



IRS Issues Guidance on New COBRA Requirements

The IRS has issued Notice 2009-27, which provides additional guidance on the new COBRA subsidy rules. In question and answer format, the IRS addresses such issues as what constitutes an involuntary termination, who is an assistance eligible individual, and how the subsidy amount is calculated. Almost concurrently, DOL updated the Q&As on its website to include additional guidance on the provision of notices under the new COBRA requirements.

Background

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for a subsidy of 65% of the cost of COBRA coverage for certain qualified beneficiaries who lose health coverage due to involuntary termination of employment. (See our February 24, 2009 [For Your Information](#).) DOL recently issued model notices, and some preliminary informal guidance was provided in a recent teleconference. (See our March 26, 2009 [For Your Information](#).) Now the IRS has issued formal guidance on various aspects of the new requirements.

IRS Notice

In [Notice 2009-27](#), the IRS provides 58 questions and answers, which basically do not present any surprises. Nonetheless, there are some welcome confirmations and clarifications.

Involuntary Termination

The most anticipated guidance has been on the definition of involuntary termination. The IRS defines an involuntary termination as “a severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employment ... where the employee was willing and able to continue performing services.” Further, the IRS indicates that an employee-initiated termination “for good reason due to employer action that causes a material negative change in the employment relationship for the employee” (e.g., if an employee’s hours are cut significantly) is involuntary for purposes of the subsidy.

Whether a termination is involuntary will depend on the particular facts and circumstances. For example, an employee’s resignation would be considered an involuntary termination if he knew he would be fired if he did not resign.

The notice also indicates that involuntary terminations will be deemed to occur in the following situations –

- a layoff with a right to recall or a temporary furlough or other suspension of employment if hours are reduced to zero and health coverage is lost
- a resignation due to a material change in the geographic location of employment
- a termination elected by the employee in return for a severance package, if the employer indicates that some of the remaining employees in the employee's group will be terminated after the offer period for the severance program
- a termination for cause, other than one which the plan sponsor designates as being for gross misconduct.

However, they do not generally occur in the following situations –

- a reduction of hours (but not to zero hours), unless it is deemed a good reason termination as indicated above
- an employee's absence from work due to illness or disability, except if the employer ends the employee's employment status during the absence
- retirement, unless the employee knew she would be terminated if she did not retire
- strike, unless it is a lockout initiated by the employer.

BUCK COMMENT. *The IRS definition of involuntary termination may be broader than many employers initially assumed. The facts and circumstances surrounding each individual's situation need to be considered in determining whether an individual was involuntarily terminated – both for purposes of providing notices to qualified beneficiaries and reviewing applications for the subsidy.*

One issue not addressed by the guidance is the coordination of the subsidy with family and medical leave. In a recent teleconference, an IRS official confirmed that this issue was not addressed in the notice. In this situation, careful review of the surrounding circumstances will be necessary.

Also during this teleconference, an IRS official indicated that military leave, although not employer initiated, could be deemed an involuntary termination. More guidance on this point would be helpful.

Assistance Eligible Individual

The guidance confirms that only qualified beneficiaries can be assistance eligible individuals (AEIs) and that to be a qualified beneficiary eligible for the subsidy, the individual must have been covered under the health plan the day before the involuntary termination. Thus, dependents added after the termination of employment are generally not AEIs, with the exception of children born to or adopted by the former employee during the COBRA period (who are specifically treated as qualified beneficiaries under COBRA). In addition, the IRS specifies that

death is not an involuntary termination and thus would not make the deceased's spouse or dependent child an AEI.

The following individuals are generally not qualified beneficiaries and therefore not eligible for the subsidy –

- domestic partners
- same-sex spouses
- spouses or children added as a result of a qualified status change after the date of termination of employment (with the exception noted above for newborns and newly adopted children)
- spouses or children added during open enrollment
- individuals who lost health coverage as a result of the employee's termination for gross misconduct.

The guidance confirms that to be an AEI, both the involuntary termination and loss of coverage must occur during the period from September 1, 2008 through December 31, 2009. However, the election of COBRA coverage can be made after this period, as long as the COBRA coverage begins during the period.

BUCK COMMENT. *When an employee is terminated mid-month, many employers continue active coverage until the end of the month. In this case, if COBRA coverage is deemed to start on the first day of the following month, coverage for an employee involuntarily terminated during December 2009 would not be effective until January 1, 2010 and would appear to render the employee ineligible for the subsidy. Thus, employers may want to reassess when they deem the loss of coverage to occur and when COBRA coverage begins under their plans and make any desired adjustments.*

Calculation of Subsidy

The IRS confirms that the 35% the AEI pays, as well as the employer's payroll tax credit, is based on the amount that the AEI would otherwise be required to pay to have COBRA coverage, including the 2% administrative fee, if applicable. If the amount that the employee is required to pay is less than the full COBRA rate, then the subsidy is based on whatever amount the employee pays. The guidance confirms that an employer charging less than the maximum allowed by COBRA may increase the premium to the maximum to get the full tax credit on the higher premium.

Non-AEIs. As noted above, the subsidy is not available for individuals who are not assistance eligible individuals (e.g., domestic partners, subsequently added dependents). To calculate the appropriate premium, the notice requires use of an incremental cost approach. The guidance indicates that the premium amount applies first to AEIs and then to the non-AEIs.

For example, if the COBRA premium is \$800 for employee plus one coverage and \$1,000 for family coverage and the employee elects family coverage to cover a dependent child AEI and a domestic partner, the subsidy would

apply to the \$800 (employee plus one coverage) but not to the remaining \$200 attributable to covering the domestic partner. If the employee covered two dependent child AEs and the domestic partner, the entire \$1,000 would be eligible for the subsidy because there is no incremental cost increase for the domestic partner.

BUCK COMMENT. *This incremental cost approach avoids the complexities of prorated premiums based on the total number of AEs and non-AEs in a family. Many plan sponsors use the prorated approach in determining the taxability of medical premiums for active employees with domestic partner coverage, so special care should be taken to ensure proper calculation of ARRA subsidy-eligible premiums.*

Severance Issues. The guidance includes some examples that illustrate how the subsidy is applied when an AEI receives severance benefits that include continued health coverage. The key factor in these situations is when the plan sponsor treats the 18-month COBRA period as beginning. Some severance plans are designed to begin COBRA coverage immediately, with any period of employer-subsidized coverage counting towards the 18-months of COBRA coverage. Other plans treat employees as not having a loss of coverage until the end of the severance period and only begin counting the 18-month period at that point.

In the first situation, the ARRA subsidy is available right away (and employer payments towards coverage will reduce the available subsidy). In the second situation, COBRA (and the ARRA subsidy) would only begin when the COBRA clock begins to run.

Coverage Eligible for Subsidy

The IRS confirms that the subsidy applies to any type of coverage (e.g., dental, vision, “mini-med” plans) other than a health flexible spending account (FSA) under Section 125 and that it applies to health reimbursement accounts (HRAs). Further, retiree health coverage generally can be treated as eligible COBRA coverage if it is identical to that made available to similarly situated active employees (although the amount charged retirees may be higher than the amount charged active employees).

Period to Which Subsidy Applies

The subsidy applies to the first period of coverage that begins on or after February 17, 2009. The notice states that the exact date on which the first period of coverage begins depends on the period with respect to which premiums are charged by the plan. If a plan charges for COBRA on a calendar month basis, the first period of coverage to which the subsidy applies generally cannot begin until March 1, 2009. However, if the plan charges for COBRA on a calendar month basis but requires qualified beneficiaries to pay a prorated portion of the monthly premium to continue coverage for the remainder of the first month, the first period of coverage for which the subsidy is available for an individual who loses coverage after February 17, 2009 will be the first partial month of coverage.

End of Subsidy Period

Eligibility for the subsidy generally ends when an AEI becomes eligible for other group coverage or Medicare. The IRS says that when an individual is eligible for new coverage, eligibility for the subsidy does not end until the first day the new coverage can take effect. For example, if the employee declines new coverage that would have become effective on the first day of the next month, the employee's eligibility for the subsidy will end on the first day of the next month. If the new coverage has a two-month waiting period, the employee will remain eligible for the subsidy until the end of the waiting period, even if the employee declines the new coverage prior to that time.

The notice also explains how retiree health coverage offered under another plan at the same time as COBRA coverage will affect eligibility for the subsidy and that a current Medicare enrollee who experiences an involuntary termination is not eligible for the subsidy.

The IRS says that the nine-month period for the subsidy can end after December 31, 2009 as long as the AEI was qualified before that date. For example, if an involuntarily terminated individual's COBRA period begins on December 1, 2009, eligibility for the subsidy will end on August 31, 2010.

The IRS also clarifies that there can be more than one nine-month period of subsidy coverage for an individual who experiences more than one involuntary termination during the period from September 1, 2008 through December 31, 2009.

High-Income Individual Exclusion

The notice provides that in the absence of a permanent waiver, a plan may not refuse to provide the subsidy for an individual whose income is too high to qualify for the subsidy. The IRS also indicates how the permanent waiver election is to be made – i.e., the individual must provide a signed and dated notification to the employer (or to whomever is reimbursed for the subsidy amount) that references “permanent waiver.” No separate notification to any government agency is required.

BUCK COMMENT. Unfortunately, neither IRS nor DOL has provided a model waiver form.

Extended Election Period

The IRS provides guidance on the second COBRA election period for those individuals who lost coverage due to an involuntary termination that occurred during the period from September 1, 2008 through February 17, 2009 and who either declined COBRA coverage or initially took the coverage and discontinued it. The notice provides that –

- The second election applies to the spouse and dependent qualified beneficiaries of an individual who elected self-only COBRA coverage.

- For a plan that uses a calendar month COBRA payment procedure, the extended COBRA period may not begin before March 1, 2009, even if it otherwise requires a partial premium payment for the first month of partial coverage.
- An AEI whose COBRA rights independent of the subsidy are still open (e.g., the termination occurred in January 2009 and the COBRA election notice was provided in February 2009) can elect to begin COBRA for coverage periods on or after February 17, 2009 under the second chance election. However, the notice also indicates that coverage and payments will be retroactive to the original COBRA start date (with the subsidy only available for coverage periods beginning on or after February 17, 2009) if the individual makes a COBRA election within the original election period.
- The amount of HRA reimbursements available under the extended election is the amount available immediately before the qualifying event, reduced by any reimbursements made after that date for prior incurred expenses.
- The extended election applies for periods before an individual can actually enroll in other coverage. For example, if an individual is unable to enroll in spousal coverage because the HIPAA special enrollment period ended before February 17, 2009, the individual can make the second election for COBRA for the period until he can enroll in the spousal coverage (e.g., during the spouse's open enrollment period).

The IRS also confirms that for purposes of the second election period, payment is timely if made by the date that is 45 days after the election.

DOL Q&As

As noted earlier, the DOL recently updated the Q&As posted on its [website](#) to reflect its recent guidance on the notice requirements. The new Q&As basically reiterate what it has previously communicated as to who must receive which notice, but include many examples to illustrate the requirements.

Conclusion

Now that Notice 2009-27 has been issued, employers for the most part have enough information to help them comply with the new COBRA requirements. Buck's consultants would be pleased to discuss the latest guidance and help employers in their compliance efforts.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.