

TRUCKER ♦ HUSS

A PROFESSIONAL CORPORATION



COBRA Subsidy: PART II

Mary Powell and Tiffany Santos
April 9, 2009

IRS Notice 2009-27

- ★ On March 31, 2009, the IRS issued Notice 2009-27, Q&A format
- ★ Notice 2009-27 discusses issues that have arisen under the COBRA subsidy provisions of the American Recovery and Reinvestment Act of 2009 ("ARRA")
- ★ This presentation discusses that notice and the new Q&As issued by the DOL. For an in-depth discussion of the original COBRA subsidy guidance under ARRA, please view the articles section of our website

Brief Overview

- ✦ ARRA provides for three (3) new COBRA rights for certain qualified beneficiaries who are “Assistance Eligible Individuals” (AEIs)
- ✦ An AEI is generally an individual who
 - > Is a qualified beneficiary as the result of an involuntary termination between Sept. 1, 2008 and Dec. 31, 2009; and
 - > Is eligible for COBRA at any time during the period from Sept. 1, 2008 through Dec. 31, 2009; and
 - > Elects COBRA

Brief Overview

★ The Three (3) New Rights Are:

- > (1) A 65% subsidy of COBRA premiums for up to 9 months
- > (2) at the discretion of the plan sponsor, the right to enroll in a less expensive health plan option
- > (3) A second COBRA election period for subsidy-eligible individuals who were involuntarily terminated during the period from Sept. 1, 2008 and Feb. 16, 2009 and who did not elect COBRA when it was first offered OR who did elect COBRA but are no longer enrolled

Brief Overview

♦ Effective Date

- > The assistance applies to the first period of COBRA coverage beginning on or after February 17, 2009
 - Generally, for most plans, this is March 1, 2009
 - For some plans, it will be earlier. For instance, if a plan charges premiums on less than a monthly basis or cuts-off coverage at the time of the qualifying event, instead of at the end of the month

Brief Overview

- ✦ AEI ceases to be eligible for the premium reduction if the individual becomes eligible for coverage under any other group health plan* or Medicare
 - > Note: Eligibility for the subsidy will not terminate if the other coverage provides only dental, vision, or counseling, or referral services (or a combination of these), or is a health FSA or health reimbursement arrangement, or onsite medical facility provided by an employer that consists primarily of first-aid services, prevention and wellness care, or similar care (or combination of such care)

Brief Overview

- ✦ The federal subsidy is available for COBRA continuation coverage under -
 - > Federal COBRA laws: ERISA and the Internal Revenue Code
 - This includes medical-only, dental-only, vision-only, EAP, or any combination thereof
 - Exclusion for COBRA coverage under a Health FSA
 - > Public Health Services Act (applies to certain State government plans)
 - > Federal Employees Health Benefits Program
 - > Comparable State Law
 - For example, in California Cal-COBRA applies to insurers that provide coverage on behalf of small employers

Brief Overview

- ◆ The responsibility to administer the subsidy belongs to:
 - > Multiemployer plans – the plan
 - > Single employer plans – the employer
 - > Insurance Companies
 - i.e., administration of state continuation coverage

Involuntary Termination

- ✦ Q&As 1-9 address “involuntary termination”
 - > An involuntary termination means a severance from employment due to the independent exercise of the unilateral authority of an employer to terminate employment, other than due to the employee’s implicit or explicit request, where the employee was willing and able to continue performing services
 - > Determination is based on all the facts and circumstances

Involuntary Termination

- ✦ An involuntary termination may include:
 - > 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 services
 - This is something that often occurs in the construction industry and the film industry
 - > A termination initiated by the employer because of an employer action that causes a material negative change in the employment relationship for the employee
 - Ex. Termination in response to an employer-imposed reduction in hours
 - > Involuntary reduction to zero hours (lay-off with a right of recall, furlough, or other suspension of employment)

Involuntary Termination

- ✦ An involuntary termination may include: (cont.)
 - > 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 he/she would be terminated
 - > An involuntary termination for cause
 - Under Federal COBRA, if the termination is due to gross misconduct, the termination is not a qualifying event and no COBRA needs to be offered
 - This is a VERY high standard and an employer should contact legal counsel before determining that COBRA does not need to be offered

Involuntary Termination

- ✦ An involuntary termination may include: (cont.)
 - > A resignation as a result of a material change in the geographic location of employment for the employee
 - > A termination elected by the employee in return for a “buy-out” where the employer indicated that a certain number of remaining employees in the employee’s group would be terminated after the offer period for the severance package
 - > A lockout initiated by the employer
 - Note: A work stoppage as the result of a strike initiated by employee (or their representatives), however, is not an involuntary termination

Involuntary Termination

- ✦ It does not include death or an absence from work due to illness or disability
 - > It should be noted that this refers only to an absence from work and not a termination from work
- ✦ An involuntary termination occurs, however, if the employer takes action to end the individual's employment status while the individual is absent due to illness or disability
- ✦ The IRS and DOL stated in a recent webinar that a call to military duty is an involuntary termination

Assistance Eligible Individual, Q&A 10-19

- ★ Clarify that an AEI must be a “qualified beneficiary”
 - > A QB is a spouse or dependent child who was covered under the group health plan on the day before the involuntary termination
 - Exception – QB includes a child born to or adopted by a covered employee during a period of COBRA coverage and, in certain circumstances, individuals for whom coverage was wrongfully denied (Treas. Reg. Sec. 54.4980B-3, Q&A 1)
 - Note - a spouse added during the employee’s COBRA period is not a qualified beneficiary

Assistance Eligible Individual

- ★ Clarify that the involuntary termination and COBRA eligibility must both occur between September 1, 2008 and December 31, 2009 to be an AEI
 - > Even though an individual became eligible for COBRA on or after Sept. 1, 2008, he/she is not an AEI if the involuntary termination occurred before Sept. 1, 2008
 - > Even if the involuntary termination occurs on or before Dec. 31, 2009, the individual is not an AEI if the loss of coverage occurs after December 31, 2009

Assistance Eligible Individual

- ★ When does the loss of coverage occur if the employer provides coverage for involuntarily terminated employees?
 - > This depends on how the employer treats the health coverage for the involuntarily terminated employee

Assistance Eligible Employee

- > If the employer treats the coverage as “active coverage” resulting in a deferred loss of coverage, then the loss of coverage (and resulting eligibility for COBRA) will be considered to occur when the employer’s provision of health coverage on the same terms as for similarly situated active employees ends – i.e., at the end of this “active” coverage period
- > However, if the employer treats the coverage as part of its obligation to provide COBRA coverage, then the loss of coverage will be considered to have occurred as of the date COBRA commences

Assistance Eligible Individual

- ♦ Example: Michael is involuntarily terminated by Dunder Mifflin on Nov. 15, 2009 as the demand for paper products falls. While Michael's coverage would normally end on Nov. 30, 2009, Michael's severance benefits include 6 months of employer-paid health coverage which will end on May 31, 2010. According to Dunder Mifflin, no loss of coverage occurs until the 6 months of severance benefits are exhausted. At that point, Michael is eligible for COBRA. Because Michael becomes eligible for COBRA after Dec. 31, 2009, he is not an AEI.

Assistance Eligible Individuals

- The employer will need to consider other issues, such as:
 - Internal Revenue Code Section 105(h) discrimination issues for self-funded plans
 - Agreement by the insurance carrier (or stop loss carrier)
 - If the individual can qualify for the COBRA subsidy

Assistance Eligible Individuals

- ✦ If an involuntary termination occurs during an existing COBRA coverage period (e.g., the termination occurs after another qualifying event, such as a divorce), do the QBs qualify as AEIs?
 - > No. The later involuntary termination does not cause the qualified beneficiary to become an AEI
 - Example: Clark is divorced from Lois on October 1, 2008 and loses coverage as a spouse. Clark elects COBRA. Lois is involuntarily terminated on February 1, 2009 by the Daily Planet as readership of newspapers drastically declines. Lois elects COBRA. Clark is not an AEI because his qualifying event was not an involuntary termination. But, Lois is an AEI.

Assistance Eligible Individuals

- ✦ However, if there is a reduction in hours in anticipation of an involuntary termination, that could cause the individual to become an AEI
 - > Example: Wayne Enterprises reduces Alfred's hours of employment in March 2009 in anticipation of widespread layoffs as the market for Wayne's products deteriorates. Alfred is first eligible for COBRA in March due to the reduction in hours. Alfred is laid off on April 20, 2009. Alfred is an AEI.
 - > Example: Don reduces his work schedule at Sterling Cooper Ad Agency to spend more time with his family in March 2009. He, therefore, experiences a reduction in hours, loses coverage, and elects COBRA as of April 1, 2009. Don is not an AEI

Assistance Eligible Individuals

- ✦ Clarify that a plan must be subject to COBRA for the premium reduction to apply
- ✦ Clarify that an individual can become an AEI more than once
 - > Example: Liz Lemon is an AEI following her involuntary termination on February 1, 2009. Liz later obtains another writing job and obtains coverage through her new employer's plan, XYZ Network, as of August 1, 2009. Liz ceases to be an AEI on August 1, 2009. Liz's new show is poorly received and is immediately cancelled. Liz is involuntarily terminated and loses XYZ Network coverage as of Nov. 1, 2009. Liz is an AEI again.
 - Liz is entitled to another 9-month premium reduction period. An AEI is eligible for up to 9 months of premium reduction for each involuntary termination

Calculation of Premium Reduction

- ★ What premium amount is used to determine the 35% share that must be paid by the AEI?
 - > It is the cost that would be charged to the AEI for COBRA continuation coverage if the individual were not an AEI (generally the 102%)
 - > However, if the premium that would be charged to the AEI is less than the maximum COBRA premium (usually 102%), for example the employer subsidizes the coverage by paying all or part of the cost, the amount actually charged to the AEI is used to determine the AEI's 35% share.

Calculation of Premium Reduction

- ★ Example: Evil Empire requires active employees to pay \$200/month for coverage. Following the destruction of the Death Star, Evil Empire has decreased staffing needs and lays off thousands of storm troopers. Evil Empire provides severance benefits to involuntarily terminated employees for 6 months at the cost of \$200/month. The 6-month period is part of the terminated employees' COBRA coverage period – thus, Evil Empire pays \$800/month towards the cost of COBRA. After this 6-month period, terminated employees must pay \$1,000/month for the remainder of the COBRA coverage period. The premium reduction available to involuntarily terminated henchman, Darth Vader, is -
 - > First 6-months: \$70 (35% of \$200)
 - Evil Empire's payroll tax credit is \$130 (65% of \$200)
 - > Next 3 months: \$350 (35% of \$1,000)
 - Evil Empire's payroll tax credit is \$650 (65% of \$1,000)

Assistance Eligible Individuals

- ★ The notice states, “A qualified beneficiary with respect to a covered employee under a group health plan is the spouse of the employee under Federal law or a dependent child of the employee under Federal law if, generally, the spouse or dependent child was a beneficiary under the plan on the day before the qualifying event.”
 - > Spouse under federal law we assume is a reference to DOMA
 - > It is unclear what is meant by a dependent under federal law

Assistance Eligible Individuals

- ✦ The notice states that a qualified beneficiary, for the purposes of the COBRA subsidy, is defined by reference to the ERISA definition.
 - > ERISA states that the term “qualified beneficiary” means, with respect to a covered employee under a group health plan, any other individual who, on the day before the qualifying event for that employee, is a beneficiary under the plan—
 - > (i) as the spouse of the covered employee, or
 - > (ii) as the dependent child of the employee.
 - Such term shall also include a child who is born to or placed for adoption with the covered employee during the period of continuation coverage
 - > ERISA does not make reference to Internal Revenue Code Section 152
 - > Certain comparable state continuation coverage rules may require continuation coverage in addition to those individuals defined above

Assistance Eligible Individual

- ✦ What happens if the COBRA continuation coverage of an AEI also covers one or more individuals who are not AEIs?
 - > Amounts paid by an AEI for coverage which includes individuals who are NOT AEIs are allocated first to the cost of covering AEIs and then to the cost of covering non-AEIs
 - If the cost of covering non-AEIs does not add to the cost of covering AEIs, then the cost of covering non-AEIs is zero, and the ARRA premium reduction applies to the full payment of the COBRA coverage
 - If the cost of covering a non-AEI adds to the cost of covering AEIs, then the incremental cost is eligible for the premium reduction

Assistance Eligible Individual

- ✦ Example: Mike, an AEI, has employee-only COBRA coverage and pays \$157.50/month (35% of \$450/month). Mike marries widow, Carol, and enrolls her and her 3 daughters, Marcia, Jan and Cindy, in the plan. The COBRA cost for self-plus-2-or-more dependents is \$1,000/month. Carol, Marcia, Jan and Cindy are not AEIs because they were not covered by the plan on day before Mike's involuntary termination. Mike pays \$550/month for coverage for Carol and the kids (\$1,000 - \$450).
 - > Mike is entitled to the premium reduction with respect to the \$450/month and must pay \$707.50 ($\$550 + \$157.50 [35\% \times \$450 = \$157.50]$)
 - Mr. Phillips' Architecture Agency's payroll tax credit is \$292.50 (65% of \$450)

Coverage Eligible For Premium Reduction

- ✦ Vision-only plans, dental-only plans and HRAs qualify for the premium reduction
- ✦ Retiree health coverage will be treated as COBRA coverage for the purposes of the premium reduction if, and only if, the retiree coverage does not differ from the coverage made available to similarly situated active employees (though the amount charged for the coverage may be higher than that charged to active employees and the retiree coverage may still be eligible for the ARRA premium reduction as long as the charge to retirees does not exceed the maximum amount allowed under Federal COBRA)

Beginning of the Premium Reduction Period

- ★ The premium reduction applies as of the 1st period of coverage beginning on or after February 17th, 2009, for which the AEI is eligible to pay only 35% of the premium and be treated as paying the full premium
- ★ Assume the plan requires that the COBRA premium be paid for based on a calendar month and an AEI has COBRA continuation coverage for the entire month of February. The employer cannot prorate the premium for February in order to apply the ARRA premium reduction to the portion of February that begins on February 17, 2009

End of Premium Reduction Period

- ★ The premium reduction applies until the earliest to occur of the following:
 - > the first date the AEI becomes ELIGIBLE for other group health plan coverage or Medicare,
 - > the date that is 9 months after the first day of the first month for which the ARRA premium reduction provisions apply to the individual, or
 - > the date the individual ceases to be eligible for COBRA coverage

End of Premium Reduction Period

- ♦ Example: Following his involuntary termination from County General, Dr. Ross is an AEI. Dr. Ross begins employment with Portland Hospital and is eligible to enroll himself and his wife Carol in the new hospital's plan. Dr. Ross declines this coverage and continues COBRA through County General's plan. Although Dr. Ross maintains his COBRA coverage, he is no longer eligible for the premium reduction as of the first day of the next COBRA month.

End of Premium Reduction

- ✦ Example: Fred and Wilma are married with a kid, Pebbles. Fred, Wilma and Pebbles are AEIs following Fred's lay off from the Slate Stone Quarry. Fred elected COBRA coverage for the whole family. Wilma begins employment with Bedrock Bank and is eligible to enroll in Bedrock's health plan with self-only or family coverage, with coverage effective the first day of the next month. Wilma enrolls in self-only coverage.
 - > Although Fred and Pebbles may continue COBRA coverage, the premium reduction is no longer available to them as of the first day of the next month because they are eligible for coverage under the plan sponsored by Wilma's employer.

End of Premium Reduction Period

- ★ What is the effect of the premium reduction if retiree health plan coverage (that may not be treated as COBRA) is offered at the same time that COBRA continuation coverage is offered?
 - > If offered under the same group health plan, the offer of COBRA continuation coverage has no effect on an individual's eligibility for the ARRA premium reduction
 - > If offered under a different group health plan, the offer can affect the individual's eligibility for the premium reduction

End of Premium Reduction Period

- ✦ Does eligibility for coverage under an HRA terminate eligibility for the premium?
 - > Not if the HRA qualifies as an FSA under Internal Revenue Code Section 106(c)
 - Under Internal Revenue Code Section 106(c), an FSA is health coverage under which the maximum amount of reimbursement which is reasonably available to a participant of the coverage is less than 500% of the value of the coverage
 - The maximum amount of the which is reasonably available is generally the balance of the HRA and the value of the HRA coverage would generally be the applicable premium for the COBRA of the HRA coverage

End of Premium Reduction Period

- ★ Clarify that the premium reduction may be available after December 31, 2009
 - > Example: Mr. Burns, through his minion Smithers, implements a massive layoff at Springfield Nuclear Power Plant and Homer is involuntarily terminated on November 15, 2009. Homer and his family become eligible for COBRA as of December 1, 2009. Homer and his family are AEs and could receive premium reductions until August 31, 2010, provided they do not become eligible for other group health plan coverage or Medicare and maintain eligibility for COBRA coverage.

End of Premium Reduction Period

- ✦ The death of an employee who is an AEI does not end the premium reduction period for the other AEIs
- ✦ Failure to timely pay COBRA premiums will end COBRA and the premium reduction
- ✦ The 9-month premium assistance period may not be extended by a second qualifying event

End of Premium Reduction Period

- ★ Clarify that if an AEI fails to notify the employer of his/her eligibility for other coverage or Medicare, the employer is not required to refund the payroll tax credit for any period that the AEI improperly received the premium reduction
 - > Note: Refund is required if the employer has knowledge of the AEI's eligibility for the other coverage

Recapture of Premium Assistance

- ✦ A plan cannot refuse the premium reduction to individual based on his or her income
- ✦ An AEI who wants to make a permanent election to waive the reduction may do so by providing a signed and dated notification to the plan
 - > Note that this is a permanent election
 - > We have created waiver forms that states in several places that the election is a permanent election

Extended Election Period—For Federal COBRA and coverage under FEHBP

- ★ Clarify that if an employee was involuntarily terminated between Sept. 1, 2008 and Feb. 17, 2009 and elects self-only COBRA coverage, any spouse or dependent children who are QBs in connection with the involuntary termination, are entitled to elect COBRA during the extended election period, notwithstanding the employee's election of self-only COBRA coverage

Extended Election Period

- ✦ Clarify that if an individual who was terminated between Sept. 1, 2008 and Feb. 17, 2009, and still has an open COBRA election period, the individual can elect COBRA during the extended election period or during his original COBRA election period
 - > Example: Rachel is involuntarily terminated by Central Perk Café in Dec. 2008 and loses coverage as of Dec. 31, 2008. Rachel received her COBRA election notice in January 2009. As of Feb. 17, 2009, Rachel has not elected COBRA. Rachel is entitled to a notice about the extended election period.
 - Rachel may elect COBRA under her original COBRA election period with COBRA coverage effective as of January 1, 2009, OR
 - Rachel may elect COBRA during the extended election period for the coverage periods beginning on or after Feb. 17, 2009

Extended Election Period

- ✦ Is the premium reduction available if an AEI was eligible for other group coverage prior to Feb. 17, 2009 but has been unable to enroll in the other plan on and after Feb. 17, 2009?
 - > Yes, the AEI is eligible for the premium reduction until the AEI is eligible to enroll in the other plan
 - > Example: Rhett is involuntarily terminated on Nov. 15, 2008 by the Mill and lost coverage on Nov. 30, 2008. Following the loss of this coverage, Rhett was eligible to enroll in the plan sponsored by his spouse Scarlett's employer during a special enrollment period. Rhett elected COBRA through the Mill's plan as of Dec. 1, 2008 and has not been eligible to enroll in Scarlett's employer's plan on or after Feb. 17, 2009. Rhett is eligible for the premium reduction as of March 1, 2009 and until the first opportunity he is able to enroll in Scarlett's employer's plan, e.g. during the open enrollment period.

Extended Election Period

- ✦ When must the first COBRA premium payment be made for coverage elected during the extended election period?
 - > The period designated by the employer, but no earlier than 45 days after the date on which COBRA is elected for that QB
 - Treas. Reg. Sec. 54.4980B-8, Q&A-5(b)

Extended Election Period

- ★ Clarify that the COBRA coverage period for individuals who elect COBRA during the extended election period begins with the first period of coverage beginning on or after Feb. 17, 2009 (generally, this is March 1, 2009)
 - > Expenses incurred after the loss of coverage and before the first period of coverage beginning on or after Feb. 17, 2009 are not covered under the resulting COBRA coverage

New DOL Notice FAQs – Issued 4/2/2009

- ★ Guidance on DOL's model general notice – Full general notice must be provided to individuals meeting all of the following criteria:
 - > Qualified beneficiaries (not just covered employees);
 - > Who experienced a qualifying event at any time from September 1, 2008 through December 31, 2009 (regardless of the type of qualifying event); **and**
 - > Who either:
 - **Have not yet been provided** an election notice; **or**
 - Who were **provided an election notice on or after February 17, 2009** that did not include the additional information required by ARRA.

New DOL Notice FAQs – Issued 4/2/2009

- ✦ Guidance on DOL's model abbreviated general notice
 - > Includes the same information as the full version regarding the availability of the premium reduction and other rights under ARRA,
 - > Does not include the COBRA coverage election information
- ✦ May be sent in lieu of the full version to individuals who meet all of the following criteria:
 - > Have experienced a qualifying event on or after September 1, 2008; and
 - > Have already elected COBRA coverage; **and**
 - > Currently have COBRA coverage.

New DOL Notice FAQs – Issued 4/2/2009

- ★ Guidance on DOL's model alternative notice
 - > Applicable to individuals who are eligible for continuation coverage provided pursuant to state law
 - > Developed for health insurance issuers that provide group health insurance coverage comparable to COBRA
 - DOL advises that issuers conform these notices to applicable State law

New DOL Notice FAQs – 4/2/2009

- ✦ Notice in connection with extended COBRA election period must be provided to any AEI (or any individual who would be an AEI if a COBRA continuation election were in effect) who:
 - > Had a qualifying event that was an involuntary termination of employment at any time from September 1, 2008 through February 16, 2009; **and**
 - > Either did not elect COBRA continuation coverage, or elected but subsequently discontinued COBRA.
- ✦ This notice must include information regarding ARRA's additional election opportunity, and premium reduction information
- ✦ Must be provided within 60 days following February 17, 2009, i.e., Saturday, April 18, 2009

New DOL Notice FAQs – Issued 4/2/2009

- ★ Notice in Connection with Extended Election Periods
Issuers are not required to send this notice under ARRA
 - > Note - State laws may require an additional election period and may require issuance of a similar notice

Contact

♦ Mary E. Powell, Esq. and Tiffany N. Santos, Esq.

Trucker ♦ Huss, APC

120 Montgomery Street, 23rd Floor

San Francisco, CA 94104

(415) 788-3111

mpowell@truckerhuss.com

tsantos@truckerhuss.com

www.truckerhuss.com

Disclaimer

- ✦ These materials have been prepared by Trucker ♦ Huss, APC for informational purposes only and constitute neither legal nor tax advice
- ✦ Transmission of the information is not intended to create, and receipt does not constitute, an attorney-client relationship
- ✦ Anyone viewing this presentation should not act upon this information without seeking professional counsel
- ✦ In response to new IRS rules of practice, we hereby inform you that any federal tax advice contained in this writing, unless specifically stated otherwise, is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding tax-related penalties or (2) promoting, marketing or recommending to another party any tax-related transaction(s) or matter(s) addressed herein