. Reg. § 301.7611-1, Q&A-4. The first example listed as a routine request in Q&A-4 involves the filing or failure to file any tax return or information return. Letter 226-J is essentially asking the church whether it is an ALE required to file Forms 1094-C and 1095-C, whether the information it provided on its Forms 1094-C and 1095-C is correct, and whether IRS records correctly identify that specified employees allowed a premium tax credit were actually full-time employees of the church. Forms 1094-C and 1095-C are information returns that ALEs use to report information required under sections 6055 and 6056 about offers of health coverage and enrollment in health coverage for their employees.<sup>9</sup> Thus, Letter 226-J and its associated process can be readily viewed as the IRS asking the church about the proper filing of an information return that the church filed with the IRS.

The second example listed in Treas. Reg. § 301.7611-1, Q&A-4 also lends support to the view that the Letter 226-J is a routine request for purposes of section 7611. That second item characterizes questions involving compliance with income tax or FICA tax withholding responsibilities as a routine request. An employer's ongoing withholding responsibilities and quarterly return filing

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<sup>8</sup> We note that the IRS could simply assess the amount reflected in the Letter 226-J, in accordance with section 4980H(d); but the IRS instead provides an opportunity for the taxpayer to confirm the information supporting the assessment in the interest of sound tax administration.

<sup>9</sup> Sections 6055 and 6056 are located in Subpart D (Information Regarding Health Insurance Coverage) of Part III (Information returns), which is in Subchapter A (Returns and Records) of Chapter 61 (Information Returns).



obligations may often generate a need for follow up information and communication, including based on the IRS' return matching program. Similarly, the ongoing health care coverage responsibilities and monthly and annual reporting to demonstrate compliance with such responsibilities often result in proposed assessments based on such information. Letter 226-J is the initial communication regarding the church's compliance with such ongoing responsibilities and is, in that way, similar to the second example listed in Q&A-4.

Finally, the third example listed in Q&A-4 characterizes questions involving any supplemental information needed to complete the mechanical processing of any incomplete or incorrect return. While the Letter 226-J does not necessarily involve asking for information needed to supplement a previously filed incomplete or incorrect return, the Letter 226-J essentially asks an ALE whether the information in the Letter 226-J is correct, so the IRS can mechanically process, or finalize the preliminary calculation of a liability, if any, under section 4980H. So, while the third item in the list of routine requests in Q&A-4 involves situations where the IRS asks a church about information the IRS has identified as being incomplete or incorrect on a return, the Letter 226-J involves the IRS asking the church to confirm the accuracy of the information in the Letter 226-J, with both processes culminating with mechanical processing of the return or the information from the Letter 226-J process, as the case may be. The close similarity between what is actually occurring with respect to a Letter 226-J and the mechanical process example in Q&A-4 supports the conclusion that Letter 226-J is a routine request for purposes of section 7611.

## **Conclusion**

After further consideration of Letter 226-J, the applicable regulations, and TE/GE's experience in the demonstrated routine nature of the initial letter and the employer's responses thereto, we have determined that Letter 226-J is appropriately characterized as a routine request within the meaning of Treas. Reg. § 301.7611-1, Q&A-4.<sup>10</sup>

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<sup>10</sup> This memorandum does not consider IRS communications to a church that may be necessary if the Letter 226-J (and the substantially similar follow-up Letter 5040-J) and the response to Letter 226-J (or Letter 5040-J) do not resolve the ESRP liability, or if a legal issue that is not otherwise related to section 4980H arises during the Letter 226-J process.