

Employee Benefits Briefing

IRS COBRA Subsidy Guidance Published DOL Model COBRA Notice Guidance Revised

On April 1, the IRS published Notice 2009-27, completing the primary round of regulatory guidance regarding the COBRA subsidy provisions that were part of the American Recovery and Reinvestment Act of 2009 ("ARRA"). On April 2, the DOL revised its Q&As regarding the model ARRA COBRA notices that were published on March 19. Vedder Price has previously published Employee Benefits Briefings regarding the COBRA provisions of ARRA (February 17, 2009) and the DOL model notices (March 25, 2009), both of which are available at www.vedderprice.com.

The IRS Notice addresses the following general topics:

- How is "Involuntary Termination" defined?
- Who is an "Assistance Eligible Individual"?
- How is the ARRA Subsidy Calculated?
- What coverage is eligible for the ARRA COBRA subsidy?
- How is the 9-month ARRA COBRA subsidy period determined?
- When does the ARRA COBRA subsidy period end?
- Can an Assistance Eligible Individual decline the subsidy?

This Bulletin addresses each general topic from the IRS Notice and discusses the DOL's revision to its model notice Q&As.

IRS NOTICE 2009-27

How is "Involuntary Termination" defined?

The primary question to ask when determining if a termination was "involuntary" is as follows: Was the termination the result of unilateral action by the

employer to terminate the employment relationship? If it was, the termination is considered involuntary; if it was not, the termination is generally considered voluntary.

Most terminations can be categorized as voluntary or involuntary using the above criteria. However, there are inevitably terminations that defy categorization. The IRS has tried to identify some of these situations and explain its views on how they should be analyzed. These situations are grouped below by their more likely outcome.

Involuntary

Disability Termination: Many employers provide that an individual's employment ends when an employee has been absent from work a certain period of time. Although the absence itself is not considered involuntary, the employer's action to terminate the employment relationship is considered an involuntary termination.

"For Cause" Termination: A "for cause" termination is considered involuntary, and thus an employee fired for cause would nonetheless be eligible for the ARRA subsidy. That said, if the employee is terminated for gross misconduct under the regular COBRA rules, no COBRA would be available in the first instance, and thus no ARRA subsidy would be available.

Relocation: If an employee resigns due to a material forced relocation, the resignation is involuntary.

Lockout: A lockout initiated by an employer is considered involuntary.

Layoff: A layoff or temporary furlough is considered involuntary, regardless of whether the employee retains recall rights.

Not Involuntary

Strike: A work stoppage due to a strike initiated by employees is not involuntary.

Reduction in Hours: Forced reduction in hours (e.g., full time to part time) is not an involuntary termination even if that reduction causes a loss of coverage and eligibility for COBRA under the group health plan. However, if the employee quits because of the reduction (and that reduction is considered a material negative change in the employment relationship), the resignation is considered involuntary.

“It Depends”

Retirement: Many terminations are identified as “retirements.” Whether such a termination qualifies for the subsidy will depend on the underlying facts and circumstances. If the facts show that, but for retirement, the individual would have been terminated, and the individual knows that fact, the retirement will be involuntary.

Voluntary Exit Package: Employers often use voluntary incentive programs in order to reduce headcounts without resorting to involuntary terminations. The IRS notes that an employee who elects a voluntary exit package will nonetheless be eligible for the ARRA COBRA subsidy 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.

Forced Resignation: If an employee terminates his/her employment, but the facts and circumstances indicate that the employee would have been fired but for his/her resignation, and the individual knows that fact, the termination will be considered to be involuntary, even if the parties characterize the termination as one of mutual agreement or a voluntary resignation.

Who is an “Assistance Eligible Individual”?

An “Assistance Eligible Individual” (i.e., someone who is eligible for the ARRA subsidy) is someone who loses coverage as the result of the involuntary termination of the covered employee during the ARRA coverage period (between September 1, 2008 and December 31, 2009). The key questions are: (1) did the involuntary termination occur

between September 1, 2008 and December 31, 2009? and (2) did the loss of coverage occur between September 1, 2008 and December 31, 2009? The answer to both questions must be “yes” in order for the individual to be an “Assistance Eligible Individual.”

For this purpose, the loss of coverage occurs on the last day of active coverage. For example, if a covered employee’s employment terminates on the 15th of the month and the employer’s plan continues coverage through the end of the month, the loss of coverage occurs on the last day of the month.

For example, if the covered employee was involuntarily terminated in August 2008, anyone who lost coverage due to that involuntary termination (even if that loss did not occur until September 2008), is not an Assistance Eligible Individual. Similarly, if the covered employee is involuntarily terminated in December 2009, but the loss of coverage does not occur until January 2010, the individual is not an Assistance Eligible Employee. By contrast, if the covered employee is involuntarily terminated in December 2009 and coverage ends on December 31, 2009, the individual will be an “Assistance Eligible Individual.”

How is the ARRA Subsidy Calculated?

The ARRA subsidy is determined based on what the employer is charging the individual for coverage (ignoring the ARRA subsidy). If the former employee is being charged \$1,000 per month for COBRA coverage, the former employee must pay \$350 per month and the ARRA subsidy is \$650 per month ($\$350 + \$650 = \$1,000$). Similarly, if the former employee is being charged the active employee rate of \$200, the former employee must pay \$70 per month and the ARRA subsidy is \$130 per month ($\$70 + \$130 = \200).

The amount of the ARRA subsidy will fluctuate depending on what the employer charges. For example, if a severance package includes subsidized COBRA at the \$200 active employee rate for 3 months, and then regular COBRA at \$1,000 thereafter, the ARRA subsidy will be \$130 for the first 3 months and then \$650 for the remaining 6 months of the ARRA subsidy period.

What coverage is eligible for the ARRA COBRA subsidy?

The ARRA COBRA subsidy applies to any plan that is considered a group health plan. This includes dental-only and vision-only, and so-called “mini-med” plans. The subsidy applies regardless of whether the employer is covering some of the expenses or whether the employees are paying the full cost of the coverage. The only group health plan that is not covered is a medical flexible spending arrangement.

The Notice also provides that the ARRA COBRA subsidy will apply to retiree medical benefits made available to Assistance Eligible Individuals if the retiree coverage does not differ from the coverage made available to similarly situated active employees, and the employer is not charging the retiree more than the maximum amount permitted under COBRA for non-retiree eligible employees.

How is the 9-month ARRA COBRA subsidy period determined?

The 9-month ARRA COBRA period is the first 9 months of COBRA coverage. Thus, if the employee’s employment terminates on June 15, 2009 and active coverage continues through June 30, COBRA coverage starts on July 1 and the ARRA COBRA subsidy period will run from July 1, 2009 through March 31, 2010.

The subsidy period cannot be manipulated (e.g., it cannot be deemed to be the period from month 9 through month 18). Thus, if the employer is subsidizing coverage for some period of time after COBRA begins, the lower subsidy period counts against the 9 months of ARRA subsidies.

However, because the ARRA subsidy period runs concurrently with the COBRA period, if an employer extends active medical coverage for some period of time after the employee’s employment terminates without counting that period against the 18-month COBRA period, the 9 months ARRA subsidy period will not begin until the extended active coverage period ends and COBRA actually starts.

For example, if in connection with an involuntary termination the employer extends active coverage for an additional 3 months, so that the COBRA qualifying event occurs at the end of month 3, and the 18-month COBRA period begins in month 4, the ARRA subsidy period will also not begin until month

4. Thus, if the employer is continuing to charge active employee rates during months 1 through 3, and then full COBRA rates for the next 18 months, the ARRA subsidy will be based on the full COBRA rates, and the ARRA COBRA subsidy will begin in month 4.

The IRS also recognizes that the employer may provide additional taxable compensation to the former employee without that additional amount reducing the ARRA subsidy. If the employer normally fully subsidizes COBRA while paying severance (i.e., charges the former employee \$0), there is no COBRA premium to subsidize and the employer cannot recover any amount from the government. By contrast, if the COBRA rate is \$1,000 and the employer charges the former employee the full COBRA premium, the employer could pay \$350 in additional severance to the former employee each month and still claim the \$650 credit from the government.

When does the ARRA COBRA subsidy period end?

The subsidy period lasts until the premium reduction applies or until the earliest of (1) the first date the Assistance Eligible Individual becomes eligible for other group health plan coverage (with certain exceptions) or Medicare coverage, (2) 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 (3) the date the individual ceases to be eligible for COBRA continuation coverage.

Consistent with the ability to apply the ARRA COBRA subsidy to retiree medical benefits, an Assistance Eligible Individual’s eligibility for retiree medical benefits that is offered under the same plan as the active benefits are offered will not cause the individual to lose his/her eligibility for the ARRA subsidy.

Can an Assistance Eligible Individual decline the subsidy?

The ARRA subsidy phases out above \$125,000 of adjusted gross income for individuals and \$250,000 for married couples filing jointly, and is eliminated altogether above \$145,000 and \$290,000, respectively. Any ARRA subsidy received by the individual whose adjusted gross income exceeds

these thresholds would be recaptured by the government as an additional tax on the individual. The adjusted gross income test is based on full-year income so an involuntarily terminated employee who earns too much will have to pay back the subsidy with his/her taxes.

An Assistance Eligible Individual may decline the subsidy. However, the employer may not refuse to provide the premium reduction on account of the recipient's anticipated (or known) income.

If an individual wishes to decline the subsidy, he/she must file a permanent waiver of the subsidy. The IRS has not provided any model form for this purpose (and does not appear intent on doing so). Rather, the IRS has stated that such waiver must be in writing, signed by the individual, and should state that it constitutes a "permanent waiver." The IRS has reiterated that the waiver is truly permanent and may not be reversed either in 2009 or 2010 regardless of the individual's adjusted gross income in those years.

DOL REVISES MODEL NOTICE Q&As

On April 2nd, the DOL modified its guidance regarding which of the model ARRA COBRA notices that were issued on March 19 should be provided to which individuals. In one of the new examples, the DOL focuses on an individual who incurred an involuntary termination on January 11, 2009, and received a general pre-ARRA COBRA notice on February 22, 2009 (5 days after enactment). The DOL concludes that the individual should receive both the general COBRA notice and the second election notice. The DOL noted that the information from both notices could be combined into a single notice, but stated that it must be made clear to the individual that the individual has 2 separate elections, with different election periods and start dates.

Both the IRS and the DOL have indicated that they intend to continue to issue guidance as developments warrant. We will continue to monitor these development and provide additional Briefings to our clients as additional guidance is issued.

If you have any questions regarding these materials, or about any of Vedder Price's recent COBRA bulletins, please contact **Phil Mowery** (312-609-7642), **Paul Russell** (312-609-7740) or any other Vedder Price attorney with whom you work.

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