

## **IRS GUIDANCE ON NEW COBRA REQUIREMENTS**

The Internal Revenue Service (IRS) has released additional guidance on the new COBRA provisions contained in the American Recovery and Reinvestment Act (ARRA). Notice 2009-27 addresses many of the questions surrounding the implementation and administration of these new COBRA requirements in a series of questions and answers (Q & As).

### **OVERVIEW**

The Notice contains 58 Q & As discussing a variety of issues, including:

- What constitutes an “involuntary termination, including a number of examples;
- Calculating the subsidy, including issues involving severance arrangements;
- Clarification that the subsidy will not be available for certain non-assistance eligible individuals who may have continuation of coverage (e.g. domestic partners and also dependents added during COBRA open enrollment), including guidance on the proper allocation of the premiums associated with this coverage;
- What plans are subject to the reduced premium requirement, including stand-alone vision and dental plans, mini-med plans and HRAs;
- Clarification on the entity eligible to receive the payroll tax credit (the employer in a plan subject to Federal COBRA);
- The waiver of the premium subsidy for high income individuals; and
- How the subsidy works with respect to state continuation of coverage requirements.

We have summarized some of the key aspects of this guidance as it relates to the Federal COBRA requirements in the following information. This summary is not exhaustive. Employers and plans subject to the new COBRA requirements should review the entire notice at [www.irs.gov/pub/irs-drop/n-09-27.pdf](http://www.irs.gov/pub/irs-drop/n-09-27.pdf).

### **INVOLUNTARY TERMINATION (Q/A-1 THROUGH Q/A-9)**

The IRS provides the first definition of an involuntary termination and some real-life examples of “what is” and “what isn’t” an involuntary termination.

#### *Definition*

- An *Involuntary Termination* is a severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employment (other than due to the employee’s explicit or implicit request) where the employee was willing and capable to continue performing services.

The determination of an involuntary termination must be made based on all the facts and circumstances of each particular situation. In some instances this may involve a review by the DOL through the appeals process. The DOL expects to issue guidance on this process in the near future.

#### *What is Involuntary Termination?*

- A failure to renew an employment contract at the time the contract expires if the employee was willing and able to execute a new contract (under similar terms and conditions as the expiring contract) and to continue to provide the service.
- An employee-initiated termination, if the termination is due to an employer action that causes a *material negative change* in the employment relationship for the employee (e.g. a resignation as a result of a material change in the geographic location of employment of the employee).
- A voluntary termination or resignation may be “involuntary” if the employer would have otherwise terminated the employee’s services and the employee had knowledge of the termination.
- Involuntary reduction in hours to zero (e.g. layoff, furlough or other suspension of employment) resulting in the loss of health coverage.
- Employer’s action to end an individual’s employment status while the individual is absent from work due to illness or disability.
- Retirement when the employer would have terminated the employee’s services; the employee had knowledge that he/she would be terminated and chose to retire.
- Termination for cause (gross misconduct exception still applies).
- Lockout initiated by the employer.

#### *What is NOT an Involuntary Termination?*

- Divorce from the employee.
- Death of the employee.
- Dependent child ceasing to be a dependent under the terms of the plan.
- An absence from work due to illness or disability.
- A strike initiated by employees.
- A reduction in hours that is not to zero hours.

- However, an employee's voluntary termination in response to an employer-imposed reduction in hours may be an involuntary termination if the reduction in hours is a *material negative change* in the employment relationship for the employee. We expect some uncertainty as to what will constitute a *material negative change*, and would welcome additional guidance.

### **ASSISTANCE ELIGIBLE INDIVIDUAL (AEI)**

The IRS further clarifies the definition of an assistance eligible individual (AEI) and provides examples to highlight certain scenarios that have been the subject of some confusion.

#### *Definition (Q/A-10)*

An *assistance eligible individual* (AEI) is:

- a COBRA qualified beneficiary as a result of the involuntary termination of the employee that occurred during the period from September 1, 2008 through December 31, 2009,
- Who is eligible for COBRA at any time during that period, and
- Elects COBRA.

#### *Examples (Q/A 11-13)*

The examples make clear that both the involuntary termination and the loss of coverage must occur within the September 1, 2008 through December 31, 2009 timeframe to qualify for the reduced premium.

- Joe experiences an involuntary termination of employment in August 2008 but his loss of coverage resulting in his COBRA eligibility does not occur until after September 1, 2008 (but before December 31, 2009). Is Joe an AEI?
  - No – the involuntary termination must have occurred during the period from September 1, 2008 through December 31, 2009. Because Joe's involuntary termination occurred prior to September 1, 2008, he is not an AEI.
- Mary's involuntary termination occurs December 20, 2009 but the loss of coverage occurs after December 31, 2009. Is Mary an AEI?
  - No – the COBRA eligibility period must occur during the period between September 1, 2008 and December 31, 2009. Mary is COBRA eligible after December 31, 2009. Therefore, she is not an AEI.

## SEVERANCE ARRANGEMENTS (Q/A-14)

In certain severance arrangements (or other agreements), the employer may decide to provide and pay for coverage under the group health plan for a period of time following a termination of employment. This coverage may be provided as "*Active Coverage*," or as "*COBRA Coverage*." How the coverage is treated is important for purposes of eligibility and the duration of any reduced premium. The subsidy only applies to a continuation of coverage that is treated as COBRA and only to the portion of the premium that is paid by the AEI.

### *Treat Severance Period as "Active Coverage"*

If the employer treats the period of severance as "Active Coverage" (meaning the loss of group health plan coverage is deferred to a later date), the loss of coverage for the purpose of the premium reduction begins when the individual is no longer treated as having coverage under the active plan.<sup>1</sup> This may cause some issues when determining eligibility for the reduced premium.

### Example

- Kate is involuntarily terminated on November 15, 2009. Health coverage in connection with an involuntary termination under the employer's group health plan would normally end November 30, 2009. However, the employer agrees to a severance package that pays group health plan benefits in full for 6 months running from December 1, 2009 through May 31, 2010. Under this arrangement the employer treats Kate as an "Active" individual under the terms of the group health plan. Kate's loss of coverage occurs May 31, 2010, triggering the COBRA qualifying event.
- Kate will not be an AEI because the loss of coverage (and therefore the COBRA period) does not occur until May 31, 2010 (outside of the September 1, 2008-December 31, 2009 window).<sup>2</sup>

### *Treat Severance Period as COBRA*

However, if the employer treats the severance period as "COBRA coverage," meaning the individual is treated as having COBRA coverage during a severance period, and the employer is paying all or part of the COBRA premium on the individual's behalf, the loss of coverage is considered to have occurred as of the date COBRA coverage began. The subsidy would apply to any premium paid by the employee or dependent for the first 9 months of coverage under the agreement or after it ends.

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<sup>1</sup> It is important to ensure that this type of severance arrangement complies with the requirements of the plan and underlying insurance policies.

<sup>2</sup> Even if the 6 month severance period ended before December 31, 2009, the subsidy would only apply to the premium actually paid by Kate. Since the employer pays the entire premium for the 6 months in this example, the subsidy would not apply to the premium paid by the employer, but would apply to the premium paid by Kate for up to 3 months after the severance arrangement ends.

## Example

- Kate is involuntarily terminated on November 15, 2009. Health coverage in connection with an involuntary termination under the employer's group health plan would normally end November 30, 2009. The employer treats Kate's severance period as COBRA coverage.
- Therefore, Kate could be eligible for the reduced premium as her qualifying event date and loss of coverage occurred during the period from September 1, 2008 through December 31, 2009. Assuming the employer paid the COBRA premium in full for 6 months, there would be no subsidy for that period, but Kate may be eligible for 3 months of reduced premium from June through August 2010.

### *Measuring the 18-month COBRA Period*

The guidance highlights the special Code § 4980B(f)(8) option for measuring the 18-month COBRA maximum coverage period and the impact it will have on the scenarios described above.

If the plan provides for the optional extension of required periods under Code §4980B(f)(8), the end of the 18-month maximum period for COBRA continuation is measured from the date coverage is lost. Under this rule, when Kate loses coverage on May 31, 2010 (or November 30, 2009), the 18-month coverage period is measured from May 31, 2010 (or November 30, 2009).

If the plan does not provide for this extension, the end of the 18-month maximum coverage period is measured from the date of the individual's involuntary termination of employment (e.g. qualified event date). Applying this rule to the examples above, the 18-month maximum COBRA period would be measured from November 15, 2009.

### **SECOND QUALIFYING EVENTS (Q/A-15)**

The IRS clarified that if a spouse is COBRA eligible due to a divorce, and later the employee experiences an involuntary termination (making the employee eligible for a reduced premium), the spouse would not be an assistance eligible individual because their COBRA eligibility was not tied to the employee's involuntary termination.

However, if in anticipation of an involuntary termination that would otherwise qualify an individual as an assistance eligible individual, the employer takes action (other than the involuntary termination) that results in a loss of coverage, the action causing the loss in coverage prior to the involuntary termination is disregarded in determining whether the involuntary termination is the qualifying event that results in COBRA. The IRS guidance is not clear as to how one will distinguish whether the action taken by the employer is "in anticipation" of an involuntary termination. More guidance is needed.

## Example

- Bob experiences a reduction in hours in March 2009 that does not constitute (and is not in anticipation of) an involuntary termination. The reduction in hours results in a loss of coverage and Bob is eligible and timely elects COBRA beginning April 1, 2009. In November 2009 Bob is involuntarily terminated from employment. Bob is **not an AEI** in connection with the November 2009 involuntary termination because the qualifying event with respect to the COBRA continuation of coverage was not his involuntary termination.

## **CALCULATION OF PREMIUM REDUCTION**

### *Establishing the Premium (Q/A 20-21)*

The “reduced premium” is 35% of the total premium the AEI would be charged for COBRA if the AEI were not eligible for the reduction (generally 102% of the applicable premium). This 102% is the maximum allowed under the COBRA requirements (except in a disability extension). The employer cannot base the AEI’s premium on more than 102% of the applicable premium. There are a number of examples provided in the guidance addressing the premium calculation.

### *Non-Qualified Beneficiaries and Reduced Premiums (Q/A-23, Q/A 25-26)*

Only qualified beneficiaries who elect COBRA and whose qualifying event with respect to the coverage is the involuntary termination of the employee’s employment from September 1, 2008 through December 31, 2009 are AEIs.<sup>3</sup> Plans may allow certain non-qualified beneficiaries to continue coverage based on the employee’s qualifying event (e.g. domestic partners and individuals added at open enrollment). These individuals are not eligible for the reduced premium.

Generally, where non-qualified beneficiaries receive continuation of coverage, the portion of the premium tied to the non-qualified beneficiary (if any) is not subject to the 65% reduction. The guidance provides an “incremental cost” approach to appropriately allocate the premium. However, under this approach there are instances where the entire premium may still be eligible for the subsidy even if some of the covered individuals are not AEIs. This is illustrated in the examples below.

### Examples:

- Lynn and her two dependent children are assistance eligible individuals and have COBRA continuation coverage. The COBRA continuation coverage also covers an individual who is not an assistance eligible individual. The unreduced

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<sup>3</sup> This will include the employee and the spouse or dependent child of the employee under Federal law, assuming such person had coverage under the group health plan on the day before the qualified event. Also, a child born or adopted by the covered employee during the COBRA period will be a qualified beneficiary.

COBRA premium associated with self-plus-two-or-more-dependents is \$1,000 per month.

- o The amount that Lynn would pay for COBRA continuation coverage if she was not eligible for the premium reduction for covering herself and her two children (the AEIs) is \$1,000 per month. The additional premium amount for coverage of the non-AEI is \$0 per month.
- o Lynn is entitled to apply the premium reduction to the \$1,000, and is entitled to COBRA continuation coverage upon the timely payment of \$350 (35% of \$1,000) for the coverage. The employer's resulting payroll tax credit is \$650 (65% of \$1,000).
- Charlie has one dependent child, and the plan charges \$800 per month for self-plus-one-dependent COBRA continuation coverage and \$1,000 for self-plus-two or more coverage. Charlie also covers a non-qualified beneficiary under the continuation coverage.
  - o Although Charlie's premium would be \$1,000 per month for self-plus-two-or-more-dependents on COBRA continuation coverage, the portion of the premium attributable to coverage for Charlie and Charlie's dependent child (AEIs) is \$800.
  - o Charlie is entitled to apply the premium reduction to the \$800 and is entitled to COBRA continuation coverage upon the timely payment of \$280 (35% of \$800) for that portion of the coverage. The amount Charlie pays for the non-assistance eligible individual is \$200. Charlie's total premium payment is \$480 (\$280 plus \$200). The employer's resulting payroll tax credit is \$520 (65% of \$800).

## OTHER ITEMS

- An individual may be an AEI on more than one occasion. With each involuntary termination resulting in AEI status, an individual is eligible for the full 9 months of a reduced premium. *Q/A-1*
- Premium reduction is available for COBRA continuation coverage of *any group health plan (except the health FSA)*. This includes HRAs, vision-only or dental-only plans and mini-med plans, even where the employee pays the entire premium, as long as the program is treated as an employer sponsored plan. *Q/A-27, Q/A-29*
- Death of the involuntarily terminated employee will not end eligibility for the reduced premium of a spouse or child, who is an assistance eligible individual as a result of the employee's previous involuntary termination. *Q/A-39*
- Failure to timely pay COBRA premiums will end the premium reduction. *Q/A-40*

- An individual currently enrolled in Medicare who becomes a qualified beneficiary as a result of an involuntary termination of employment from September 1, 2008 through December 31, 2009 will not be eligible to receive the premium reduction, even if they are eligible for COBRA continuation of coverage. *Q/A-41*
- The employer is not required to refund the payroll tax credit claimed by the employer for an individual who lost eligibility for the reduced premium (due to eligibility for other group health plan coverage or Medicare) and failed to notify the plan. However, it appears that if the employer knew the individual was eligible for other coverage, the employer may not take the credit as it relates to the individual. It is not clear what constitutes “knowledge” on the part of the employer. More guidance is needed. *Q/A-42*
- The plan may not refuse to provide the subsidy to an individual based on their income. The individual is the only person who can waive the subsidy. *Q/A-45*
- To waive the premium reduction the AEI must provide a signed and dated written notification that includes reference to a “permanent waiver”. This must be provided to the person reimbursed for the premium reduction (e.g. the employer in a plan subject to Federal COBRA). *Q/A-46*
  - At this point a model waiver form has not been provided.

## **CONCLUSION**

This guidance has been particularly helpful in clarifying some of the confusion as to what constitutes an “involuntary termination.” The IRS acknowledges that there remain many unanswered questions and issues and they will provide future guidance. We will continue to monitor these requirements and provide you with up-to-date information.