

# ARRA – Step Two

## *Reimbursement for COBRA Premium Subsidy*

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Last spring, we discussed the COBRA provisions in the American Recovery and Reinvestment Act of 2009 (“ARRA”). Among the most important is a federal subsidy for “assistance eligible individuals” equal to 65% of the premium for COBRA coverage. This COBRA subsidy has been very successful for employees who have lost their jobs. However, the COBRA subsidy has increased administrative burdens on employers.<sup>1</sup> In addition, employers must be certain that the ARRA subsidy is extended only to eligible individuals and applied to the correct premium amount. Otherwise, an employer may find that it has advanced the premium subsidy but is not eligible for reimbursement. This article discusses those issues and also discusses how employers can obtain reimbursement for the federal subsidy.

Under the ARRA, “assistance eligible individuals” are treated as having fully paid their COBRA premiums if they pay 35% of the regular premium for continued health plan coverage. The employer (or in some cases, the health plan or insurer) must pay the balance, or 65%, of the COBRA premium and seek reimbursement on the employer’s (or other payor’s) payroll tax returns. It is crucial for employers to know which health plan participants are “assistance eligible individuals” and what constitutes the regular premium for COBRA coverage in order to determine whether COBRA premiums qualify for reimbursement. In addition, employers should be attentive to the recordkeeping requirements related to the premium reimbursement.

### **WHO IS ELIGIBLE FOR THE COBRA SUBSIDY?**

The Internal Revenue Service published guidance on the COBRA subsidy on April 28, 2009 in Notice 2009-27. The ARRA provides that an “assistance eligible individual” is an employee (i) who is a qualified beneficiary under COBRA, e.g., eligible for COBRA continuation group health coverage; (ii) whose employment is involuntarily terminated during the period commencing on September 1, 2008 and ending on December 31, 2009; and (iii) who has elected continuation of health plan coverage.

The IRS defines involuntary termination of employment as “a severance from employment due to the independent exercise of the unilateral authority of the employer to terminate employment, other than due to the employee’s implicit or explicit request, where the employee was willing and able to continue to provide services.” In Notice 2009-27, the IRS clarified that an involuntary termination under the ARRA is the involuntary termination of employment, and not the



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involuntary termination of *health plan coverage*. In addition, the IRS stated that an involuntary termination can occur where an employer declines to renew a contract that has expired, if the employee was willing and able to enter into a new contract on similar terms and conditions. Moreover, an involuntary termination can occur as a result of a layoff, furlough or other suspension of employment; the termination of employment while an employee is absent due to illness or disability, and when an employee resigns due to a material change in the employee's geographic location of employment. Essentially, whether a termination will be considered to be an involuntary termination for purposes of the ARRA subsidy depends on the facts and circumstances of each case.

To qualify as an "assistance eligible individual," a health plan participant must experience an involuntary termination between September 1, 2008 and December 31, 2009. An individual who was involuntarily terminated prior to September 1, 2008 and who was still on COBRA coverage on February 17, 2009 - the date of enactment of the ARRA - is not an "assistance eligible individual". Similarly, if an involuntary termination occurs before December 31, 2009, but the loss of group health plan coverage does not occur until after that date, the employee will not qualify as an "assistance eligible individual".

Employers who extend health plan coverage to employees, who have been involuntarily terminated, such as pursuant to a severance agreement, should carefully evaluate when an employee will be considered to have experienced a loss of coverage under the ARRA rules. The IRS has stated that the loss of coverage will depend on how the employer treats the provision of health coverage for the involuntarily terminated employees. If the employer treats the extension of health coverage as deferring the loss of coverage, such as by delaying the commencement of the COBRA period, then the loss of coverage will not occur until the extension of health coverage ends. However, if the employer treats the extension of health plan coverage as COBRA continuation health coverage, e.g., by providing the COBRA notice and election, then the loss of coverage will occur on the date on which COBRA coverage commences.

#### **WHAT IS THE COBRA PREMIUM FOR PURPOSES OF THE SUBSIDY?**

The IRS has stated that the premium used to determine the federal subsidy is "the cost that would be charged to the assistance eligible individual for COBRA continuation coverage were not an assistance eligible individual". Therefore, if the COBRA premium is 102% of the premium for active employees, then the federal subsidy is 65% of that amount.

If an employer pays for all or a portion of the COBRA premium, the federal subsidy will only apply to that portion of the COBRA premium charged to the employee. For example, if an employer provides six months of COBRA coverage to employees who are involuntarily terminated, the federal subsidy will not apply



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to the payments made by the employer during the initial six-month period, but will apply to the COBRA premium charged to the former employee after the expiration of the initial six-month period. Under this example, former employees will receive six months of COBRA coverage paid for by their employer and for the following nine months, will pay only 35% of the COBRA premium assessed for their coverage.

The ARRA premium reduction, and resulting federal subsidy, is available for COBRA coverage for vision-only and dental-only plans, in addition to group health plans. It is also available for certain retiree health coverage and for coverage under a health reimbursement arrangement.

The beginning of the premium reduction period depends on the period for which premiums are charged by a health plan. If group health plan coverage continues through the end of the calendar month in which an employee is terminated, then the premium reduction period and the federal subsidy begin on the first day of the following month. If, however, group health plan coverage ends on the day on which an employee is terminated and the employee is required to pay a pro rata portion of the premium for the remainder of the month, then the premium reduction period begins on the day of termination of employment.

#### **HOW IS AN EMPLOYER REIMBURSED FOR THE FEDERAL SUBSIDY?**

Employers are reimbursed by claiming the COBRA subsidy amount as a credit against payroll taxes. The employer may take the credit once the 35% premium is paid by or on behalf of the assistance eligible individual. The credit is treated as a deposit made on the first day of the return period and is applied against the employer's deposit requirements; therefore an employer may reduce its payroll tax deposits during a quarter by the amount of subsidy provided during that quarter.

Form 941, the Quarterly Federal Tax Return, has been updated. Form 941, dated January 2009, allows reporting of the COBRA subsidy amount as a credit on line 12a. Employers must also report the number of individuals provided COBRA premium assistance on Line 12b. The subsidy may also be claimed on the Employer's Annual Federal Tax Return, Form 944, however, this form has yet to be updated. It is important to note that an employer may not be the proper party to provide the subsidy and take the tax credit. For example, in the case of a multiemployer plan, the plan provides the COBRA subsidy and therefore is entitled to take the credit.

While no additional documentation related to the COBRA subsidy need be submitted with Form 941, anyone claiming the credit for COBRA assistance must maintain supporting documents, including:

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- information on the payment of the assistance eligible individual's 35% share of the premium;
- in the case of an insured plan, copy of invoice or other supporting statement from the insurance carrier and proof of timely payment of the full premium to the insurance carrier required under COBRA;
- in the case of a self-insured plan, proof of the premium amount and of coverage provided to the assistance eligible individual;
- attestation of involuntary termination;
- proof of eligibility for COBRA coverage between September 1, 2008-December 31, 2009; and
- a record of the social security numbers of all covered employees, the amount of subsidy reimbursed with respect to each covered employee, and whether the subsidy was for one individual or two or more.

An employer can claim the tax credit even if no additional deposits are due for a quarter. If the amount of the subsidy exceeds the payroll tax liabilities, an employer can choose to have the excess amount refunded or applied to the next quarter.

An employer is not required to claim the tax credit on Form 941 for the quarter in which the COBRA subsidy is provided, but can choose to claim the credit on Form 941 for a later quarter in the same calendar year.

Where an employer has appointed an agent to file payroll tax returns and make payroll tax deposits and payments on its behalf, the agent may claim the tax credit on the payroll tax return filed on behalf of the employer, and any payroll tax deposits made on behalf of the employer can be reduced by the amount of the tax credit.

As evident from this discussion, the application of the ARRA premium subsidy and rules for claiming the related tax credit can be complex. Employers, as well as other entities obligated to advance COBRA premiums for the federal subsidy, should carefully review guidance provided by the IRS and Department of Labor and monitor this guidance for periodic updates in order to ensure that all requirements for claiming the tax credit have been satisfied.

<sup>1</sup> According to the International Foundation of Employee Benefit Plans, 80% of employers surveyed have incurred increased administrative costs due to the COBRA subsidy. BNA Pension & Benefits Reporter, April 28, 2009.



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