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Client Alert

Law & the Workplace℠

A report for clients and friends of the Firm

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Finally: Answers To Unanswered Questions – IRS and DOL Issue Guidance On The COBRA Premium Subsidy

As discussed in our recent Client Alerts, the *American Recovery and Reinvestment Act* (the "ARRA" or "Act") provides for a temporary government subsidy of COBRA premiums for certain employees who were involuntarily terminated from employment during the period from September 1, 2008 through December 31, 2009 and their eligible family members. See following links to previous client alerts [*Client Alert 1*] [*Client Alert 2*]. Specifically, the Act provides for a subsidy of 65 percent of the required COBRA premiums for "assistance eligible individuals" for a maximum of 9 months. In general, an "assistance eligible individual" is a COBRA "qualified beneficiary": (i) whose COBRA qualifying event is the employee's involuntary termination of employment that occurred during the period from September 1, 2008 through December 31, 2009, (ii) who is eligible for COBRA continuation coverage during that period, and (iii) who is not eligible for other group health coverage or Medicare.

Since the ARRA's enactment on February 17th, employers and health plan administrators have confronted many unanswered questions with regard to implementation of the subsidy program, some of which have been addressed in guidance that the Internal Revenue Service ("IRS") and the U.S. Department of Labor "DOL") have posted periodically on their websites. The DOL also published multiple model notices that can be used in a variety of situations. However, little guidance has been issued with respect to certain important issues, such as what constitutes an "involuntary termination" for purposes of the Act. There has also been confusion regarding who should be receiving the various types of COBRA subsidy notices.

Earlier this week, the IRS issued Notice 2009-27 (the "Notice"), which provides guidance in the form of "Questions and Answers" (Q&As) on some of the significant questions and issues that have been lingering since the ARRA was enacted, including the definition of "involuntary termination," how the subsidy interacts with certain severance arrangements, and how to calculate the premium subsidy under various circumstances. [IRS Notice 2009-27] In addition, today the DOL posted an update to its "FAQs for Employers About COBRA Premium Reduction Under ARRA" ("DOL FAQs") describing, among other things, the intended recipients of its model COBRA notices. [http://www.dol.gov/ebsa/faqs/faq-cobra-premiumreductionER.html]

IRS Notice 2009-27

The IRS Notice poses and answers questions, and provides examples, relating to the following topics pertaining to the COBRA subsidy:

- What Constitutes an Involuntary Termination (Q&As 1-9),
- Who is an Assistance Eligible Individual (Q&As 10-19),
- How to Calculate the Premium Reduction (Q&As 20-26),
- What Type of Coverage is Eligible for the Premium Reduction (Q&As 27-29),
- When Does the Premium Reduction Period Begin and End (Q&As 30-44),

- Recapture of the Premium Reduction (Q&As 45-46),

- The Extended Election Period (Q&As 47-55),

- Payments to Insurers Under Federal COBRA (Q&A 56), and

- Comparable State Continuation Coverage (Q&As 57-58).

Set forth below is a summary of some of the more significant issues addressed in the Notice, with particular attention paid to the issue of what constitutes an "involuntary termination of employment" for purposes of determining eligibility for the subsidy.

Involuntary Termination

Perhaps the most important guidance contained in the Notice relates to the definition of "involuntary termination of employment," since this definition is critical to determining whether an individual is entitled to the subsidy. In this regard, the IRS appears to be creating a "behest test" for determining whether a termination is involuntary. Using this behest test, the IRS generally states that an "*involuntary termination means a severance from employment due to the independent exercise of unilateral authority of the employer to terminate the employment, other than due to the employee's implicit or explicit request, where the employee was willing and able to continue performing services.*" The IRS further states that the determination of whether a termination is involuntary is based on all of the facts and circumstances, and clarifies that the following circumstances generally would be considered an involuntary termination of employment:

- The failure of an employer to renew an employee's contract at the time the contract expires, if the employee was willing and able to renew the contract on similar terms and conditions;

- An employee-initiated termination of employment for good reason following an employer's action that causes a material negative change in the employment relationship for the employee;

- Voluntary termination (or retirement) where the employee knew that the employer would otherwise have terminated the employee's services absent such voluntary termination or retirement;

- Layoffs, furloughs, or other suspensions of employment, even if temporary and even if there is a right of recall, which result in a reduction to zero hours of employment;

- An employer's action to end an individual's employment status while the individual is absent due to illness or disability;

- Termination for cause;

- Resignation of employment as the result of a material change in the employee's geographic location of employment;

- A lockout initiated by the employer; and

- Termination elected by the employee in return for a severance package (i.e., a "buy out") where the employer indicates that, after the offer period for the severance package, a certain number of remaining employees in the employee's group will be terminated.

The Notice also clarifies that the following circumstances would <u>not</u> be considered to be an involuntary termination of employment:

- COBRA qualifying events other than an involuntary termination of employment (e.g., death of an employee, divorce, or a dependent child ceasing to be a dependent child under the applicable requirements of the health plan);

- A reduction in hours of employment that is not a reduction to zero hours of employment. However, the IRS points out that an employee's voluntary termination of employment in response to an employer-imposed reduction in hours may be considered involuntary if the reduction in hours is a material negative change in the employment relationship;

- Absence from work due to illness or disability (prior to the employer taking action to end the individual's employment status);

- Retirement, unless the employee knew that the employer otherwise would have terminated the employee's services, as described above; and

- A work stoppage as a result of a strike initiated by employees or their representatives.

Additional Guidance

As noted, the Notice provides guidance on a number of additional topics related to the subsidy, as follows:

Assistance Eligible Individuals.

The Notice provides further guidance on who is an assistance eligible individual to whom the subsidy is applicable. Among other things, the Notice makes clear that:

- The involuntary termination and the eligibility for COBRA continuation coverage must occur during the period from September 1, 2008 through December 31, 2009; however, the election of COBRA continuation coverage is not required to occur during the period from September 1, 2008 through December 31, 2009, as long as the COBRA continuation coverage begins during that period. The subsidy period itself can extend past December 31, 2009.

- In order to be an assistance eligible individual, the individual must be a qualified beneficiary for COBRA purposes (i.e., covered under the plan on the day before the involuntary termination, except for a child born to or adopted by a covered employee during the period of COBRA coverage and certain other limited cases).

- If another qualifying event, such as divorce, occurs before the termination of employment, the qualified beneficiary from that first event generally is not entitled to the subsidy, except in circumstances where the original qualifying event was in anticipation of involuntary termination (e.g., a reduction of hours in anticipation of involuntary termination).

- Individuals who participate in a "church plan" or other plan not subject to COBRA that voluntarily offers continuation coverage are not eligible to receive the subsidy.

Calculation of Premium Reduction.

In the Notice, the IRS clarifies that the premium that is actually required to be paid by the assistance eligible individual for COBRA continuation coverage is the amount used to determine the individual's 35% share of the premium payment. Accordingly, if the employer pays a portion of the premium, then the subsidy will only apply to the remaining portion of the premium that is charged to the assistance eligible individual. Importantly, the Notice includes several examples relating to how to calculate the 35% subsidy, including in connection with severance arrangements and in situations where a portion of the premium is attributable to coverage for an individual who is not a COBRA qualified beneficiary (e.g., a domestic partner). Among other things, these examples demonstrate that:

- A period of employer-paid COBRA coverage counts against the maximum nine-month subsidy period. Thus, for example, if an employer pays a former employee's COBRA premium for the first six months of coverage, a subsidy is available only for a maximum of another three months.

- The reduced premium does not apply to portions of the premium attributable to COBRA coverage for individuals who are not COBRA qualified beneficiaries. However, the portion of the premium allocated to such individuals is determined based on the incremental cost of such individuals' coverage after taking into account the premium for the qualified beneficiaries. Thus, for example, if an individual with family COBRA coverage added a domestic partner and there was no additional COBRA premium due for such person, no portion of the premium would be allocated to the domestic partner.

- If an employer makes a taxable severance payment only to employees who are assistance eligible, that would not be considered an employer payment of the COBRA premium for purposes of calculating the subsidy. If, instead, the employer reimburses the former employee for COBRA premiums, the portion reimbursed would be treated as an employer-paid COBRA premium and would not be eligible for the subsidy.

Coverage Eligible for Premium Reduction.

The Notice discusses what types of health coverage and plans are eligible for premium reduction, which generally includes any group health plan, except for a flexible spending arrangement offered under a Code Section 125 cafeteria plan. The guidance specifically states that this includes dental-only, vision-only and "mini-med" plans and, under certain circumstances, retiree medical plans.

Beginning and End of Premium Reduction Period.

The Notice discusses various issues, and provides specific examples, relating to the duration of the premium reduction period, including when eligibility for the subsidy would end due to the availability of other group health coverage. The Q&A's and accompanying examples discuss, among other issues, the effect of (i) a spouse's eligibility for health coverage under another plan, (ii) an offer of retiree health coverage as an alternative to COBRA coverage, and (iii) Medicare eligibility. The Notice clarifies that:

- Eligibility for the subsidy ends when an individual is eligible for coverage under another group health plan (whether as a participant or as the spouse or other dependent of an eligible person), even if the person does not enroll for such coverage. If the other plan has a waiting period, the subsidy becomes unavailable on the first day after the end of the waiting period.

- An offer of retiree health coverage from another plan (not the one from which coverage was lost) could result in the subsidy being lost, depending on when the eligibility for COBRA arose and when the election period for retiree coverage ended.

- An employer need not refund the payroll tax credit taken for the subsidy where an assistance eligible individual did not notify the employer that he or she was eligible for other coverage unless the employer knew of the other coverage. Penalties are instead imposed on the individual.

- An individual who has two involuntary terminations of employment could become eligible twice for the subsidy. A separate maximum nine-month subsidy period would apply to each termination.

Recapture of Premium Assistance.

The Notice clarifies that a plan may not refuse to provide the subsidy to an individual whose income reaches the limits set forth in the Act, unless the individual has permanently waived the subsidy, and includes guidance as to how such a waiver may be accomplished. The IRS explains that a separate notification to the government is not required; the Act only requires a signed and dated waiver to be provided to the entity that is reimbursed for the subsidy.

Extended Election Period.

The Notice includes several Q&As regarding the various rules that apply when certain assistance eligible individuals elect COBRA continuation coverage during the extended election period provided for by the Act. These Q&As make clear that:

- An individual who does not have an election of COBRA coverage in effect on February 17, 2009, but who would have been an assistance eligible individual if such an election was in effect, is allowed an extension of the COBRA election period. This would include the spouse and children (who are "assistance eligible individuals") of an employee who initially elected self-only coverage.

- If an assistance eligible individual elects coverage during the extended election period, the first period of coverage for such individual is the month beginning March 1, 2009 (if the plan at issue requires that COBRA coverage be paid for based on a calendar month), and the premium subsidy only applies to the premiums due for coverage for March and the following months, even if the plan otherwise requires individuals who lose coverage before the last day of the month to pay a pro rata portion of the monthly premium for the first partial month of coverage.

- If a plan requires that COBRA coverage be paid for based on a monthly period that starts on the day after the day coverage is lost, the first period of coverage on or after February 17, 2009 is the monthly period that corresponds with the day after the loss of coverage. For example, if the last day of coverage was October 3, 2008, then the first period of coverage on or after February 17, 2009 for an individual who elects COBRA coverage during the extended election period is the period from March 4, 2009 through April 3, 2009.

- The extended election period is available for all assistance eligible individuals who are qualified beneficiaries as a result of an involuntary termination of employment during the required period even if they still have an open COBRA election period as of February 17, 2009, and such individuals may elect COBRA coverage either retroactively (during their existing COBRA election period) or only for periods on or after February 17, 2009 (under the extended election period).

- The extended election period generally is not available to individuals whose continuation coverage is provided pursuant to State law only. However, some states (such as New York) have adopted similar rules.

- An assistance eligible individual who was eligible for other group health coverage prior to February 17, 2009, but has been unable to enroll in such other coverage on and after February 17, is allowed the subsidy until he or she is eligible to enroll in other coverage.

- Timely payment of the initial premium for COBRA coverage elected during the extended election period means payment that is made in accordance with COBRA's otherwise applicable rules for payment of the initial premium (i.e., a plan may not require payment earlier than 45 days after the date of the election).

Payments to Insurers Under Federal COBRA.

The Notice provides that if the insurer of an insured single employer plan has agreed to collect COBRA premiums directly from the qualified beneficiary, it must treat a 35 percent payment as payment of the full premium even before the employer pays the remaining 65 percent.

Comparable State Continuation Coverage.

The Notice discusses some of the circumstances under which a state continuation coverage program is considered to provide comparable coverage that qualifies for the premium subsidy, and provides further clarification with respect to an insurer's right to be reimbursed for the subsidy where the plan is subject solely to state continuation coverage.

DOL FAQs

As discussed in our March 2009 Client Alert (linked above), the DOL issued various model notices and forms to assist employers and other plan sponsors in complying with ARRA's notice requirements and in implementing the subsidy program. The DOL issued a full general notice and election form, an abbreviated general notice (without an election form), a notice and election form in connection with extended election periods and an alternative notice.

Among other things, the new DOL FAQs clarify the population to whom these notices should be sent as follows:

> The **full general notice** should be sent to all qualified beneficiaries who experienced a qualifying event from September 1, 2008 through December 31, 2009 who have not yet been provided with an election notice or who received an election notice on or after February 17, 2009 that did not contain the required information about the subsidy. This notice should be sent regardless of whether the qualifying event was involuntary termination.
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> The **abbreviated general notice** should be sent to anyone who experienced a qualifying event on or after September 1, 2008, has elected COBRA coverage and is currently on COBRA coverage. This notice would also be sent regardless of whether the qualifying event was involuntary termination.
>
> The **extended election period notice** should be sent only to assistance eligible individuals who had a qualifying event from September 1, 2008 through February 16, 2009 and who did not elect COBRA coverage or elected it but subsequently discontinued it. However, insurers subject to state, rather than federal, continuation coverage requirements need not send this notice (although insurers should be mindful of the fact that they may be required by state law to send a similar notice). As noted in our earlier Client Alert, this notice must be sent by April 18, 2009.
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> The **alternative notice** should be sent to individuals covered by state-mandated continuation coverage laws (e.g., mini-COBRA). The DOL reminds health insurance issuers to ensure that these notices also conform to applicable state law.

Plan sponsors should review the DOL FAQs carefully, as they contain a number of helpful examples of situations in which each notice must be sent, including examples where an individual must receive information contained in more than one of the notices.

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If you have questions regarding the new IRS guidance or relating in any way to the COBRA subsidy program, please feel free to contact any member of our COBRA Subsidy Team.

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Client Alert

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