

Dear Client and Friends,

March, 2009

On its website, in a Question & Answer format, IRS has explained how employers are to administer the COBRA continuation premium subsidy provided to former employees and others covered by COBRA under the recently enacted **American Recovery and Reinvestment Act of 2009**. In particular, the information helps employers claim the COBRA continuation coverage credit on payroll tax forms to obtain speedy reimbursement for their subsidy to employees who involuntarily lose their jobs. Please call our offices if you think any of these new changes may affect you. We will help you navigate financial matters that are increasingly complex.

Background on COBRA: The health benefit provisions of the Consolidated Omnibus Budget Reconciliation Act of '85 (COBRA) provide certain former employees, retirees, spouses, former spouses and dependent children the right to temporary continuation of health coverage at group rates. COBRA generally covers health plans maintained by private-sector employers with 20 or more full and part-time employees. It also covers employee organizations or federal, state or local governments. It does not apply to churches and certain religious organizations.

The Recovery Act provides a 65% premium subsidy for 9 months to employees involuntarily terminated between September 1, 2008 through December 31, 2009. **If an eligible employee pays 35% of the premium, the group health plan must treat that individual as having paid the full premium required for COBRA continuation coverage.** The Recovery Act also provides a mechanism for reimbursing the person to which premiums are payable—e.g., an employer—for the difference between the full premium and the amount paid by the employee. While employers must treat the 35% payment by eligible former employees as full payment, they are entitled to a credit for the other 65% of the COBRA cost on their quarterly employment tax return. Employers use the updated Form 941, Employer's Quarterly Federal Tax Return, to report their COBRA premium assistance payments.

New details on COBRA coverage subsidy: The IRS announced that important information on how the COBRA coverage subsidy works, who pays for it, who is eligible for it, and how to be reimbursed for it, is available on IRS's website. IRS says it will continue to update information on this website as it becomes available. COBRA subsidy information will also be available through the Dept. of Labor and the Dept. of Health and Human Services, which share responsibility for the COBRA requirements with IRS.

When are the COBRA subsidy provisions effective? The Q&As explain that these provisions became effective on Feb. 17, 2009, but that under a transition rule the regular premium amount may continue to be paid for up to two months after Feb. 17, 2009 (e.g., for March and April),

and that the subsidy can be provided retroactively. IRS also says that the due date for the first-quarter Form 941 will not be extended. The Q&As note that under these temporary COBRA provisions, the qualifying event (involuntary termination) for assistance-eligible individuals must occur on or before Dec. 31, 2009, and the COBRA subsidy may apply for up to nine months.

Who must pay the COBRA subsidy premium? The subsidy requirement applies to group health plans that are subject to the Federal COBRA continuation coverage requirements or to similar requirements under State law. Employers with such a plan that receive a 35% payment from an assistance-eligible individual must make the remaining 65% payment. The subsidy requirements apply to all plans subject to the COBRA requirements, including self-insured plans. In that case, the employer must provide the COBRA coverage if the eligible individual pays 35% of the otherwise required premium and the remaining 65% is treated as a payment of payroll taxes by the employer maintaining the plan.

If more than one entity may be responsible for receiving COBRA premiums, the person to whom the reimbursement is payable is: (1) the multiemployer group health plan; (2) the employer maintaining a group health plan that is subject to Federal COBRA continuation coverage requirements or that is self-insured; or (3) the insurer providing coverage under a plan not included in (1) or (2). The Q&As clarify that only this person is eligible to offset its payroll taxes by the amount of the subsidy.

Claiming the COBRA subsidy credit: An employer who provides the subsidy may take the COBRA coverage credit on its employment tax return, but only after it has received the 35% premium payment from the individual. The Q&As explain that an employer claims the COBRA subsidy credit on the newly revised Form 941, Line 12a (COBRA premium assistance payments). The number of individuals provided COBRA premium assistance must be indicated on Line 12b, and if there is no tax credit amount because no subsidy was provided, then Line 12b should be zero. If Line 12a is larger than Line 10 (Total taxes after adjustment for advance earned income credit (EIC)), Line 13 (Sum of Lines 11 and 12a) would also be larger than Line 10, resulting in an overpayment that could be applied to the next return, or requested by the employer as a refund. IRS notes that in addition to Form 941 all appropriate forms (e.g., 941X) are being revised and will be updated on the IRS website as soon as possible.

The Q&As include what is effectively a “trick” question. Suppose an employer paid the COBRA subsidy and took the payroll credit for March, but in April finds out that the employee didn't continue his coverage (i.e., did not pay the 35%). Would the credit be allowed as a negative, which would increase the deposit due? IRS, reemphasizing that **the premium subsidy and the related employer credit applies only after the individual has paid his 35% of the premium**, answers that this situation should never occur.

No additional information relating to the COBRA subsidy beyond that requested on Lines 12a and 12b is to be submitted with Form 941 (either electronically or in paper form). But, those claiming the credit **must maintain supporting documentation**, including, but not limited to:

... Information on the receipt, including dates and amounts, of the assistance eligible individuals' 35% share of the premium;

... For 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;

... For a self-insured plan, proof of the premium amount and proof of the coverage provided to the assistance eligible individuals;

... Attestation of involuntary termination, including the date (which must be during the period from Sept. 1, 2008, to Dec. 31, 2009), for each covered employee whose involuntary termination is the basis for eligibility for the subsidy;

... Proof of each assistance eligible individual's eligibility for COBRA coverage at any time during the period from Sept. 1, 2008, to Dec. 31, 2009, and election of COBRA coverage;

... A record of the Social Security Numbers (SSNs) of all covered employees, the amount of the subsidy reimbursed for each covered employee, and whether the subsidy was for one, two, or more individuals; and

... Other documents necessary to verify the correct amount of reimbursement.

The Q&As clarify that an employer can claim the credit at the end of the quarter, rather than reducing its tax deposits during the quarter, if it wishes. An employer can either offset its payroll tax deposits or claim the subsidy as an overpayment at the end of the quarter.

Recipients of the COBRA premium subsid: Any COBRA qualified beneficiary associated with the related covered employee, such as a dependent child of an employee, who is covered immediately before the qualifying event—i.e., the involuntary termination of the covered employee's employment that occurs during the period between Sept. 1, 2008, and the period ending Dec. 31, 2009—can be an individual eligible for the COBRA subsidy. A covered employee must involuntarily lose his job, he can't have left voluntarily. The individual must also be eligible for COBRA coverage, or similar state coverage, during this period.

The Q&As clarify that the subsidy isn't included in an individual's income when paid. However, under phase-out provisions, individuals whose modified adjusted gross income (MAGI, namely, AGI plus excluded foreign earned income and income from U.S. possessions or Puerto Rico) exceeds \$125,000 (\$250,000 for joint return filers) will have increased their tax liability on their 2009 return to repay part or the entire subsidy. The full amount of the subsidy must be repaid as an additional tax if a taxpayer's MAGI exceeds \$145,000 (\$290,000 for joint return filers).

Illustration: John, a bond trader who files as a single taxpayer, is laid off from work on Aug. 31, 2009 and begins receiving COBRA continuation coverage effective Sept. 1, 2009. Despite his high income (\$1.2 million MAGI), John is eligible for COBRA premium assistance for the period Sept. 1, 2009 through June 30, 2010. However, all of the COBRA premium assistance John receives in 2009 will be recaptured. Note, however, that high income taxpayers who are otherwise assistance eligible individuals may elect not be treated as such. In effect they can elect to waive assistance and thereby avoid recapture when they file their returns.

In 2010, John's MAGI falls to below \$125,000. The COBRA premium assistance John receives in 2010 will not be subject to recapture.

This can all be very confusing. If you would like more details about this or any other aspect of the new law, please call our offices and ask to speak to one of our shareholders or email us at info@taxwarriors.com.

Sincerely,

Drucker & Scaccetti, P.C.

215-665-3960