

April 1, 2009

IRS Issues New COBRA Subsidy Guidance

The Internal Revenue Service has issued new guidance on the COBRA provisions of the American Recovery and Reinvestment Act of 2009 (Recovery Act). The [new guidance](#) is in question and answer format and addresses a number of key questions related to the new COBRA subsidy requirements, including for example who is involuntarily terminated, who is eligible for the subsidy, how the subsidy is calculated and when the subsidy begins and ends.

New COBRA Requirements

As we noted in our [client alert](#) on February 24, 2009, the Recovery Act imposes new COBRA requirements on group health plan sponsors and their insurers and administrators.

The new COBRA requirements obligate companies to: (a) temporarily subsidize COBRA premiums for certain employees; (b) offer “second chance” COBRA elections to certain employees who have left employment; (c) update COBRA and (in some cases) HIPAA documents; (d) notify plan participants of their new COBRA rights; and (e) file new reports with the government.

Highlights of the New Guidance

Involuntary Terminations. The new guidance clarifies that an involuntary termination for COBRA subsidy purposes may include a termination of employment due to:

- an employer’s failure to renew a contract, if the employee was willing to execute a new contract on similar terms;
- an employee’s termination for “good reason” due to “employer action that causes a material negative change in the employment relationship”;
- layoff, furlough or other suspension of employment resulting in employment loss;
- illness or disability;
- retirement, if the employer would have terminated the employee’s employment and the employee knew of the pending termination;
- cause (note that if the employee is terminated for “gross misconduct,” the employee and his or her covered family members are not eligible for COBRA);

- voluntary termination by the employee due to a reduction in hours that resulted in a material negative change in the employee's employment relationship;
- employee resignation due to a material change in the employee's geographic work location;
- employer initiated lock-out; and
- employer initiated "buy-out" where the employer indicates that after the buy-out offer period, a certain number of remaining employees may be terminated.

The new guidance makes clear that the following events do not result in an involuntary termination for purposes of the COBRA subsidy requirements:

- death of the employee;
- reduction in hours other than to zero (but see the exception noted above);
- retirement (but see the exception noted above); and
- an employee or employee-representative initiated work stoppage.

Assistance Eligible Individuals. The new guidance clarifies who is an "assistance eligible individual" (AEI) for purposes of the new COBRA subsidy requirements. The new guidance makes clear that the employee must be involuntarily terminated **and** lose group health plan coverage resulting in COBRA coverage during the period from September 1, 2008 through December 31, 2009.

- If the employee is involuntarily terminated before September 1, 2008 but loses coverage during the period from September 1, 2008 through December 31, 2009, he or she and his or her covered family members are not eligible for the subsidy.
- Similarly, if the employee is involuntarily terminated during the period from September 1, 2008 through December 31, 2009 but loses coverage after December 31, 2009, he or she and his or her covered family members are not eligible for the subsidy.
- This means that, if an employer provides continued health benefits during a severance period that ends after December 31, 2009 and chooses to have COBRA start at the end of the severance period (rather than choosing to have COBRA coverage run concurrently with the severance period), the subsidy requirements do not apply to the employee and his or her covered family members.

COBRA Subsidy Calculations.

- The new guidance makes clear that the COBRA subsidy applies only to the amount paid by or on behalf of the AEI. For example, assume the monthly COBRA premium plus 2% administration fee is \$1,000.
 - If the AEI is required to pay the full cost of the \$1,000, the AEI is eligible for a subsidy of \$350 (35% of \$1,000) and the employer is eligible for a tax credit of \$650 (65% of \$1,000).
 - If the AEI is only required to pay \$500 of the \$1,000, the AEI is eligible for a subsidy of \$175 (35% of \$500) and the employer will be eligible for a tax credit of \$325 (65% of \$500).
- If a plan that previously charged less than the maximum premium allowed by COBRA increases the premium to the maximum allowed by COBRA, the subsidy applies to the increased premium.
- The new guidance also clarifies how the COBRA subsidy requirements apply when coverage is provided to both AEIs and individuals who are not AEIs (such as domestic partners). If there is no additional cost to providing coverage to an individual who is not an AEI, the subsidy applies to the entire premium. If there is an additional cost to providing coverage to the individual who is not an AEI, the subsidy applies only to that portion of the premium required to cover the AEIs.

Coverage Eligible for COBRA Subsidy. The new guidance makes clear that the COBRA subsidy applies to vision-only and dental-only plans, but does not apply to flexible spending arrangements (FSAs) offered under cafeteria plans. The subsidy is also available for health reimbursement arrangements (HRAs), including HRAs provided under cafeteria plans. The subsidy also applies to retiree health plans that provide the same coverage to similarly situated active employees (even if a higher premium is charged to retirees).

COBRA Subsidy Period. The new guidance provides a detailed discussion of when the COBRA subsidy period begins and ends.

- The subsidy coverage period begins on the first day of the first COBRA premium period beginning after February 17, 2009 (March 1st for most plans).
- The COBRA subsidy period ends on the earliest of (a) the first date the AEI is eligible for group health plan or Medicare coverage, (b) the date that is nine months after the first day of the first month in which the COBRA subsidy applies to the AEI, or (c) the date

the AEI is no longer eligible for COBRA coverage. Coverage may end sooner if the AEI fails to pay the COBRA premium on time.

- If the AEI is eligible for but chooses not to enroll in other group health plan coverage, the subsidy does not apply.
- The COBRA subsidy is available after December 31, 2009 for individuals who qualify as AEIs before December 31, 2009. For example, an employee who is involuntarily terminated and loses group health plan coverage on September 1, 2009 could receive a COBRA subsidy until May of 2010.
- An AEI is eligible for up to nine months of COBRA subsidy for each involuntary termination.

COBRA Subsidy Recapture. Plans must provide the COBRA subsidy even if the AEI's income is over the income qualification limits, unless the AEI has permanently waived the COBRA subsidy (or the COBRA subsidy period has ended). An AEI may permanently waive the COBRA subsidy by providing written notice to the person who is reimbursed for the premium. Once made, the election is irrevocable and cannot be reversed even if the AEI later makes less than the income qualification limits.

"Second Chance" Elections. The new COBRA provisions require companies to offer "second chance" COBRA elections to AEIs terminated from September 1, 2008 through February 17, 2009. Under COBRA, plans must give employees and other qualified beneficiaries 45 days to make the first COBRA premium payment. The same 45 day grace period applies to COBRA premiums made under second chance elections.

Other Guidance

The DOL has published [model COBRA forms](#) and has issued some [general guidance](#) on the new COBRA requirements.

In addition to the guidance summarized in this client alert, the Internal Revenue Service has issued [guidance](#) on new COBRA requirements on its website.

Assistance With COBRA Compliance

We are happy to assist you with complying with the new COBRA requirements.

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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