In March 2012, the Internal Revenue Service (IRS) published its revised audit guidelines for COBRA audits. The revised guidelines are the result of a 10-year task force review. The publication of these guidelines suggests that the IRS is increasing its focus on COBRA compliance.

Employers should review their COBRA procedures for compliance with the law’s requirements to be prepared in the event they are selected for an audit. The IRS guidelines indicate how an auditor might determine compliance.

**BACKGROUND**

The IRS appointed a task force in 1993 to address questions and concerns from field personnel on health benefits provided under COBRA. The purpose of the task force was to provide IRS examiners with procedural guidelines to conduct COBRA examinations and compliance checks.

In 2002, a second task force was convened to revise the original guidelines to incorporate operational changes at the IRS and legislative changes, such as the enactment of the Health Insurance Portability and Accountability Act (HIPAA) and the Family and Medical Leave Act (FMLA).

**GENERAL COBRA REQUIREMENTS**

The revised guidelines contain definitions related to COBRA coverage and a basic description of several COBRA requirements. These include the notices that must be provided to covered employees and their families and the period of time during which a qualified beneficiary must be allowed to elect COBRA coverage.

The guidelines also describe the type of coverage that must be provided and the length of the coverage period. Premium requirements for COBRA coverage are also discussed in the guidelines, along with special rules related to COBRA coverage for retirees and employer bankruptcy.

**EXAMINATION PROCEDURES**

The audit guidelines outline how the examiner should determine if an employer who is subject to COBRA has violated any of the law’s requirements. The guidelines indicate that the examiner should review the employer’s COBRA procedure and obtain certain information.

- A copy of the COBRA coverage procedures manual;
- Copies of standard COBRA coverage form letters sent to qualified beneficiaries;
- A copy of the employer’s internal audit procedures for COBRA coverage;
- Copies of all group health care plans; and
- Details regarding any past or pending lawsuits filed against the employer for failing to provide appropriate continuation coverage.

An examiner should obtain:
The guidelines indicate that the examiner may wish to investigate specific areas for noncompliance, based on the procedures that are in place. This investigation could involve interviews of responsible parties regarding:

- The number of qualifying events 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 COBRA coverage.

Copies of federal and state employment tax returns filed during the current period under examination and the preceding year;

A list of all individuals affected by a qualifying event during the current year;

A list of all individuals covered on the first and last days of the current and preceding years for each plan; and

Individual personnel records with specific COBRA information to confirm whether qualified beneficiaries were properly provided with COBRA coverage and to determine when any excise tax computation should begin.

If an employer denies COBRA coverage based on the employee’s termination for gross misconduct, the guidelines suggest that the examiner should check to see if the covered employee was denied unemployment benefits for the same reason. In a multi-employer plan, if a grievance for gross misconduct was arbitrated independently under the union agreement, the decision may help with the determination. If the employer lost in the grievance process, this may indicate a failure to comply with COBRA law requirements.

PENALTIES

In addition to specifying what an employer/plan administrator and its group health plans must do to be in compliance, the COBRA provisions in the Internal Revenue Code include tax sanctions that may apply to non-compliant employers. Other potential liabilities related to COBRA violations include ERISA statutory penalties, lawsuits to compel coverage and adverse selection of COBRA coverage.

Penalty Amount

The IRS’s revised guidelines include a section regarding the excise tax penalties that may be imposed for Internal Revenue Code violations. The excise tax amount is $100 per qualified beneficiary (but no more than $200 per family) for each day of the noncompliance period.

Noncompliance Period

The noncompliance period begins on the date the failure to comply 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 generally ends on the date the violation is corrected. However, even if the failure is not corrected, the noncompliance period will end six months after the last date on which continuation coverage would have been required for the particular qualified beneficiary.
**Exceptions**

There are situations where an excise tax might not be imposed. The excise tax cannot be imposed if none of the parties subject to the tax knew or would have known by exercising reasonable due diligence that the failure existed. However, the noncompliance period would begin when the responsible person became aware or should have been aware of the noncompliance. Also, the exception does not apply where the failure is not corrected before the employer is notified of an income tax examination.

In general, the excise tax does not apply to a violation that is:

- Due to reasonable cause and not to willful neglect; and
- Corrected within 30 days after it is discovered or would have been discovered by exercising reasonable due diligence.

The IRS may also waive the penalty if the violation is due to reasonable cause and not to willful neglect and the tax would be unreasonably burdensome.