GROOM LAW GROUP

www.groom.com

The 411 on the 941: Everything You Need to Know About How to Claim the COBRA Subsidy Tax Credits

PUBLISHED: June 4, 2021

Since the American Rescue Plan Act ("ARPA") was enacted in March 2021, employers and insurers have been diligently familiarizing themselves with the rules for administering the temporary 100% COBRA premium subsidy established under the law and preparing and sending notices to potential "Assistance Eligible Individuals" who may qualify for the subsidized coverage. A less immediate, but no less significant issue, is how employers and insurers will claim the tax credit being offered by the Federal government to reimburse the employers and insurers for the premiums they subsidized.

Recently released Notice 2021-31 provides some direction regarding the rules for claiming the tax credit. Since then, the IRS has released the draft Forms and Instructions for claiming the COBRA subsidy tax credit – Forms 941 (along with Schedule R) and 7200.

Below are answers to some of the questions we've been hearing about the draft Form 941. Keep in mind the next Form 941 is due on July 31, 2021, but employers and insurers can generally begin reducing their employment tax deposits now.

If you have any questions, please do not hesitate to contact your regular Groom attorney or the authors listed below:

Katie Bjornstad Amin
kamin@groom.com
(202) 861-2604

David Block
dblock@groom.com
(202) 861-5427

Christine Keller
ckeller@groom.com
(202) 861-9371

Malcolm Slee
mslee@groom.com
(202) 861-6337

Brigen Winters
bwinters@groom.com
(202) 861-6618

The Basics

What entities can claim the COBRA subsidy tax credit?

ARPA provides that a "person to whom premiums are payable" is entitled to claim the tax credit for COBRA premiums not paid by an assistance eligible individual ("AEI") due to the subsidy. In Notice 2021-31, the IRS calls the "person to whom premiums are payable" the "Premium Payee."

Premium Payees eligible to claim the tax credit are:

- In the case of any group health plan which is a multiemployer plan, the *plan*.
- For other self-funded plans, and insured plans that are subject to federal COBRA, the *employer* maintaining the plan.
- In the case of any group health plan not listed above (such as insured plans sponsored by small employers that are not subject to federal COBRA, but are subject to state continuation coverage requirements), the *insurer* providing the coverage.

Note that the IRS has informally said that where a plan is subject to both Federal and state COBRA, for example, a large employer insured plan, the employer claims the tax credit for all months of coverage, even the state continuation coverage months.

What tax credit is available for providing the COBRA subsidies?

The tax credit is credited against the tax imposed by Internal Revenue Code ("Code") section 3111(b), the Medicare hospital insurance tax. The tax credit is fully refundable, meaning that Premium Payees can receive a payment from the IRS if the amount of the credit exceeds their Medicare hospital insurance tax obligations (including where they do not owe any Medicare hospital insurance tax).

Claiming the Tax Credit

When can a Premium Payee claim the tax credit?

A Premium Payee is entitled to the tax credit as of the date it has received a potential AEI's election of COBRA continuation coverage. For example, if an employer that sponsors a plan that is subject to federal COBRA receives a COBRA election from an AEI on June 17 electing COBRA retroactive to April 1, the employer would be entitled to the tax credit for April, May, and June as of June 17 (assuming the AEI is eligible for COBRA coverage during that entire period). If the AEI maintains COBRA coverage through July, the Premium Payee becomes entitled to the tax credit for July on July 1.

What if an AEI receiving the COBRA subsidy fails to provide notice to the plan of his/her eligibility for coverage under a disqualifying group health plan or Medicare, and the plan continues to provide the subsidy?

The Premium Payee is still entitled to claim the tax credit for all the periods that it provided the subsidized coverage, unless the Premium Payee knew of the individual's eligibility for the other coverage.

How does a Premium Payee claim the tax credit?

The Premium Payee claims the tax credit on its quarterly employment tax return (typically a Form 941). The Premium Payee can receive advance payments of the tax credit on Form 7200.

- **Employment Tax Return:** In anticipation of receiving the tax credit, a Premium Payee may reduce deposits of federal employment taxes (including amounts withheld from employees), up to the amount of the anticipated tax credit. Then, each quarter, the Premium Payee should report the tax credit claimed, and the number of individuals receiving the tax credit for that quarter, on its federal employment tax return(s), typically a Form 941, Employer's Quarterly Federal Tax Return. For example, a Premium Payee claiming the tax credit for April, May, and June coverage months can claim the tax credit on the quarterly Form 941 due on July 31, 2021.

- **Form 7200:** If the anticipated tax credit exceeds deposits available, a Premium Payee may also request an advance of the tax credit by filing a Form 7200. The IRS only accepts this form via fax. The Premium Payee must still file the Form 941 to claim the tax credit, however.

GROOM INSIGHT: While the COBRA subsidy tax credit is taken against the Medicare Hospital Insurance Tax under Code section 3111(b), IRS guidance is clear that the Premium Payee may reduce any withheld income taxes and taxes under FICA that it would otherwise be required to deposit, up to the amount of the anticipated credit. In other words, if the COBRA subsidy tax credit happens to exceed what is effectively the adjusted Medicare tax obligation, the refundable credit can be applied to reduce the other employment tax obligations.

If an insurer providing the coverage is eligible to claim the tax credit, how does it do so?

The insurer claims the credit using the same process described directly above. All Premium Payees, whether employers, insurers, or multiemployer plans, claim the tax credit using the Form 941 (and, if applicable, Form 7200).

What's changing on Form 941 and Schedule R?

As noted above, IRS has recently published a draft Form 941 that it revised to facilitate the claiming of the COBRA subsidy tax credit. The Forms 941 and 7200 have been the vehicles for claiming some of the other tax credits enacted by Congress to help employers during the COVID-19 crisis (e.g., the employee retention tax credit and the tax credit for providing paid sick/family leave). However, those tax credits were largely targeted at smaller employers, while the COBRA subsidy tax credits will likely impact many more employers (and insurers). Therefore, employers and insurers are likely to be significantly more interested in the changes to the Form 941 and the Form 7200 filing processes.

The recently released draft Form 941 provides three lines that the Premium Payee should complete in order to claim the tax credit: (i) line 11e, nonrefundable portion of COBRA premium assistance credit, (ii) line 11f, number of individuals provided COBRA premium assistance, and (iii) line 13f, refundable portion of COBRA premium assistance credit. Lines 11e and 13f both reference the Instructions to Form 941, which were updated on June 2, 2021 to reflect the tax credit. Also, the recently released draft Schedule R (used to report client-specific information for entities that file an aggregate Form 941 for multiple employers) has been updated to reflect the newly added lines 11e, 11f, and 13f to Form 941.

When may a Premium Payee reduce its deposits of federal employment taxes, and when and how does the Form 7200 get filed to request an advance of the tax credit?

A Premium Payee may reduce its deposits when it becomes entitled to the tax credit (i.e., when the Premium Payee receives a potential AEI's election of COBRA continuation coverage). If the anticipated tax credit exceeds the tax deposits available for reduction, the Premium Payee may, but is not required to, file a Form 7200 to request an advance payment of the tax credit.

The Premium Payee may file the Form 7200 after the end of the payroll period for which the Premium Payee becomes entitled to the tax credit. (If the Form 7200 isn't filed, the Premium Payee will receive the payment of the tax credit after the Form 941 for the quarter is processed.)

As an example of how this process works, assume that on June 17, 2021, an employer receives a COBRA election from an AEI effective retroactive to April 1, 2021. The employer pays its employees twice a month (on the 15th and the last day of the month).

The employer may reduce its federal tax deposits as of June 17, 2021 in anticipation of the credit. If the credit exceeds the reduction in deposits, the employer may file Form 7200, but not until July 1 (the day after the end of the payroll period of June 16-June 30) to receive an advance payment of the remaining tax credit.

On July 1, the employer becomes entitled to the credit for July coverage and may reduce its federal employment tax deposits as of that day. However, the employer cannot file the Form 7200 for an advance of the credit for July coverage until July 16.

The employer claims the credit for June on the second quarterly Form 941, due July 31. The employer claims the credit for July on the third quarterly Form 941, due October 31. If the Premium Payee later discovers that it should have claimed more in tax credits for a quarter than it reported on that quarter's Form 941, the employer must file an amended Form 941, the Form 941-X. The employer <u>cannot</u> claim that tax credit on the next quarterly Form 941(in this case, due October 31).

What if a Premium Payee doesn't have any employment tax liability?

If the Premium Payee does not have any employment tax liability, the Premium Payee should claim the tax credit on Form 941 for the quarter the Premium Payee becomes entitled to the tax credit (even if does not typically file a Form 941). In addition, the Premium Payee should report any advance payments received, and should enter "zero" on all remaining non-applicable lines so that the overpayment amount on the Form 941 is the amount of the tax credit reduced by any advance payment received.

Third-Party Payers

May a Premium Payee that uses a third-party payer (e.g.., a PEO) to report and pay employment tax receive the tax credit?

Yes. In that case, the third-party payer *is not* entitled to receive the tax credit, regardless of whether it is considered an "employer" for other purposes, unless it meets certain requirements (explained below). However, the third-party payer may claim the tax credit on the employment tax returns it files on behalf of a client that is a Premium Payee. There are different reporting rules depending upon what type of third-party payer the Premium Payee uses (i.e., reporting agent, certified PEO (CPEO) or Code section 3504 agent, or non-certified PEO and or other third party payer).

How can a Premium Payee that uses a third-party payer request an advance payment of the tax credit?

A Premium Payee that uses a third-party payer to report and pay employment tax to the IRS must submit its own Form 7200 to request an advance payment of the tax credit – the third-party payer <u>cannot</u> file the Form 7200 for the Premium Payee. The Premium Payee will then need to provide a copy of the Form 7200 to the third-party payer so that the Premium Payee's Form 941 takes into account the credit that it reported on the Form 7200.

Can a third-party payer, like a PEO, be treated as a Premium Payee for purposes of claiming the tax credit?

Yes, in some circumstances. However, in order to do so, the third-party payer must: (i) maintain the group health plan, (ii) be considered the sponsor of the group health plan and be subject to the applicable DOL COBRA guidance, including providing the COBRA election notices to qualified beneficiaries, and (iii) have received the COBRA premium payments directly from AEIs (were it not for the subsidy).

If a PEO is claiming the tax credit for itself, it will do so on Form 941 like all other Premium Payees. The PEO reports the tax credit it is claiming on line 8 of the Schedule R, rather than separately with respect for each client employer. If client employers are <u>separately</u> claiming their own tax credits, those would be separately reported with respect to those clients on Schedule R as well. The PEO may reduce deposits of federal employment taxes relating to its own employees in anticipation of the credit, and if the anticipated credit exceeds the reduction of deposits, the PEO may file the Form 7200 and request an advance payment of the credit, just like other Premium Payees.

What information must a third-party payer obtain from its clients that are Premium Payees in order to claim the tax credit on their behalf?

The third-party payer must obtain any information that would have been necessary for the Premium Payee to claim the tax credit on its own. Either the third-party payer or the client employer must keep records substantiating the eligibility for the credit. If the IRS asks, the third-party payer and/or client employer will have to be able to provide records substantiating eligibility for the credit (including documentation demonstrating that individuals were AEIs). The client employer and the third-party payer are both potentially liable for employment taxes that become due as a result of any improper claim of tax credits.

We hope this alert answers any questions you have about with claiming the COBRA subsidy tax credit, but we are sure that new questions will arise over the weeks to come. If you need any additional guidance regarding the COBRA subsidy tax credit, Form 941, or Form 7200, please contact your Groom attorney, and we would be happy to discuss these issues with you further.