Employee Benefits Alert: IRS Issues New Guidance on COBRA Subsidy

4/7/2009

The Internal Revenue Service has issued Notice 2009-27 (the "Notice"), which contains, in question and answer format, new guidance relating to the COBRA subsidy made available under the American Recovery and Reinvestment Act of 2009 (the "Act"). The Act's key provisions were discussed in more detail in our prior Alerts, available here and here.

Since the passage of the Act, employers, current and former employees, and benefits practitioners have raised many questions as to the interpretation of the Act. The Notice provides answers to many of these questions. The following are some highlights from the Notice, chosen based on the issues that have been raised most frequently by our clients and colleagues.

Involuntary Termination Defined

The Notice generally defines "involuntary termination" as "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 implicit or explicit request, where the employee was willing and able to continue performing services."

The determination of whether a termination is "involuntary" is based on all of the facts and circumstances. For example, if a termination is designated as voluntary or as a resignation, but the facts and circumstances indicate that, absent such voluntary termination, the employer would have terminated the employee's services, and that the employee had knowledge that the employee would be terminated, the termination is involuntary.

More specifically, the Notice sets forth the following situations which are likely to constitute an "involuntary termination":

- The employer's failure to renew a contract at the time the contract expires, if the employee was willing and able to execute a new contract providing terms and conditions similar to those in the expiring contract and to continue providing the services.
- An employee-initiated termination from employment, if the termination from employment constitutes a termination for good reason due to employer action that causes a material negative change in the employment relationship for the employee.
- An involuntary reduction to zero hours, such as a lay-off, furlough, or other suspension of employment, resulting in a loss of health coverage.
- An employee's voluntary termination in response to an employer-imposed reduction in hours, if the reduction in hours is a material negative change in the employment relationship for the employee.

- An employer's action to end an individual's employment while the individual is absent from work due to illness or disability (but mere absence from work due to illness or disability before the employer has taken action to end the individual's employment status is not an involuntary termination).
- Retirement, if the facts and circumstances indicate that, absent retirement, the employer would have terminated the employee's services, and the employee had knowledge that the employee would be terminated.
- A termination for cause.[1]
- Resignation as the result of a material change in the geographic location of employment for the employee.
- A termination elected by the employee in return for a severance package (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.

An "involuntary termination" generally does not include:

- A mere reduction in hours, if the reduction in hours is not a reduction to zero. 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.
- A work stoppage as the result of a strike initiated by employees or their representatives (however, a lockout initiated by the employer is an involuntary termination).
- Qualifying events such as divorce or a dependent child ceasing to be a dependent child under the generally applicable requirements of the plan (such as loss of dependent status due to aging out of eligibility).
- Death of an employee or absence from work due to illness or disability.

Covered Plans

The Notice confirms that premium assistance is available for dental-only, vision-only, and "mini med" plans, as well as health reimbursement accounts.

Interplay of Premium Reduction and Severance

The guidance contains some helpful guidelines for employers who subsidize COBRA as part of their severance packages:

- If an employer subsidizes a portion of COBRA, the premium assistance is calculated based on the amount the assistance eligible individual pays.
- If an employer does not require terminated employees to pay for coverage at all during a "severance period" following termination of employment, but the employer considers the COBRA continuation coverage to begin on the date of termination, the nine-month premium assistance period will run from the date of termination. If, however, the plan provides that the COBRA continuation coverage is measured from the end of the "severance period,"[2] rather than

from the date of termination, the nine-month premium assistance period will begin to run at the end of the severance period.

- If an employer reimburses an assistance eligible individual for the employee's portion of the premium, and excludes that amount from an employee's gross income, the employer is not entitled to any payroll tax credit with respect to the reimbursed portion. However, a taxable severance benefit paid to an assistance eligible individual will not have any effect on the calculation of the premium assistance nor on the employer's payroll deduction.

Timing and Duration of Premium Assistance

The Notice provides that both involuntary termination *and* loss of coverage must occur during the period from September 1, 2008 through December 31, 2009 in order for a terminated employee to be eligible for premium assistance. Thus, if an employee is terminated in December 2009, but does not lose coverage until January 2010, he will not be eligible for the premium assistance. However, the employee's COBRA election is not required to be made prior to December 31, 2009, so long as the resulting COBRA continuation coverage begins prior to December 31, 2009.

The Notice confirms that the premium reduction may extend beyond December 31, 2009 for individuals who qualify as "assistance eligible individuals" prior to December 31, 2009.

Also, an individual may become an "assistance eligible individual" more than once, and is entitled to nine months of premium reduction for each involuntary termination.

Recapture of Premium Assistance

Even if an assistance eligible individual's income is high enough that the recapture of the premium reduction is certain to apply, a plan may not refuse to provide the premium reduction to an individual because of the individual's income. The Notice makes clear that the premium reduction must be provided unless the assistance eligible indiviual has notified the plan that he has elected to permanently waive the premium reduction (or the period for the premium reduction has ended).

Open Issues

The Notice answers many of the questions which have been puzzling benefits practitioners for the past six weeks. However, several questions remain unanswered, including:

- What mechanism should Multiemployer Plans use for collection of the premium reimbursement?
- If an assistance eligible individual has paid for individual coverage through March and April of 2009, may he re-instate his COBRA as of May 1, 2009? If so, is he entitled to nine months of premium assistance starting May 1, 2009?

- What penalties apply to employers who provide the subsidy, intentionally or unintentionally, to qualified beneficiaries who are not assistance eligible individuals?

We look forward to additional information from the IRS and the Department of Labor.

Endnotes

[1] Note however, that for purposes of Federal COBRA, if the termination of employment is due to "gross misconduct" of the employee, the termination is not a qualifying event and the employee and other family members losing health coverage by reason of the employee's termination of employment are not eligible for COBRA continuation coverage. Generally, a denial of COBRA based on "gross misconduct" requires a fairly high level of misconduct, and whether "gross misconduct" exists should be reviewed carefully on a case-by-case basis in light of all applicable facts and case law.

[2] In this case, the plan must, by its terms, provide that the COBRA maximum coverage period begins on the date coverage is lost, rather than from the date of the qualifying event. A plan should be carefully reviewed, and the insurer of insured plans consulted, in order the confirm the availability of this delayed coverage period.

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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