

**COBRA-Subsidy Update –
IRS Guidance Clarifies Involuntary Termination,
DOL Confuses the Notice Requirement and Other Issues.**

Overview. On March 31, 2009, IRS issued Notice 2009-27 which provided surprisingly succinct and helpful guidance for administering the COBRA-subsidy. The Notice begins with an excellent four page summary and overview of the COBRA-subsidy sections of the ARRA. It continues with twenty-three pages of FAQ arranged under the following topics: Involuntary Termination; Assistance Eligible Individual; Calculation of Premium Reduction; Coverage Eligible for Premium Reduction; End of Premium Reduction Period; Recapture of Premium Assistance; Extended Election Period; Payments to Insurers Under Federal COBRA; and Comparable State Continuation Coverage. The entire notice is accessible at <http://www.irs.gov/pub/irs-drop/n-09-27.pdf> or you can email Mike Thompson at the address noted below and he will be happy to forward a .pdf of the Notice. This e-blast will address some of the more pertinent aspects of the Notice. Additionally, on April 2, 2009, DOL updated its FAQ and, among other things, altered its earlier guidance regarding who should receive which notice. This information is addressed at the end of the e-blast.

Involuntary Termination. By far the most eagerly anticipated portion of the guidance was the promised direction regarding what is an involuntary termination. Per the notice: “An involuntary termination means 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.” Additionally, an employee-initiated termination constitutes an involuntary termination if the termination is “for good reason due to employer action that causes a material negative change in the employment relationship for the employee.” The determination of whether the termination is an involuntary termination is based on “all the facts and circumstances” meaning that the characterization of the termination as a resignation, etc. is not dispositive.

IRS continued their analysis of involuntary termination by providing several categories of events that will and will not satisfy the involuntary termination requirement. These pretty much fell in line with what we anticipated with a couple of clarifications of the “gray area”. First, per the Notice, a reduction in hours is generally not an involuntary termination unless the employee voluntarily terminates in response to the reduction and the reduction in hours is a “material negative change in the employment relationship for the employee”. No guidance is offered on what constitutes a material negative change but it seems prudent to err on the side of inclusion for the subsidy. Second, there was significant confusion related to when the termination was related to neither an employer-initiated event nor an employee-initiated event. For example, the employment is terminated because the employee is unable to return to work because of an illness or disability. In such a case, where the “employer takes action to end the individual’s employment status”, the termination would be involuntary. The answer clarifies that, until the employer takes action to end the individual’s employment status, there is no involuntary termination. Thus, although the psychological aspects of a termination in

such circumstances may be somewhat negative, there will be instances where terminating the employee will be much more economically favorable to both the employer and the employee (e.g., where the employee has exhausted his or her FMLA leave and is no longer eligible for the employer's health plan due to a reduction in hours). The IRS did not provide complete clarity to the involuntary termination question and admitted as much during an April 6, 2009 webinar, but it certainly provided greater clarity than was previously available.

Loss of coverage. IRS clarified that, in situations where the employer subsidizes the COBRA premium, such as part of a severance payment, when the loss of coverage occurs is determined based on how the employer treats the insurance coverage. If the employer treats it as COBRA, the loss occurs immediately. If the employer treats coverage as continuing until the severance subsidy expires, the loss occurs at that time. When the loss of coverage occurs is important for two reasons (a) because the loss must occur within the ARRA subsidy period and (b) the ARRA-subsidy will be reduced by any employer-subsidy (i.e., the ARRA 65% subsidy is calculated on what the qualified beneficiary is required to pay even where the employer is paying for part of the coverage).

Calculation of Premium. Notwithstanding the direction set forth above, the Notice recognizes that a Plan that charged less than the full 102% for COBRA coverage prior to the ARRA, is permitted to raise its COBRA premiums to that level. Further, the employer is permitted to pay the AEI (and can limit such payments to persons who qualify as AEI's) a taxable benefit to assist with the COBRA payment. Apparently, all the IRS is concerned with is ensuring that the money is paid in a taxable benefit and not excluded under Code § 106.

Excluded Family Members. The ARRA subsidy is not available to beneficiaries such as a spouse or child who were not covered before the qualifying event and added to the coverage at a later enrollment period. This exclusion does not apply to a child adopted or born to the covered employee during the period of COBRA coverage.

Dental and Vision. The Notice clarifies that the ARRA-subsidy is available for COBRA continuation of vision and dental plans but not for flexible spending arrangements.

Failure to Notify of Alternate Coverage. We have addressed multiple questions about the employer's liability where the employer provides the subsidy paying the insurance carrier 65% of the applicable premium and takes an equal credit on its payroll taxes and, sometime thereafter, learns that the employee was eligible for another plan that she failed to disclose. In such a case, the IRS notes that the employer will not be liable for any portion of the 65% subsidy "unless the employer otherwise knew of the [employee's] eligibility for such [alternative] coverage."

Income Limits. We have previously opined that the income limitations for the ARRA-subsidy were of no concern to the employer since improperly taken subsidy is recouped on the employee's 1040. The IRS has taken this position one step farther instructing

that the employer cannot refuse to provide the premium reduction even if the employer knows that the employee's income exceeds the permissible thresholds.

DOL Alters Guidance Regarding Who Receives Which Notice. On April 2, 2009, DOL updated its FAQs to include additional information regarding the notices that must be sent to comply with ARRA. Previously, DOL had advised that any COBRA-eligible employee terminated from September 1, 2008 to the present must receive some sort of notice. Although we opined that this was incorrect under the statute, we recommended compliance with DOL's process though compliance would create certain administrative headaches. During the April 6, 2009 webinar, DOL officials explained that they did not believe they could require that the General Notice be sent to employees who are not AEI's and who were not terminated between September 1, 2008 and February 16, 2009. Doing so would be an *ex post facto* application of the law which is prohibited. Therefore, DOL's most recent guidance requires that employers send extended election period ("EEP") AEIs the EEP Notice. The General Notice must be sent to all qualified beneficiaries (AEIs and all others) who had not been provided a COBRA election form as of February 17, 2009. No notice is required to non-AEI employees who received a COBRA notice prior to February 17, 2009. If the notice was "good" when it was sent, it is valid. However, note that if a previously-compliant General Notice was sent to a qualified beneficiary on or after February 17, 2009, a new ARRA-subsidy General Notice must be sent to that qualified beneficiary. This is because these notices were sent after the new law was effective and were not "good" when they were sent. If you are confused or simply need three or four aspirin, we understand. The "who gets what" question has been a "bouncing ball" since the beginning. The updated DOL FAQs can be accessed at <http://www.dol.gov/ebsa/faqs/faq-cobra-premiumreductionER.html>.

Conclusion. Questions remain on how the ARRA-subsidy will play out over the long run. It has been brought to our attention that many of the larger COBRA TPA's are taking the position that the notices and other issues are the employers' responsibility and they are not assisting with their preparation in any fashion. This leads to inconsistencies in the preparation of the notices and, invariably, will lead to inconsistencies in administering the subsidy which, unfortunately, will lead to some "unique" claims issues and possible litigation – none of which was intended with the passage of the subsidy. Please let us know if we can be of assistance in complying with the ARRA-subsidy.