



HEFFERNAN INSURANCE BROKERS

A Member of the Heffernan Group

DATE: April 6, 2009
TO: Our Valued Client Partners & Friends
FROM: HIB Account Team
RE: **LEGISLATIVE UPDATE 2009-09**
COBRA Subsidy: The Heat Is On Today's IRS Notice 2009-27

We are pleased to bring you our **Legislative Update 2009-09: COBRA Subsidy: The Heat Is On, Today's IRS Notice 2009-27**. The following is further clarification with regard to the implementation and management of the COBRA Premium Assistant program implemented in the Americans Recovery and Reinvestment Act of 2009 (ARRA).

We will continue to keep you informed of any changes and or clarifications, but in the meantime, we hope you find this informative, and please, if you have any questions, contact your HIB Account Team for assistance.

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With the introduction of the model federal notices (<http://www.dol.gov/ebsa/COBRAmodelnotice.html>) most Plan Sponsors and all COBRA administrators are working to comply with the COBRA subsidy notice requirements. With IRS Notice 2009-27 (<http://www.irs.gov/pub/irs-drop/n-09-27.pdf>), issued today, we have some further guidance. The purpose of this Memorandum is to discuss and hopefully bring a degree of certainty to the election process.

BASICS

1. **When are the Notices Due?** For purposes of federal COBRA, Plan Sponsors must provide all notices by April 18, 2009. Absent regulations or government pronouncement on whether the mailbox rule applies, Plan Sponsors must make their own decision as to the meaning of "provide notice by."
2. **Who Must Provide the Notices?** Plan Sponsors have the responsibility to provide the notices. Plan Sponsors usually will engage their COBRA administrators to send the notices. At present, federal law would require insurers to provide notice for small group COBRA under state law.
3. **How are Notices to be Sent?** The notices are to be sent by first class mail. Some Plan Sponsors may want to obtain a certificate of mailing from the U.S. Postal Service as proof of mailing. A few may want to use certified/return receipt services, but the law only requires first class mailing.

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THE MODEL NOTICES

- 1. The Full General Notice.** Although it might appear ambiguous to some (due to the DOL's use of notice "headers"), Plan Sponsors must send the Full General Notice to those individuals who had a COBRA Qualifying Event on or after September 1, 2008 and have yet to receive an Election Notice. In practice, this Notice most likely goes to individuals who had a COBRA Qualifying Event in January or February of 2009 and have yet to receive the regular Election Notice. The employer has 44 days from the date coverage is lost to provide the notice (30 days to notify their administrators and 14 days for the administrator to send the notice). This Full General Notice includes the basic COBRA election information as well as the new subsidy provisions. If the Qualified Beneficiary has received the old Election Notice and is still in his/her election period, some recommend sending the Full General Notice rather than the Abbreviated Notice to assure compliance with the notice requirements.
- 2. The Abbreviated Notice.** This Notice, as we have said in our prior Update 2009-8, must go to all Qualified Beneficiaries who have elected COBRA prior to the enactment of the COBRA subsidy benefit (February 17, 2009) and remain so.
- 3. The "Alternative Notice".** Specially designed for state law plans, it places the burden on the insurer to provide the Notice. California, for example, has initiated legislation (AB 23) to assure that insurers and Knox-Keene plans have the duty to provide notice of the premium subsidy. Absent that legislation, insurers may do so voluntarily.
- 4. The Extended Election Notice.** This Notice goes to all Qualified Beneficiaries who had a COBRA Qualifying Event on or after September 1, 2009 and who either did not elect COBRA or did elect it but let the coverage lapse.

HOT TOPICS

- 1. Health Plan Choices.** Under basic COBRA law Qualified Beneficiaries must elect from the coverage in place at the time coverage is lost. The [final COBRA Regulations](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=1999_register&docid=99-1520-filed) (http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=1999_register&docid=99-1520-filed) dated February 3, 1999 also allow the employer to provide an alternative to COBRA. The subsidy legislation also allows a Plan Sponsor to offer an alternative plan to Qualified Beneficiaries. Please refer to my Legislative Update 2009-5 for an in depth description of the rules involved in such an offering.

Despite the basic COBRA rule, people still ask if a Qualified Beneficiary who qualifies as an Assistance Eligible Individual (AEI) has a free choice of plans at the time he/she elects the subsidy. In fact, the Qualified Beneficiary may only choose between his/her existing plan coverage or elect the lesser benefit alternative if offered by the Plan Sponsor.

Now comes open enrollment. If the Qualified Beneficiary, receiving premium assistance, elects to change coverage to a richer plan or to add his/her dependents, the 65% subsidy will still be based on the original COBRA premium. For example, the beneficiary who chose to continue single coverage only at the time of the original Qualifying Event, could, at the time of the open enrolment, add his/her eligible family members changing his full COBRA premium from \$450.00 per month to \$1,000.00 per month. Today's notice at Q&A 2 states that the family members, if they were not Qualified

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Beneficiaries when the Qualifying Event occurred, the subsidy will be limited to the employee-only coverage. That is to say the employee pays 35% of the \$450 as well as 100% of the \$550 (family premium).

2. **The Election.** As of March 1, 2009 a Qualified Beneficiary who qualified as an AEI could elect to pay only 35% of COBRA premium even though he/she has not received the Election Notice. I recommend, however, that the AEI discuss it with the Plan Sponsor before paying the lesser amount. The election is effective for periods beginning on March 1, 2009. The Plan Sponsor cannot implement the subsidy automatically or even with an opt-out notice in lieu of sending the Notice. The Assistance-Eligible Individual must elect the subsidy to have it happen. The Plan Sponsor cannot do it by negative election.
3. **Involuntary Terminations.** In a recent Compliance Assistance Webcast, (<https://event.on24.com/eventRegistration/EventLobbyServlet?target=registration.jsp&eventid=139337&sessionid=1&key=3A818D91BC18D31F024968D47757389D&sourcepage=register>) IRS representatives explored the issue of what constitutes an involuntary termination. For example, if people retire or resign in anticipation of a lay off in response to the employer's request for volunteers, the departure is considered an involuntary termination.

In today's IRS Notice at Q&A 1 we received a working definition:

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. 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 the services. In addition, an employee-initiated termination from employment constitutes an involuntary termination from employment for purposes of the premium reduction 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.

Q&A 2 states that a layoff, even within the right of recall, is an involuntary termination. Q&A 5 states that an involuntary termination can include retired if the facts and circumstances indicate, that, absent retirement, the employer would have terminated the employee's services and the employee retired in lieu of the termination.

In the webcast, IRS officials said if an Ohio employer closes a plant in Youngstown, Ohio but offers employees a comparable position in Huntington Beach, California, and the employee refuses to make the move, the termination is considered involuntary.

The IRS also will treat a significant reduction in work hours, which results in the employee terminating to look for a job with more pay, as an involuntary termination. See Q&A 3 in today's notice. Finally, the IRS states that an individual called up for active military duty does not undergo an involuntary termination (possibly due to USERRA rights to return to work).

What about residents and interns covered under a group health plan who reach the end of their residency or internship? Do they leave voluntarily? Are they even employees? In our view, they are

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employees and would have COBRA rights upon termination of their employment. Much like independent contractors, or more simply, disabled employees who are no longer able to work, it is our current view that their termination is involuntary. Would they qualify for unemployment benefits? In the case of union trainees who complete their training and change employers, the multi-employer union plan would be obligated to provide COBRA. In our view, absent clear guidance, the union plan, like an insurer, can provide the subsidy and seek federal reimbursement.

4. **Election Appeals.** The statute requires expedited review of claims brought by Qualified Beneficiaries who have been denied COBRA subsidy benefits. To facilitate the DOL review, the notices allow Plan Sponsors to provide a written explanation of the basis for the denial. The DOL has a 15 day period to affirm or overturn the Plan Sponsor's decision.
5. **Domestic Partners.** As we have discussed previously, the COBRA subsidy program does not apply to domestic partners, participants in a civil union, and certain state-mandated coverage for other non-qualifying dependents. As you know, the IRS does not recognize these individuals for purposes of federal law. The answer may be different under small group COBRA for COBRA eligibility; however, the subsidy is federal law and only applies to federally recognized dependents.
6. **High-Income Individuals.** These individuals can elect to collect or waive the Plan Sponsor's subject. Despite their W-2 income, Plan Sponsors must provide notice to these individuals who are COBRA Qualified Beneficiaries with a COBRA Qualifying Event occurring on or after September 1, 2008 and before December 31, 2009. Their disqualification is based on modified adjusted gross income. W-2 wages are not determinative.
7. **Cessation of the Subsidy Due to Eligibility for Other Coverage.** Q&A 35 discusses the situation where a person is currently eligible for other coverage but cannot enroll until some future date. The notice advises that the subsidy would cease only when the other coverage could take effect.

Additionally, the notice makes it clear that the death of the AEI does not end the eligibility of the Qualified Beneficiary spouse and dependent children.

Failure to pay premium timely will terminate the subsidy.

Individuals covered by Medicare prior to electing COBRA may elect COBRA but will not be eligible for the subsidy.

SEVERANCE PAY

1. **Basic COBRA Rule.** It is settled law that the Plan Sponsor may provide extended health care coverage as a part of a severance or separation agreement. The terms of the agreement will determine the timing of COBRA rights. If the agreement says that the Plan Sponsor will provide three months extended coverage to all affected individuals and that COBRA rights attach thereafter, then the three months of employer-provided coverage (even if partially contributory) will not reduce the duration of COBRA coverage or rights to the subsidy.

On the other hand, if the agreement says that, if COBRA is elected, the employer will provide the first three months at no cost to the Qualified Beneficiary, then the Qualified Beneficiary will have 15 remaining months of COBRA coverage and, most likely 9 months of premium subsidy.

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2. Today's Notice. Q&A 14 considers the employer's unilateral continuation of coverage without a COBRA election at no cost to the employee as deferring his/her eligibility for the subsidy. The actual loss of coverage will occur at the end of the 100% payment under a severance plan, at which point COBRA rights attach. If the COBRA rights attach during the period in which the subsidy will be available (September 1, 2008 through December 31, 2009) then the Qualified Beneficiary will be eligible to receive the subsidy. However, if the unilateral severance benefit ends after December 31, 2009 then there will be no subsidy.

3. Enter the New COBRA Subsidy Law on February 17, 2009. Now the facts become very important.

Example A. Employer pays 100% of the first three month of a \$1,000 COBRA premium only if the individual elects COBRA. The severance agreement became effective March 1, 2009.

- Since the Qualified Beneficiary has no premium due during the first three months, there is no employer subsidy. The subsidy is intended to reduce the Assistance-Eligible Individual's (AEI) cost by 65%. Here the AEI has no COBRA premium due until the fourth month. The subsidy starts then for nine months.
- If the employer pays 80% (e.g. \$800) of the COBRA premium for three months, then the AEI would be responsible for 20% (i.e. \$200) of the monthly COBRA premium. In this situation, the employer would subsidize 65% (\$130) of the \$200 and the AEI would pay \$70.

Example B. Employer agrees to pay 80% of the COBRA premium (if elected) under a severance agreement beginning October 1, 2008 and lasting six months.

- The Qualified Beneficiary would pay 20% from October 1, 2008 through February 28, 2009. The AEI would be able to reduce his/her 20% as of March 1, 2009 to \$70 with the employer providing a subsidy at 65% of \$200. In April the employer would pick up \$650 leaving the AEI a premium due of \$350.

Example C. Employer agrees, as a part of a severance agreement, to provide 100% subsidy effective March 1, 2009 for two months, in the event the Qualified Beneficiary elects COBRA.

- The employee has no COBRA premium requirement. Today's notice makes it clear that the employer cannot receive reimbursement for the premiums paid for March and April. The AEI gets 9 months of subsidy benefit.
- If the severance agreement required the employer to pay 80% of the \$1,000 COBRA premium as of March 1, 2009, then the result is different. The employer pays 65% of the \$200 and receives reimbursement in accordance with today's notice. The AEI pays \$130 per month. As of May 1, 2009, the AEI would have seven months of subsidy remaining at 35% of the full COBRA premium and the employer would get a reimbursement of 65% or the full COBRA premium.

Example D. Let's say the severance agreement says the Qualified Beneficiary electing COBRA need only pay \$200 per month toward the COBRA cost for twelve months beginning March 1, 2009.

- The Plan Sponsor may still only take credit for 65% of the \$200. Here, the nine months runs and the AEI reverts to paying 100% of the COBRA premium in the 13th month.

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In today's notice, the IRS confirms in Q&A 20 that the subsidy is to be based on the actual amount the AEI is charged for coverage.

If the actual amount charged to the AEI is \$200 the AEI pays \$70.00; the employer payroll tax credit is \$130, even though the employer is already covering the first \$800 of a \$1,000 premium.

If some or all of the 35% is being paid by a third party such as the state, a charity, parent or guardian (not the employer) it counts toward the 35% AEI payment obligation.

4. **Renegotiating Severance Agreement.** It is our understanding that renegotiating a severance agreement requires an analysis of IRC 409A applicability and the probability of deferred compensation. It is likely that any renegotiation for the purpose of maximizing the COBRA subsidy benefits may come under IRS scrutiny.

THE 941 AND REPORTING

1. Reimbursement Requirements:

- **941 Quarterly Reporting.** The IRS has modified Form 541 for 2009 to include the ability to claim a tax credit so long as the employer can validate the date the AEI pays his/her 35% for the XXX involved. Interestingly, if an AEI begins COBRA on June 1, 2009, makes his/her COBRA and subsidy election on May 29, 2009, then the employer must wait (up to 45 more days before the AEI pays his/her 35% pursuant to basic COBRA rules allowing 45 days following the election to pay COBRA premium.
- **Adjustments and Overpayments.** Please refer to the IRS website (<http://www.irs.gov/newsroom/article/o,,id=204505,00.html>) for a full description of how an employer can make adjustments or receive reimbursement when the subsidy extends his/her 941 obligation.

2. Reporting in Support of Credit. Employers must maintain supporting documentation:

- Information on the receipt of each AEI's 35% share of the premiums (including dates and amounts);
- In the case of an insured plan, copies of the invoices or other supporting statements from the insurance carrier and proof of each timely payment of the full premium to the insurance carrier required under COBRA;
- In the case of a self-insured plan, proof of each premium amount and proof of the coverage provided to the AEIs;
- Attestation of involuntary termination, including the date of the involuntary termination, for each covered employee whose involuntary termination is the basis for eligibility for the COBRA subsidy;
- Proof of each AEI's eligibility for COBRA coverage at any time during the period from September 1, 2008 to December 31, 2009, and election of COBRA coverage;
- A record of the Social Security Numbers of all covered employees, the amount of the COBRA subsidy reimbursed with respect to each covered employee, and whether the COBRA subsidy was for one individual or two or more individuals; and

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- Other documents necessary to verify the correct amount of reimbursement.

So there you have it. Until the next time, we have some working answers. We will keep you aware of further regulatory developments.

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