Compliance Services Alert

Aug. 16, 2021

COBRA subsidies under ARPA - Part II: More IRS Q&As on the subsidies and tax credits

Executive summary

The IRS has provided additional guidance on the ARPA COBRA subsidies and has clarified several key issues, particularly regarding who is eligible to claim tax credits for supplying the subsidy:

- **The common law employer maintaining the plan is the entity entitled to the credit –** In general, the common law employer of the affected employee or former employee is entitled to the tax credits equal to the subsidy supplied to that individual and dependents affected by the same qualifying event. That will be the case even if another entity (such as a PEO or a parent company) is the plan sponsor.
- **Exceptions to the general rule regarding the common law employer -** In some business reorganizations, or if COBRA is offered by a plan maintained by a state agency, the entity maintaining the plan, rather than the common law employer, may be the entity entitled to claim the tax credit.
- **Extended COBRA –** If a subsidy-eligible individual's 18-month COBRA period is extended, subsidies may be available for at least a portion of the extended period.
- **Dental and vision subsidies –** Medicare enrollment terminates eligibility for COBRA subsidies just like it would (under most plans) for COBRA generally.

The IRS has issued another round of Q&As addressing the COBRA subsidies available under the American Rescue Plan Act (ARPA). The new FAQs clarify several key points that will be of interest to employers, particularly regarding who is entitled to claim tax credits for supplying the subsidy in situations where multiple employers participate in the same healthcare plan.

Background

As part of the ARPA COVID-19 relief legislation, Congress included COBRA premium subsidies for individuals who lose or lost healthcare coverage due to involuntary termination of employment, or involuntary or voluntary reduction in hours, if their available COBRA coverage period fell or falls at least partially within the window from April 1 through Sept. 30, 2021. ARPA also gives such individuals a second chance to elect COBRA if they did not do so when first eligible.

Employers offering healthcare coverage to their employees were directed to provide the COBRA opportunity at no cost to subsidy-eligible individuals ("assistance eligible individuals," or AEIs), and claim the subsidy as a credit (even a refundable one) against the employer's Medicare tax obligation.

We explained the first set of ARPA COBRA subsidy rules in detail here, and when the IRS issued its first set of Q&As, we discussed them here.

The end of the period for which the subsidy is available is approaching and employers and plan sponsors are thinking more seriously about their eligibility for the credit and how to file for the credit. The most recent IRS Q&As expand on the prior guidance and provide more direction on which entity, the plan sponsor or the employee's or former employee's common law employer (in cases where they may not be the same entity), is eligible for the credit.

The *common law employer* is typically entitled to the subsidy tax credit…

The general rule is that the *common law employer* of the employee who experienced the reduction in hours or the involuntary termination of employment is the entity that can claim the subsidy tax credit. This may not be the plan sponsor.

In most cases, the common law employer is the entity one would expect from a common-sense perspective. It would be the entity that controls what the employee does and how the employee does it. It is typically the entity that hires and fires the employees and imposes workplace conduct and other policies on the employees.

> **Lockton comment:** There are a pair of similar, multi-factor tests to determine common law employer status, one under ERISA and one under IRS guidance. In both cases, the key factor is who controls the employee; that is, who tells the employee what to do and how to do it. A discussion of all the factors involved in these tests is beyond the scope of this alert. See this IRS webpage for more information. These rules are needed in situations where it might not be clear, such as companies that use professional employee organizations (PEOs) or other types of workplace organizations. See additional discussion below.

As noted above, the notion that the common law employer is the entity typically entitled to the tax credit is interesting because often the common law employer is not the sponsor of the plan that supplied the COBRA coverage.

Plan covers multiple members of a single controlled group

Where there are multiple employers in a "controlled group" of companies, trades or businesses, often one entity – perhaps the parent organization – sponsors healthcare plans in which several, if not all, of the other entities in the controlled group participate.

> **Lockton comment:** Whether multiple employers are in a controlled group depends on their level of shared ownership. The rules for that determination can get complex very quickly, but very generally, a parent-subsidiary (i.e., vertical) controlled group exists if the parent has 80% or more control of the subsidiary or chain of subsidiaries. A brother-sister (i.e., horizontal) controlled group exists if the same five or fewer individuals,

estates or trusts together own 80% or more of each entity and 50% or more of each entity when taking into account the smallest ownership percentage in any such entity.

For more information on controlled group determinations, ask your Lockton account service team for our monograph.

Although the COBRA premium otherwise due from AEIs will be forgiven *by the plan*, it is the employee's or former employee's common law employer who can claim the tax credit.

Example: Company A owns 100% of Companies B and C. Company A offers healthcare benefits under the "Company A group welfare benefits plan" in which all three companies participate. The plan forgives the COBRA premium otherwise payable by AEIs employed or formerly employed by any of the three companies. For AEIs employed or formerly employed by Company A (and their dependents), Company A claims the subsidy tax credit. But for AEIs employed or formerly employed by Company B or Company C, that company – not the plan sponsor – claims the subsidy tax credit. Company A will presumably settle up with Companies B and C later if it was Company A that effectively fronted the COBRA premium subsidy for the employees or former employees of Companies B and C.

Plan covers multiple employers who are *not* in a single controlled group

If there is a single plan covering multiple employers who are not in a single controlled group – this plan will be a multiple employer welfare arrangement (MEWA), such as an association or similar sort of plan – the plan, like in the example above, will forgive the COBRA premium otherwise due from AEIs, but (also like in the example above) it is the participating common law employers – not the plan sponsor – who may claim the subsidy tax credits for the AEIs who were their employees or former employees. The plan sponsor will presumably settle up with the participating employers after the fact.

…But sometimes the entity maintaining the plan, rather than the common law employer, is entitled to the subsidy tax credit

Notwithstanding the fact that the common law employer is *typically* entitled to the subsidy tax credit, even if not maintaining the plan that provides the COBRA coverage, there are exceptions.

PEOs and other third parties that pay wages and withhold/remit taxes on behalf of the common law employer

Many common law employers hire professional employee organizations (PEOs) or other third parties (like payroll vendors) to pay wages, withhold and remit taxes to the federal government and report those wages, all on behalf of the common law employer. While the common law employer – not the PEO or other third party – *might* be entitled to claim the subsidy tax credit on behalf of its employees and former employees (and their dependents) who are AEIs, even if the PEO or other vendor is maintaining the health plan supplying the COBRA coverage, there's an exception that will often apply, under which the PEO or other vendor claims the subsidy tax credit.

The exception applies where the PEO or other vendor:

- Maintains the group health plan and supplies the COBRA coverage
- Is considered the sponsor of the group health plan and is subject to the applicable federal COBRA guidance, including providing COBRA election notices to qualified beneficiaries
- Would have received the COBRA premium payments directly from the AEIs were it not for the ARPA COBRA subsidies.

In that case, the PEO or other vendor, *not the common law employer,* is entitled to claim the subsidy tax credit.

Business reorganizations where the seller retains the COBRA obligation

The general, default rules for COBRA in business reorganizations provide that the selling group, if it maintains a group health plan after the sale, retains the COBRA obligation for people on COBRA at the time of the reorganization and for those whose COBRA qualifying event (i.e., termination of employment) is caused by the reorganization.

In that case, the entity that maintains the plan providing the subsidized COBRA coverage (i.e., the seller or the entity in the seller's group that maintains the plan) is entitled to the subsidy tax credit, and the common law employer (i.e., the entity sold) is not.

> **Lockton comment:** While this result follows the logic of COBRA business reorganization rules, it is counterintuitive when considered against the general rule announced by the IRS that the common law employer is the entity entitled to the subsidy tax credit.
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> For more information on COBRA's applicability in the business reorganization context, ask your Lockton account service team for our monograph.

State agencies maintaining coverage for other state agencies and/or local governments

Sometimes a single state agency maintains a group health plan for employees of not only that agency, but various other state agencies and local governments. In such a case, if the plan is subject to federal COBRA (it typically will be, under the Public Health Service Act), and the employees of the various participating agencies are required to remit their COBRA premiums directly to the state agency maintaining the plan, the state agency maintaining the plan is entitled to claim the subsidy tax credit rather than the common law employer.

State law-based COBRA-like extensions when premium payment is made to the insurer

In states with extended COBRA-like periods beyond the federal COBRA period (Cal-COBRA, for example, tacks an extra 18 months of continuation coverage atop an 18-month federal COBRA qualifying event), the common law employer is entitled to the COBRA subsidy tax credit even though the premium for the state-imposed extension employer is the premium payee entitled to the credit even if the COBRA premium after the federal COBRA period is paid directly to the insurer (and the insurer is not entitled to the credit).

Conclusion

The premium assistance credit will generally be available to the common law employer of the employee or former employee even in some circumstances where the common law employer may not have the direct COBRA obligation. However, there are some situations where that is not the case so employers will need to review their situations in cases where they may not have that direct obligation.

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