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A Timely Analysis of Legal Developments

ASAP

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The 65% COBRA subsidy passed as part of the American Recovery and Reinvestment Act of 2009 (ARRA) left open many questions as to eligibility for the subsidy. The IRS has now issued guidance on the meaning of "involuntary termination" along with other much-needed guidance on how the subsidy works.

IRS Clarifies Key Provisions of the New COBRA Subsidy

By Nancy L. Ober

The American Recovery and Reinvestment Act of 2009 (ARRA), signed into law by President Obama on February 17, 2009, provides a 65% COBRA subsidy for eligible employees (and their covered dependents) who lose group health plan coverage due to an involuntary termination of employment during the period September 1, 2008, through December 31, 2009. Generally, the employer must pay the COBRA administrator the 65% subsidy amount and then receive reimbursement through a payroll tax credit. The ARRA does not contain definitions of many of its terms, including the meaning of "involuntarily terminated." On March 31, 2009, the IRS issued much-anticipated guidance on this and other COBRA subsidy issues in Notice 2009-27. Highlights of the new guidance are below. For information concerning ARRA's changes to COBRA, see Littler's February 2009 ASAP, *Stimulus Package: An In-Depth Look at the New COBRA Subsidy in the ARRA*.

"Involuntary Termination" is Broadly Defined

Notice 2009-27 broadly defines an *involuntary termination* for purposes of the COBRA subsidy to mean an employer-initiated termination where the employee was willing and able to continue performing services. A termination or retirement designated as voluntary will be considered involuntary if the employee knew that absent resignation or retirement the employer would have terminated the employee's services. Similarly, an employee's "voluntary" election to terminate in exchange for a severance package, either as an individual or as part of a group, is an involuntary termination if the employer indicated that after the offer expires a certain number of remaining employees in the employee's group will be terminated.

An involuntary termination may include the employer's failure to renew a contract at its expiration if the employee was willing to renew the contract on similar terms. An employee's resignation "for good reason" due to an employer action that constitutes a material negative change in the employment relationship also qualifies as an involuntary termination. While a reduction in hours is generally not an involuntary termination, a

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reduction in hours to zero, such as a layoff with right of recall or a temporary furlough, is. The termination of an employee who is absent from work due to an illness or disability is also an involuntary termination for purposes of the COBRA subsidy.

Other Requirements for Subsidy Eligibility

Notice 2009-27 clarifies other eligibility requirements for the subsidy. The ex-employee and family members (except for a child born or adopted during the COBRA period) must have been covered under the group health plan immediately before the involuntary termination to be eligible for the subsidy. The subsidy does not apply to individuals added during a subsequent open enrollment or special enrollment period. An individual (such as a domestic partner) is not eligible for the subsidy if he or she does not meet the definition of a qualified beneficiary under federal COBRA, even if the individual may be covered under the terms of a plan or pursuant to state law.

Individuals who become eligible for COBRA due to a qualifying event (such as a divorce or a reduction in hours that does not itself constitute an involuntary termination) that occurs before the involuntary termination are not eligible for the subsidy. However, if a reduction in hours is in anticipation of an involuntary termination, the subsequent termination qualifies for the subsidy.

Plans Eligible for the COBRA Subsidy

Notice 2009-27 clarifies that the COBRA subsidy applies not just to group medical plans but also to vision-only and dental-only plans and to health reimbursement arrangements. The subsidy does not, however, apply to a flexible spending arrangement under a Section 125 cafeteria plan.

Commencement of and Termination of the COBRA Subsidy

Both the involuntary termination and the loss of coverage must occur during the period September 1, 2008, through December 31, 2009, but the subsidy only applies to coverage after February 17, 2009 (the date of enactment of ARRA). The subsidy may continue after December 31, 2009, for individuals who qualify by December 31, 2009.

If the employer continues to provide health coverage after the employee's termination on the same terms as it does for active employees, the COBRA subsidy will begin after this coverage period terminates. For example, under a severance plan, in lieu of putting an employee on COBRA and subsidizing COBRA, an employer may agree not to terminate the employee's "active" coverage for a certain period of time (where benefits are insured, this will generally require the acquiescence of an insurance company). However, if the employer treats this coverage as part of the 18-month COBRA period, eligibility for the subsidy begins when the employee is involuntarily terminated.

Eligibility for the subsidy ends when the employee or dependent is able to enroll in other group health coverage or Medicare, regardless of whether he or she actually enrolls. Coverage under a dental-only, vision-only or Section 125 flexible spending arrangement (FSA) does not count as other health coverage, but the Notice makes it clear that coverage under a health reimbursement arrangement (HRA) does count, unless the HRA is an FSA (where the maximum amount of the reimbursement available is less than 500% of the value of the coverage). If the individual cannot enroll in the other plan immediately (for example, due to a waiting period), the subsidy ends only on the first date that coverage can take effect. If the individual was eligible for other group health plan coverage prior to February 17, 2009, but has been unable to enroll in the other coverage on and after February 17, 2009, the subsidy applies until the individual is eligible to enroll in other group health plan coverage.

Calculating the Subsidy

An ex-employee (or covered dependent) who qualifies for the subsidy is required to pay 35% of the COBRA premium. Notice 2009-27 defines the COBRA premium for this purpose as the amount the employee would pay if he or she were not eligible for the subsidy. If the employer pays part of the COBRA premium, the employee's share is 35% of the reduced amount he or she is required to pay, provided that the employer payments are counted toward the employee's 18 months of COBRA coverage.

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The subsidy applies to COBRA premium increases charged by the plan as permitted under COBRA. The Notice provides that if the employer provides a separate taxable payment to the ex-employee to defray the cost of the premium increase, the subsidy still applies to the full amount of the increased premium. The subsidy likewise applies to the increased premiums resulting from the ex-employee or dependent's election of a more expensive plan during a subsequent open enrollment. However, the subsidy does not apply to the portion of any COBRA premium attributable to coverage for individuals who are not eligible for the subsidy (such as a spouse who was not enrolled before the involuntary termination of employment or a domestic partner).

What Employers Should Do Now to Comply with the New Guidance

Employers should be guided by the IRS's definition of involuntary termination in identifying individuals eligible for the COBRA subsidy. Employers should offer the subsidy under any dental-only and vision-only plans and HRAs that are not FSAs. Employers who pay for continued, post-termination health coverage should review how that coverage is treated for COBRA purposes to determine when subsidy eligibility begins. Employers should have processes in place to ensure that the subsidy is correctly calculated and that it is based only on COBRA coverage that qualifies for the subsidy.

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