

## BENEFIT NEWS BRIEFS

### ***IRS Posts a Comprehensive Audit Techniques and Tax Law COBRA Guide***

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The Internal Revenue Service recently posted on its website the *Audit Techniques and Tax Law COBRA Guide*. The *Guide* is available by "[clicking here](#)" or online at: [http://www.irs.gov/businesses/small/article/0,,id=255893,00.html#\\_Toc\\_269](http://www.irs.gov/businesses/small/article/0,,id=255893,00.html#_Toc_269).

While the *Guide* has details on IRS audit techniques for *COBRA* compliance and a detailed summary of the *COBRA* law, we will be looking only at the *COBRA* audit techniques used by the IRS. Individuals responsible for administration of their health plan's *COBRA* provisions and notices can use this *Guide* as a "check" on current operating practices.

We have adapted the article to the multiemployer plan context. So, where the *Guide* refers to the "taxpayer" or "employer" we use the term "plan" or "health plan." We have also deleted certain technical tips or comments that are not applicable to the multiemployer plan context, as well as citations to the Code. The interested reader can consult the original *Guide* for statutory citations.

The *COBRA* provisions in the Internal Revenue Code (IRC) consist of:

- Operating requirements (what a health plan must do to be in compliance)
- Tax sanction (what happens in the event of noncompliance)

The tax sanction for noncompliance is an excise tax of up to:

- \$100 per day,
- per qualified beneficiary,
- for each day of the noncompliance period.

The tax sanction is designed as a deterrent against noncompliance, rather than as a remedy for individuals who have been affected by the noncompliance. Consequently, there is no relief under IRC for individuals who have been denied (or charged an excessive premium for) *COBRA* continuation coverage.

A failure to comply with *COBRA* requirements in the IRC may also be a failure to comply with parallel requirements that *COBRA* added to the *Employee Retirement Income Security Act of 1974 (ERISA)*, which is administered by the Department of Labor. *ERISA* provides a remedy for individuals who have been denied (or charged an excessive premium for) *COBRA* continuation coverage.

The *COBRA* tax is to be reported on Form 8928, *Return of Certain Excise Taxes Under Chapter 43 of the Internal Revenue Code*.

### **Examination Procedures**

The *Guide* instructs the examiner that if the plan is subject to *COBRA* requirements, then the first step is to determine if noncompliance has occurred. The *Guide* notes a good place to start is with the continuation coverage procedures the plan has in place. To determine what procedures are in place, the examiner is instructed to obtain the following information from the plan:

- A copy of the *COBRA* procedures manual;
- Copies of standard *COBRA* form letters sent to the qualified beneficiaries;
- A copy of the plan's internal audit procedures for *COBRA*;
- Copy of the health care plan document;
- Details pertaining to any past or pending lawsuits filed against the plan for failing to provide appropriate *COBRA* continuation coverage.

Based on the procedures in place, the *Guide* encourages the examiner to probe specific areas for noncompliance and interview responsible parties regarding the following:

- The number of qualifying events (for example, terminations, reduced hours, etc.) occurring in the year under examination through the current date;
- The method by which qualified beneficiaries are notified of their rights to continuing health care coverage under *COBRA*;
- The method by which the plan administrator is notified that a qualifying event has occurred;
- The election made by qualified beneficiaries to continue health care coverage; and
- The premium paid by qualified beneficiaries for continuing coverage under the plan.

The *Guide* also notes the following documents can also provide the examiner useful information:

- List of all individuals affected by a qualifying event (for example, termination, death, etc.) during the current year; and
- List of all individuals covered on January 1 and December 31 of the current and preceding years for each plan; this list should include all qualified beneficiaries (in other words, covered employee, spouse and dependent children).

The *Guide* indicates the examiner should review the various records and confirm whether or not qualified beneficiaries were properly notified of their rights to continuing health coverage. These records will also provide the beginning dates of any failure to comply, and determine when the excise tax computation should begin and should include documents to support the following items of information:

- Name and address of each beneficiary (for purposes of third party confirmation if necessary);
- Date the qualifying event took place;
- Copies of the notification letters sent to qualified beneficiaries (to determine the period they were eligible to elect coverage, and in fact were offered coverage, and also to confirm they received their notice of rights under *COBRA*);
- Type of coverage received under *COBRA* (to determine if the qualified beneficiary received the proper coverage);
- Premium payments required under *COBRA* (review of health plan documents previously requested may indicate whether the premium charged was excessive);
- Copy of letter to plan administrator notifying them of a qualifying event;
- Reasons for termination of *COBRA* coverage properly elected by the beneficiary; and
- Reasons for employment termination.

### **Computing the Excise Tax**

The assessed tax amount for *COBRA* violations is \$100 per qualified beneficiary, but not more than \$200 per family, for each day of a period that the plan is in violation. The period of violation is called a "noncompliance period."

The noncompliance period begins on the date the failure to comply with *COBRA* takes place. Depending on the circumstances, this might be the first date that coverage is denied, the date that a notice is not sent out as required, or some other date. The noncompliance period ends on the date the *COBRA* compliance failure is corrected. However, the noncompliance period for any particular qualified beneficiary will end, even if the failure is not corrected, on the date that is six

months after the last date on which continuation coverage would have been required for that beneficiary.

The limitation on the excise tax for unintentional failures that are due to reasonable cause and not to willful neglect for multiemployer plans is the lesser of:

- 10 percent of the total amount paid or incurred by the trust during the tax year to provide medical care; or,
- \$500,000

**It would be very unusual for the maximum amounts to be applied against a plan.** However, the law does provide for minimum tax amounts in the following situations:

- There is a failure to comply with the continuation coverage requirements;
- The failure is not corrected before the date the IRS notifies the plan that an income tax examination will be initiated;
- The failure occurred or continued during the period under examination; and
- If the examiner determines that the failure is *de minimis*, the amount of tax per beneficiary will be the lesser of \$2,500 or the amount of tax that would be imposed without regard to the inadvertent failure and the 30-day grace period exceptions discussed below.

If the failure is more than *de minimis*, the amount of tax will be the lesser of \$15,000 or the amount of tax that would be imposed without regard to the inadvertent failure and the 30-day grace period exceptions discussed below. The minimum tax is allowed to override the inadvertent failure and 30-day grace period rules to ensure that plans have an incentive to monitor themselves for compliance.

### **The Inadvertent Failure Rule**

The Code provides that the excise tax cannot be imposed on any failure during any period for which it is established to the satisfaction of the IRS that none of the persons who would be liable for the tax knew, or would have known by exercising reasonable due diligence, that the failure existed.

The noncompliance period would begin, however, when the plan became aware or should have been aware of the noncompliance. Also, the exception does not apply where the failure is not corrected before the IRS notifies the plan of an income tax examination, and thus triggers imposition of the minimum excise tax described above.

### **The 30-Day Grace Period Rule**

According to the *Guide*, The Code also provides that the excise tax generally does not apply to any failure if:

- The failure is due to reasonable cause and not to willful neglect; and
- The failure is corrected within 30 days after it is discovered, or would have been discovered, exercising reasonable due diligence.

A failure is considered corrected if the *COBRA* rules are retroactively satisfied to the extent possible and the qualified beneficiary is placed in a financial position that is as good as such beneficiary would have been in had the failure not occurred.

Even if a *COBRA* failure is due to reasonable cause and not to willful neglect, the Secretary of Treasury is authorized to waive part or all of the excise tax to the extent that the tax would be unreasonably burdensome.

The *Guide* closes with links to the Code *COBRA* statute, *COBRA* regulations and additional *COBRA* guidance. Look in the *Guide* under the heading "Appendix" for these links.

Individuals responsible for administering *COBRA* for their plan may wish to print off these materials and create a *COBRA* compliance reference for internal use.

Now is as good a time as any to schedule a review of the plan's *COBRA* procedures, and to make sure such procedures are periodically reviewed and updated and to train the appropriate staff members in these procedures. Since the IRS has provided a roadmap of what it will be looking for, it seems prudent to take steps to confirm the plan has the appropriate policies and procedures in place and that they are being adhered to.

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**LEGAL DISCLAIMER:** Information contained in this publication is not legal advice, and should not be construed as legal advice. If you need legal advice upon which you can rely, you should seek a legal opinion from your attorney.