

Insurers, TPAs May Bear Sizeable Excise Tax Burden for COBRA Violations

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Since 1989, failures to comply with the continuation coverage requirements of COBRA have potentially triggered excise taxes under [IRC § 4980B](#) on those responsible for the error, equal to \$100 per affected person, per day. However the Internal Revenue Service rarely imposed and collected the tax and there previously has been no affirmative duty on taxpayers to report or pay it.

That situation changed for plan years beginning on or after January 1, 2010. Now there is an affirmative obligation on employers and other responsible parties – including insurers, HMOs, and third party COBRA administrators – to report and pay the excise tax on IRS Form 8928. (A [draft version](#) is available online.) The tax is equal to \$100 per affected person, per day, for each day of the noncompliance period. (A cap of \$200/day applies when a failure affects more than one qualified beneficiary.) The noncompliance period begins on the day the failure first occurs and ends on the earlier of (a) the day the failure is corrected; or (b) the date which is 6 months after the last day in the maximum applicable COBRA period.

Examples of failures that would trigger excise taxes are COBRA notice failures (missing, late, or incomplete initial or qualifying event notices); COBRA premium violations (overcharging, or not complying with grace period rules); and procedural failures such as not allowing COBRA recipients to make changes at open enrollment, or on special enrollment events.

The maximum excise tax that may apply to an employer for unintentional failures – those which are due to reasonable cause and not willful neglect – is equal to the lesser of (a) \$500,000 or (b) an amount equal to 10% of the employer's aggregate health plan expenditure during the prior tax year. For insurers and third party administrators, however, the maximum excise tax for unintentional failures is \$2,000,000.

For willful violations, the \$500,000 and \$2,000,000 tax caps would not apply. Additionally, minimum excise taxes apply in the event a COBRA failure is discovered on audit. The minimum tax amounts are the lesser of (a) \$2,500 or (b) the excise tax calculated without application of certain exceptions noted below. This minimum amount increases to \$15,000 where the failures for any year are more than de minimis.

Taxes must be paid, and Form 8928 filed, on or before the due date (without extension) of the employer's federal income tax return (or that of insurer, HMO or TPA, where applicable). An automatic 6-month extension of the filing deadline only is available by filing [Form 7004](#), however the excise tax still must be paid on the original deadline.

Interest is charged on taxes not paid by the due date even when a filing extension applies. Penalties of as much as 25% of the unpaid tax amount also separately apply for late filing of Form 8928, and for late payment of excise taxes, respectively.

Certain exceptions to the excise tax obligation do apply. First, the tax will not apply during the period where the employer or responsible party did not know, or by exercising reasonable diligence would not have known, that a COBRA violation had occurred. Second, once a COBRA violation is discovered, no excise tax will apply if the failure was due to reasonable cause and not willful neglect, and it is corrected within 30 days of discovery. "Correction" for these purposes means retroactively undoing the error, and putting the affected parties in at least the same financial position they would have been in, had the failure not occurred. When the error is failure to offer COBRA coverage, correction will include a retroactive offer of coverage back to the date it originally would have been available, in exchange for which the former employee must pay applicable premiums and the COBRA administrative charge. An

employer or other responsible party generally cannot demand a lump sum payment of past-due premiums but must instead work out a payment schedule.

Although not an “exception,” there are additional prerequisites that must be met in order for the excise tax to apply to insurers, HMOs, or third party administrators. First, the third party must be the cause of the COBRA error (other than as a result of employer action or inaction), and it must have assumed responsibility for the error under a legally enforceable written agreement. TPAs in particular will want to review their service agreements in this regard, and be sure to carve out responsibility for errors arising from employer action or inaction.

Church and governmental plans are exempt from the excise tax for COBRA violations. And finally, the IRS may waive all or part of the excise tax where the failure was due to reasonable cause and not willful neglect, and where the amount of tax is excessive relative to the failure involved. In such instances, a statement of reasonable cause should be filed with the Form 8928 that also addresses the need to abate excessive taxes. Generally it is necessary to pay the tax with the filed return and hope for reimbursement later, but given the potentially extremely large tax amounts at issue it is possible that the IRS could accept the return without the full tax payment. A seasoned tax advisor should be consulted in such instances.

Excise taxes apply under [IRC §4980D](#) to a number of other health plan failures, including violations of HIPAA, the Genetic Information Nondiscrimination Act (“GINA”), the Mental Health Parity and Addiction Equity Act, and prospectively will apply to violation of as yet un-issued regulations that will govern non-discrimination under insured health plans. Excise taxes under [4980E](#) and [4980G](#) also apply to failures to make “comparable employer contributions” under HSA and Archer MSA arrangements. Only employers, not insurers or TPAs, however, are subject to these other types of health plan excise taxes. Future posts will discuss these other excise taxes in more detail.

http://www.law.cornell.edu/uscode/26/usc_sec_26_00004980---B000-.html

<http://www.irs.gov/pub/irs-dft/f8928--dft.pdf>

<http://www.irs.gov/pub/irs-pdf/f7004.pdf>

http://www.law.cornell.edu/uscode/26/usc_sec_26_00004980---D000-.html

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