

# Internal Revenue Service Guidance on COBRA Premium Assistance Subsidies

On April 1, 2009, the Internal Revenue Service (IRS) published Notice 2009-27, as required by the COBRA premium subsidy provisions of the American Recovery and Reinvestment Act of 2009 (ARRA). An electronic copy of the IRS Notice can be found on the IRS Web site [here](#). Along with the Department of Labor's model notices and related guidance (discussed in a [companion e-alert](#)), the IRS guidance provides significant clarification for plan sponsors attempting to apply the COBRA subsidy provisions of ARRA.

As you may recall, on February 20, 2009, Reinhart published a preliminary analysis of ARRA describing our current understanding of the then-new COBRA compliance requirements under ARRA. New information about the COBRA subsidy provisions of ARRA is becoming available almost daily. This e-alert is intended to update our prior guidance and provide additional commentary on who is eligible for the COBRA premium subsidy.

**Involuntary Termination.** To be eligible for COBRA premium assistance, an individual must experience an "involuntary termination" of employment. The IRS has broadly defined this term. The general test for whether an involuntary termination occurs is whether employment is severed due to unilateral employer action where the employee was willing and able to continue performing services. In addition, an employee-initiated termination will be deemed an "involuntary termination" under ARRA if the employee's termination is the result of an employer-initiated "material negative change in the employment relationship to the employee."

What this broad definition will mean for plan sponsors is that the plan sponsor may not be able to rely on its existing coding system to determine whether a particular individual is eligible for the subsidy. "Involuntary termination" includes, for example:

- temporary and permanent lay-offs;
- a reduction of hours to zero;
- terminations for cause (other than gross misconduct);
- an employer's failure to renew an employment contract at the time the contract expires if the employee was willing and able to execute a new contract with similar terms and conditions;

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- voluntary employee terminations when continued employment is conditioned on a material relocation of employment;
- voluntary employee terminations in return for a severance package where the employer indicates that after the offer period for the severance package, a certain number of employees will be terminated.

The IRS guidance confirms that an employee's death is not an "involuntary termination" as defined by ARRA. In addition, an employee's absence from work due to illness or disability is not an "involuntary termination" until the employer takes steps to sever the employment relationship entirely. (Note, however, that if the medical leave is treated as the COBRA qualifying event, the later termination of employment on account of continued disability will not be a subsequent qualifying event that would render the individual eligible for COBRA premium assistance.) Retirement is also generally not an involuntary termination unless an individual had knowledge that he or she would be terminated if he or she did not retire.

**Termination and Loss of Coverage.** To be an "assistance eligible individual" (or "AEI") entitled to the COBRA premium subsidy, an individual's qualifying event and loss of coverage must both occur during the period beginning September 1, 2008 and ending December 31, 2009. This rule is called the "border rule." To determine when the loss of coverage occurs, employers must look at the first day of COBRA coverage (*e.g.*, if coverage is extended through the end of the month of termination, then the first day of the COBRA coverage period is the first day of the following month). If the first day of COBRA coverage is not within this period, that individual is not an AEI. Employers should note that the border rule will have significant impact in determining whether individuals who became eligible for COBRA in September 2008, or who terminate employment in December 2009, are AEIs.

**Beginning of Premium Reduction Period.** The premium reduction applies as of "the first period of coverage beginning on or after February 17, 2009." The IRS has clarified that the definition of a "period of coverage" is "a monthly or shorter period with respect to which premiums are charged by the plan with respect to such coverage." For examples on how this applies in determining the "first period of coverage," see Q&As 30-32 and 48-49.

**Extended Coverage, by Any Name.** The IRS also advised how to determine when a loss of coverage occurs if an employer extends health coverage for an AEI after termination of employment at subsidized rates. Plan sponsors often refer to

these periods by many names (*e.g.*, extended active coverage, a severance period, self-payment options). The rule is relatively simple. The key factor is whether the extended coverage, regardless of the name, counts against the maximum COBRA coverage period.

- If the extended coverage does not count toward the 18-month maximum COBRA continuation period (*e.g.*, the loss of coverage is deferred), then the loss of coverage for purposes of the COBRA premium subsidy occurs when the extended coverage ends.
- If an employer considers the extended coverage to run concurrently with COBRA continuation coverage and counts it toward the 18-month maximum COBRA continuation period, then the loss of coverage, for purposes of the COBRA premium subsidy, occurs on the date the extended coverage begins.

**Calculation of Premium Reduction.** As we initially concluded, the 35% reduction (and the corresponding 65% subsidy that the employer may claim as a credit on its payroll taxes) applies to the amount actually charged for COBRA, not the maximum amount that could be charged. If the employer completely subsidizes any month of COBRA premiums (*i.e.*, the individual pays nothing), then the employer is not entitled to any subsidy on its payroll taxes for that individual for that month. However, that month will count against the individual's maximum nine month period of COBRA subsidy.

**Eligibility for Other Coverage.** If an AEI loses eligibility for the ARRA premium subsidy and the AEI's employer continues to claim a payroll tax credit for the premium reduction, the employer is not generally required to refund to the IRS the excess premium reduction merely because the AEI failed to notify to employer of eligibility for other group health plan coverage or Medicare. If the employer had actual knowledge of such eligibility, a refund may be required.

**Election to Waive Premium Assistance.** High income individuals who are subject to the recapture tax if they receive the COBRA subsidy are entitled to waive the subsidy to avoid the recapture tax. We note three clarifications on this waiver:

- An individual is subject to the recapture tax if the individual's income in the year that he or she receive the subsidy exceeds the relevant thresholds. Thus, for an individual who receives the subsidy in 2009 and 2010, the recapture tax could be applied in 2009, and then again in 2010, if his or her income exceeded the threshold in each year.
- The waiver, once made, is permanent and irrevocable, regardless of any change



in modified adjusted gross income in the future. For example, an individual who is eligible for the subsidy beginning in 2009 and ending sometime in 2010, cannot get the subsidy in 2010 if he or she waives it when first eligible in 2009. Thus, individuals who anticipate high income in 2009 but a lower income in 2010 may actually decide to take the subsidy and pay the applicable recapture tax in 2009 with the expectation that he or she will not be subject to the tax in 2010.

- The process for waiving the subsidy must include a signed and dated notification from the employee that includes a reference to a "permanent waiver."

If you have any questions on this e-alert or compliance with the COBRA premium subsidy in general, please contact your [Reinhart attorney for assistance](#).

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