

## **IRS Issues COBRA Q&As for Stimulus Bill 65% Assistance Payment Provisions**

**April 7, 2009**

On March 31, the Internal Revenue Service (IRS) issued Notice 2009-27, which contains 58 detailed questions and answers (Q&As) addressing the COBRA 65% assistance payment provisions enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA).

The Q&As, which provide written verification of many recent informal comments from IRS representatives, are generally favorable toward assistance-eligible individuals (AEIs) and greatly expand the general understanding of employers regarding the ARRA COBRA provisions.

However, among other things, the Q&As may require an employer to do the following:

- Revise its interpretation of “involuntary termination”
- Review who qualifies as an AEI
- Modify its calculation of which COBRA premiums are eligible for the 65% assistance payment and in turn, eligible for reimbursement to the employer
- Treat some retiree medical coverage as eligible for the 65% assistance payment (and change ARRA supplemental COBRA notices);
- Ignore some other coverage for purposes of ending the 65% assistance payment
- Change how, and to whom, it offers a second-chance election

The balance of this LawFlash will briefly discuss these changes. Note, however, that there are many detailed concepts and rules in the 58 Q&As that are not addressed in this LawFlash. For a broader discussion of all of the concepts and rules contained in the Q&As, please contact any of the Morgan Lewis attorneys listed at the end of this LawFlash.

### ***What is an involuntary termination?***

Notice 2009-27 provides a large amount of much-welcomed clarification regarding when an individual suffers or does not suffer an involuntary termination of employment but also requires additional analysis for certain termination scenarios.

Under the Q&As, it is now clear that the following qualify as an involuntary termination of employment:

- A layoff with a right of recall or temporary furlough

- An employer decision to terminate due to illness or disability
- A termination for cause
- An employer lockout

The following are not considered an involuntary termination of employment:

- An initial 36-month COBRA qualifying event followed by an involuntary termination
- A death
- An employee absence from work due to illness or disability
- An employee strike

Finally, the following may or may not be considered an involuntary termination of employment (and require further analysis):

- A failure to renew a contract
- A voluntary termination
- A reduction in hours
- A retirement
- A resignation due to material change in geographic location
- A severance package
- A termination following a reduction in hours

The biggest challenge created by the Notice is how to examine the terminations of employment that fall into the may/may not be category. These determinations are dependent on the facts and circumstances of the case, and raise challenging interpretive issues. Additional guidance includes the following General Principles and Specific Guidance (drawn directly from the Notice or paraphrased where appropriate):

### **General Principles**

- 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 employee-initiated termination from employment constitutes an involuntary termination from employment 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.

### **Specific Guidance**

- **Employment Contracts:** 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. It is unclear how this will work when the original contract, by its terms,

clearly refused to anticipate a renewal or when other individuals in similar situations never had their contracts renewed.

- **Voluntary Termination:** If a termination is designated as voluntary or as a resignation, but the facts and circumstances indicate that, absent such voluntary termination, the employer would have terminated the employee's services, and that the employee had knowledge that the employee would be terminated, the termination is involuntary. This may occur when an employee knows that RIFs are on the horizon.
- **Reduction in Hours:** An employee's voluntary termination in response to an employer-imposed reduction in hours may be an involuntary termination if the reduction in hours is a material negative change in the employment relationship for the employee. This may occur when an employer reduces an employee's hours to less than full-time and the employee has to quit in order to secure full-time employment elsewhere.
- **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 the employee would be terminated, the retirement is an involuntary termination. A pending RIF or "An Offer You Can't Refuse" would seem to fall into this category.
- **Change in Geographic Location:** An employee's voluntary termination in response to a material change in the geographic location where the employee's job is performed would constitute an involuntary termination. This may occur when an employer located on the East Coast indicates it is closing its current location, moving to Arizona, and that anyone who wants to move to Arizona is guaranteed a job.
- **Severance Package:** A severance package may still be an involuntary termination if it is part of a situation 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. This is another example (like retirement) of "An Offer You Can't Refuse."
- **Termination Following a Reduction in Hours:** If, in anticipation of an involuntary termination that would otherwise qualify an individual as an assistance-eligible individual, the employer takes action other than the involuntary termination of the individual, and this results in a loss of coverage for the individual (for example, a reduction in hours for the employee in anticipation of involuntarily terminating the employee), the action causing the loss of coverage prior to the involuntary termination is then disregarded in determining whether involuntary termination is the qualifying event that results in the COBRA continuation coverage for the individual. This seems related to the current COBRA rule "In Anticipation of a Divorce" and will apply when hours are first reduced, COBRA is triggered due to the reduction, and the individual is subsequently terminated.

Even with the additional guidance in the Notice, there are still a number of scenarios where employers must conduct a fact-intensive investigation of the reason underlying the termination of employment. Employers may decide to conduct these investigations when an individual calls to elect COBRA coverage or when they choose to elect the 65% assistance payment. Conservative employers may still treat the termination as voluntary and let the DOL exercise its appeal authority associated with the "may/may not be" circumstances outlined above.

### ***Who qualifies as an AEI?***

The Notice is very clear that both the involuntary termination of employment and the eligibility for COBRA coverage must occur during the period bounded by September 1, 2008 and December 31, 2009. If only one of these requirements occurs during the eligibility period, then the individual is not assistance eligible. Employers should therefore pay particular attention to when COBRA coverage begins because an involuntary termination that occurs in December 2009 but is followed by COBRA coverage that begins January 1, 2010 will render the individual ineligible for the stimulus bill 65% assistance payment.

Similarly, when an existing severance benefit is treated by the employer as giving rise to health plan coverage that precedes the onset of COBRA coverage, such a severance benefit can render the individual ineligible for the ARRA 65% assistance payment if the severance continues beyond December 31, 2009.

Finally, when COBRA coverage first begins due to a divorce or when a child ages out of coverage, neither event results in eligibility under the stimulus bill for the former spouse or child, even when the employee subsequently suffers an involuntary termination of employment.

### ***Which COBRA premiums are eligible for the 65% assistance payment?***

The Notice clarifies that only the premium actually charged to the employee is eligible for the 65% assistance payment.

Further, to the extent the premium represents an incremental additional cost for an individual who is not an AEI (such as a subsequently acquired spouse or a domestic partner), the additional cost is not eligible for the 65% assistance payment. When determining whether there is an incremental additional cost, the COBRA premium is allocated first to the cost of covering AEIs. This means that if there is no additional charge for covering an individual who is not an AEI (if, for example, the employer has three pricing tiers of employee, employee plus one, and employee plus family, the employee already has family medical coverage and then adds a domestic partner) then the entire COBRA premium is eligible for the 65% assistance payment and reimbursement from the employer's payroll tax deposits. Conversely, if the employee has single-employee coverage and adds a domestic partner, the difference between the employee and the employee-plus-one pricetag will not be eligible for the 65% assistance payment.

It remains to be seen whether the IRS will adopt this incremental additional cost approach to related issues such as determining the imputed income attributable to employees who cover their domestic partners under employer-subsidized medical coverage.

The Notice also provides welcome guidance describing how an employer can start or delay the onset of the 65% assistance payment nine-month period and, also, how employers can eliminate a current employer subsidy, charge the employee the full COBRA premium, and even provide a taxable gross-up to the employee who formerly received an employer subsidy.

### ***When is retiree medical coverage eligible for the 65% assistance payment?***

The biggest surprise contained in the Notice is found in Q&A 28 which permits employers to offer the 65% assistance payment for certain types of retiree medical coverage. When, according to the Q&A, retiree medical coverage is the same as active employee medical coverage (but for the premium charged) such coverage is treated as COBRA coverage and is eligible for the 65% assistance payment. In practical application, this saves employers from offering a second-chance COBRA election to these individuals, sidesteps whether the individuals can get back into retiree medical if they elect COBRA under a second-

chance offer, and simply allows the retiree to apply for the 65% assistance payment for their retiree medical premium. This approach, however, is not currently supported by the model DOL Notices and may come too late for employers that have already distributed second-chance election notices to their retiree medical population.

### ***When is eligibility for other coverage ignored?***

The Notice reinforces that mere eligibility for other group health coverage or Medicare will generally end the nine-month assistance payment period but also creates a number of exceptions to the general rule:

- Specifically, eligibility for other coverage, when such eligibility predates February 17, 2009, will not end the 65% assistance payment if the former employee is currently precluded from enrolling in such coverage. For example, eligibility for spouse medical coverage for the 2009 calendar year open-enrollment period does not end AEI status if the former employee does not have a current right to enroll in the spouse's medical benefits.
- The same result occurs for retiree medical coverage offered under a different group health plan if the eligibility is offered before February 17, 2009 and the enrollment period ends before such date.
- Finally, with regard to individuals currently enrolled in Medicare, the Medicare coverage makes the individual ineligible for the 65% premium reduction but will not end the individual's opportunity to enroll in COBRA if they otherwise qualify for the second-chance election.

### ***Who is offered a second-chance election?***

Finally, the Notice clarifies that a spouse or child who is a COBRA-qualified beneficiary and who did not enroll in COBRA after an involuntary termination of employment occurring on or after September 1, 2008 must be offered a second-chance COBRA election even if the former employee previously elected single-employee COBRA coverage.

### **Additional Information**

As mentioned previously, there are far more details and new rules contained in the Notice than are discussed here. For a broader discussion of all of the issues contained in the Q&As, please contact any of the Morgan Lewis attorneys listed at the end of this LawFlash.

Additional IRS information regarding the COBRA assistance payment provisions, including the new Q&As, can be found at <http://www.irs.gov/newsroom/article/0,,id=204505,00.html>.

Additional DOL information regarding the COBRA assistance payment provisions can be found at <http://www.dol.gov/ebsa/cobra.html>.

Additional HHS information regarding the state law components of the COBRA assistance payment provisions can be found at: <http://www.cms.hhs.gov/COBRAContinuationofCov/>.

For additional Morgan Lewis information regarding the COBRA 65% assistance payment provisions, see our March 19, 2009 LawFlash (available at [http://www.morganlewis.com/pubs/EconoStimulus\\_ModelCOBRANotices\\_LF\\_19mar09.pdf](http://www.morganlewis.com/pubs/EconoStimulus_ModelCOBRANotices_LF_19mar09.pdf)), our February 24, 2009 LawFlash (available at

[http://www.morganlewis.com/pubs/EconoStimulus\\_COBRAFurtherDetails\\_LF\\_24feb09.pdf](http://www.morganlewis.com/pubs/EconoStimulus_COBRAFurtherDetails_LF_24feb09.pdf)), and our February 17, 2009 LawFlash (available at [http://www.morganlewis.com/pubs/EconoStimulus\\_COBRAAction\\_LF\\_17feb09.pdf](http://www.morganlewis.com/pubs/EconoStimulus_COBRAAction_LF_17feb09.pdf)).

A copy of the presentation given during our webcast, “Stimulus Plan COBRA Changes: Rules and Ramifications,” as well as supplementary material and an audio recording of the webcast, can be accessed at <http://morganlewis.com/pubs/cobrawebcast>.

For more information on any of the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

### **Chicago**

David Ackerman	312.324.1170	<a href="mailto:dackerman@morganlewis.com">dackerman@morganlewis.com</a>
Andy R. Anderson	312.324.1177	<a href="mailto:aanderson@morganlewis.com">aanderson@morganlewis.com</a>
Brian D. Hector	312.324.1160	<a href="mailto:bhector@morganlewis.com">bhector@morganlewis.com</a>

### **Dallas**

Riva T. Johnson	214.466.4107	<a href="mailto:riva.johnson@morganlewis.com">riva.johnson@morganlewis.com</a>
John A. Kober	214.466.4105	<a href="mailto:jkober@morganlewis.com">jkober@morganlewis.com</a>
Heath Miller	214.466.4118	<a href="mailto:hmillier@morganlewis.com">hmillier@morganlewis.com</a>
Erin Turley	214.466.4108	<a href="mailto:eturley@morganlewis.com">eturley@morganlewis.com</a>

### **New York**

Craig A. Bitman	212.309.7190	<a href="mailto:cbitman@morganlewis.com">cbitman@morganlewis.com</a>
Gary S. Rothstein	212.309.6360	<a href="mailto:grothstein@morganlewis.com">grothstein@morganlewis.com</a>

### **Philadelphia**

Robert L. Abramowitz	215.963.4811	<a href="mailto:rabramowitz@morganlewis.com">rabramowitz@morganlewis.com</a>
I. Lee Falk	215.963.5616	<a href="mailto:ilfalk@morganlewis.com">ilfalk@morganlewis.com</a>
Amy Pocino Kelly	215.963.5042	<a href="mailto:akelly@morganlewis.com">akelly@morganlewis.com</a>
Robert J. Lichtenstein	215.963.5726	<a href="mailto:rlichtenstein@morganlewis.com">rlichtenstein@morganlewis.com</a>
Joseph E. Ronan, Jr.	215.963.5793	<a href="mailto:jronan@morganlewis.com">jronan@morganlewis.com</a>
Steven D. Spencer	215.963.5714	<a href="mailto:sspencer@morganlewis.com">sspencer@morganlewis.com</a>
Mims Maynard Zabriskie	215.963.5036	<a href="mailto:mzabriskie@morganlewis.com">mzabriskie@morganlewis.com</a>
David B. Zelikoff	215.963.5360	<a href="mailto:dzelikoff@morganlewis.com">dzelikoff@morganlewis.com</a>

### **Pittsburgh**

Lisa H. Barton	412.560.3375	<a href="mailto:lbarton@morganlewis.com">lbarton@morganlewis.com</a>
John G. Ferreira	412.560.3350	<a href="mailto:jferreira@morganlewis.com">jferreira@morganlewis.com</a>
Lauren Bradbury Licastro	412.560.3383	<a href="mailto:llicastro@morganlewis.com">llicastro@morganlewis.com</a>
R. Randall Tracht	412.560.3352	<a href="mailto:rtracht@morganlewis.com">rtracht@morganlewis.com</a>

### **Washington, D.C.**

Jessica R. Bernanke	202.739.5447	<a href="mailto:jbernanke@morganlewis.com">jbernanke@morganlewis.com</a>
Althea R. Day	202.739.5366	<a href="mailto:aday@morganlewis.com">aday@morganlewis.com</a>
Benjamin I. Delancy	202.739.5608	<a href="mailto:bdelancy@morganlewis.com">bdelancy@morganlewis.com</a>
David R. Fuller	202.739.5990	<a href="mailto:dfuller@morganlewis.com">dfuller@morganlewis.com</a>
Mary B. (Handy) Hevener	202.739.5982	<a href="mailto:mhevener@morganlewis.com">mhevener@morganlewis.com</a>
Dean R. Morley	202.739.5989	<a href="mailto:dmorley@morganlewis.com">dmorley@morganlewis.com</a>
Gregory L. Needles	202.739.5448	<a href="mailto:gneedles@morganlewis.com">gneedles@morganlewis.com</a>

**Palo Alto**

S. James DiBernardo  
Zaitun Poonja

650.843.7560  
650.843.7540

[jdibernardo@morganlewis.com](mailto:jdibernardo@morganlewis.com)  
[zpoonja@morganlewis.com](mailto:zpoonja@morganlewis.com)

**About Morgan, Lewis & Bockius LLP**

Morgan Lewis is an international law firm with more than 1,400 lawyers in 22 offices located in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, Minneapolis, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, and Washington, D.C. For more information about Morgan Lewis, please visit [www.morganlewis.com](http://www.morganlewis.com).

**IRS Circular 230 Disclosure**

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. For information about why we are required to include this legend in emails, please see <http://www.morganlewis.com/circular230>.

This Alert is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered Attorney Advertising in some states.  
Please note that the prior results discussed in the material do not guarantee similar outcomes.

© 2009 Morgan, Lewis & Bockius LLP. All Rights Reserved.