

EMPLOYMENT LAW CLIENT E-ALERT  
MARCH 2009

UPDATE: ADDITIONAL CHANGES TO RECENTLY ENACTED COBRA RULES AND NEW MODEL NOTICES AND FORMS ISSUED

As we recently reported to you in our February 2009 Client Update, "[Federal Stimulus Law Includes Immediate and Important Changes to COBRA](#)," the recently enacted federal stimulus package includes significant changes to COBRA rules. On March 19, the Department of Labor issued model notices for the COBRA subsidy under the American Recovery and Reinvestment Act of 2009 (ARRA), and additional guidance for employers and employees regarding the changes.

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OVERVIEW OF THE LAW

- The American Recovery and Reinvestment Act of 2009 ("ARRA") includes help for Assistance Eligible Individuals ("AEIs").
- AEIs are "involuntarily terminated" employees during the period from September 1, 2008 through December 31, 2009 and their COBRA beneficiaries at the time (including children born or adopted after that date).
- If COBRA was denied because termination was for "gross misconduct," there are no rights under ARRA for anyone who would otherwise be an AEI.
- AEIs can qualify for 65% tax-free reimbursement for COBRA costs for up to nine months, but no subsidy is allowed after the AEI becomes eligible for other group coverage (even if the coverage is not taken) or Medicare.
- No subsidy is allowed for COBRA coverage prior to March 1, 2009. For purposes of reimbursements, the term "COBRA" includes coverage under most state mini-COBRA laws. It also includes stand-alone vision, dental and counseling plans covered by COBRA, but not section 125 flex-accounts.

- Employers who collect 35% of the COBRA costs from the AEI (or from a third party paying for the AEI) must advance the remaining 65%. The 65% advance can then be claimed as a credit against the employer's payroll taxes. There is no credit if the employer pays the AEI's 35% share.
  - Mini-COBRA employers collect and forward only 35% to insurers. Insurers then claim the credit against their payroll taxes.
- AEIs who dropped COBRA or who did not elect it have a "second chance" to enroll as of March 1, 2009 for the balance of the original COBRA period.
  - This "second chance" feature is expected to be a requirement of state mini-COBRA requirements. New Hampshire has already taken necessary action. Rhode Island and Massachusetts are expected to act soon.
- High income AEIs are not allowed to benefit from the subsidy. They can waive it permanently or pay back the subsidy when they file their tax return. The subsidy rights start to phase out for modified adjusted gross income ("MAGI"), which is line 37 on Form 1040, and it is increased by certain foreign income. The subsidy rights phase out at \$125,000 for single and head of household and at \$250,000 for joint filers. The subsidy cannot be claimed at all when these levels reach \$145,000 and \$290,000.
- DOL has prepared model Notice and form kits that describe ARRA:
  - April 18, 2009 is the required deadline to distribute to AEIs associated with an involuntary termination during the period September 1, 2008 through February 16, 2009.
  - There are forms which must be distributed to persons currently on COBRA for any COBRA event, not just involuntary termination, which occurred during period September 1, 2008 through February 16, 2009.
  - The forms must also be used after February 16, 2009 for any COBRA event, not just involuntary termination, during period September 1, 2008 through December 31, 2009. This may require re-noticing persons who received "old-style" notices after February 16, 2009.
  - In mini-COBRA states, it's not clear who will distribute ARRA mini-COBRA Notices and forms. The federal government assumes that insurers will. In many states, like Massachusetts, this has been done by employers. It's a big and unresolved issue.
- Employers with various levels of coverage may allow AEIs to "trade down" to lower levels of major medical coverage within 90 days of getting their ARRA COBRA Notices. Trading up is not allowed except in connection with annual open enrollment periods for a plan. Employers with various levels of coverage are not required to allow "trade downs" except during normal open enrollment periods.

## NEW NOTICES AND FORMS/IMPORTANT DEADLINES

DOL has prepared three kits, each with model Notices and election forms for employer use. There is the Full General Notice Kit, the Abbreviated Notice Kit, and the Extended Election Period Notice Kit. [The DOL website guidance is at this link](#) (with links to the forms in WORD format). Customization of this form is allowed where necessary. There is also a kit for those mini-COBRA states where insurers send out Notices and process elections, and that is described in Section 7 of this article.

[Full General Notice Kit](#). This new General Notice kit goes to all qualified COBRA beneficiaries, not just covered employees, who experience a qualifying event during the period from September 1, 2008 through December 31, 2009, regardless of the type of qualifying event, EXCEPT FOR:

- those who were provided a pre-ARRA COBRA Notice prior to February 17, 2009,

- those who are currently on COBRA and who receive the new Abbreviated General Notice described below,
- those who let COBRA expire or who did not elect COBRA and are entitled to the Extended Election Period Notice described below.

**Please Note:** The distribution deadline for the new Full General Notice will be the normal COBRA deadline, no later than 44 days after the COBRA event.

Abbreviated General Notice Kit. This contains the same information as the Full version. It may be sent in lieu of the full version to individuals who experienced a qualifying event on or after September 1, 2008 and who elected COBRA coverage and still have it.

**Please Note:** Even though DOL does not specifically state this, April 18, 2009 should be considered as the deadline to distribute the Abbreviated General Notice. It might seem odd to send this to COBRA people who had qualifying events that were clearly not considered an "involuntary termination." However, the present DOL view is to send notices to all persons currently on COBRA for any type of event since September 1, 2008.

Extended Election Period Notice Kit. This is for AEIs whose COBRA event is related to involuntary termination between September 1, 2008 through February 16, 2009 and who did not elect COBRA continuation coverage, or who elected it but subsequently discontinued COBRA. It advises of "second chance" rights to elect coverage as of March 1, 2009 and also advises about the subsidy.

**Important Note:** At a webinar on March 24, the DOL seemed to back away from a March 20 Notice in the Federal Register which says that all persons who have experienced any type of COBRA event since September 1, 2008 have to receive a notice about ARRA or their COBRA notice is incomplete. DOL is taking this position only for those who receive the Abbreviated General Notice Kit (i.e. currently on COBRA for any type of event since September 1, 2008).

## Examples

- Joe quit on September 2, 2008. He and his family got pre-ARRA COBRA notices before February 17, 2009 and declined COBRA. They get no additional notices.
- Sally died on October 5, 2008. Her family got pre-ARRA COBRA notices before February 17, 2009 and declined COBRA. They get no additional notices.
- Pete quit on November 1, 2008. He elected COBRA and is still on it as of February 17, 2009. He gets the Abbreviated Notice, even though he would not be an AEI.
- Jack was laid off on December 1, 2008. He declined COBRA. He gets the Extended Election Period Notice by April 18 because his termination was involuntary and he is not on COBRA.
- Jim's hours were cut back on October 1, 2008. He lost coverage and his employer forgot to give him a COBRA notice. He gets the new Full General Notice because he had not gotten a pre-February 17, 2009 pre-ARRA COBRA notice.

After the appropriate Notice is sent, the normal COBRA rules take over. The former employee or COBRA beneficiary who receives a Complete Notice Kit has 60 days to respond. Does he/she want COBRA? If "second chance" enrollment rights are available, does he/she want them? If eligible for the 65% subsidy, does he/she claim rights to it?

An AEI must verify that the employee was terminated involuntarily and that the AEI is not eligible for other coverage. AEIs are warned that a 110% penalty applies to those who accept subsidies when ineligible.

## "SECOND CHANCE" ENROLLMENT RIGHTS

ARRA gives a "second chance" to AEIs who lost coverage before February 17, 2008 because they dropped COBRA or did not elect it on time. March 1 is the "second chance" new enrollment date. "Second chance" COBRA coverage will last for the balance of the COBRA period (i.e. 18 months with extended coverage periods, if applicable) that dates back to the COBRA event. "Second chance" COBRA stops under the same rules as regular COBRA. Generally, that occurs when the

AEI becomes covered by (not just eligible for) a new group plan without preexisting condition requirements or Medicare, or if the AEI does not pay timely premiums.

The period between the involuntary termination and March 1, 2009 will be disregarded for purposes of determining whether there has been a 63-day break that would trigger loss of HIPAA protection for preexisting conditions.

### Example

- Rick is an AEI who was terminated involuntarily on November 15, 2008. He did not elect COBRA. He gets his Extended Period Election Notice on April 18, 2009. He is not eligible for other group coverage. He has a "second chance" to enroll under COBRA.

Rick has 60 days from April 18, 2009 to make that decision. His "second chance" COBRA would start as of March 1, 2009. He would have 45 days after making the election to catch up on premiums for the coverage since March 1, 2009 (just like regular COBRA).

Rick's "second chance" COBRA will last for the balance of the 18 months from his November 15, 2008 severance date (i.e. until May 15, 2010). He would lose the "second chance" coverage only if it would be lost under normal COBRA rules (i.e. Rick become eligible for and accepts other group coverage or becomes entitled to Medicare by filing for it or starting Social Security).

Please Note: State law action is required to extend "second chance" election to mini-COBRA beneficiaries. New Hampshire has done that, and we expect Rhode Island and Massachusetts to follow soon.

### 65% COBRA SUBSIDY RIGHTS AND THE 15-DAY APPEAL PROCEDURE

A 65% federal subsidy may be claimed by AEIs. The subsidy will last for nine months or until the AEI becomes eligible for other group coverage or Medicare. Unlike the rules for COBRA, where other coverage must be obtained to shut off COBRA coverage, the subsidy is lost as soon as an AEI becomes eligible for Medicare or other group coverage. Eligibility under a spouse's plan or reaching the 1st of the month of a 65th birthday (Medicare eligibility date) are examples of eligibility which would disqualify an AEI from the subsidy.

A key condition is that the AEI (or a third party other than the former employer) must pay 35% of COBRA costs. If the former employer pays everything, there is no subsidy. The employer that pays 100% cannot claim the 65% credit because it must collect the 35% as a condition for the credit. We discuss this problem in more detail in Section 7 of this article.

The subsidy is tax-free except for "high income" people and is not considered income for welfare entitlements.

"High income" people do not get the benefit of the subsidy. There will be a procedure where they can waive the subsidy up-front by notifying the employer and the IRS. Alternatively, they will get an increase in their taxable income for the year in which the subsidy was received. The "high income" test is whether the person's MAGI exceeds certain limits. As previously mentioned in the Overview, MAGI is adjusted gross income on line 37 of the 2009 Form 1040, not just wages, and it is increased by exclusions for foreign income. For single filers, the amount phases out ratably for MAGI between \$125,000 and 145,000. For joint filers, the amount phases out ratably for MAGI between \$250,000 and \$290,000.

Please Note: The Trade Act of 2002 allowed "Trade Adjustment Assistance Eligible Individuals" to get 65% credit towards COBRA costs. ARRA increases this to 80% for coverage prior to January 1, 2011 and extended the duration of COBRA for participants collecting or entitled to collect from Pension Benefit Guaranty Corporation. This is irrelevant for most. The Health Coverage Tax Credit Customer Contact Center has a toll-free hotline at (866) 628-4282.

### Examples

- Rick, from previous examples, elected "second chance" COBRA as of March 1, 2009. Because he was terminated involuntarily during the period September 1, 2008 - December 31, 2009, and because he is not eligible for Medicare or other group coverage, he qualifies for the 65% subsidy. The subsidy will last for nine months (i.e. until November 30, 2009). His 65% subsidy will stop as soon as he becomes eligible for other group coverage (such as through a spouse's plan or Medicare), even if he does not accept that coverage. He can still continue with COBRA, but must now pay the full cost.

- Jim died on January 2. His wife was on the plan and hopes to continue coverage with a 65% subsidy. Death is not considered an involuntary termination. Jim's widow may continue on the plan under normal COBRA rules.
- Sybil lost her job as a hedge fund manager on March 15 and collected \$400,000 of severance. She would like the subsidy. She has a choice: claim the subsidy and then report that she owes extra taxes equal to the subsidy when she files her 2009 tax return; or file a permanent waiver of the subsidy with the employer and make reference to it when the 2009 tax return is filed.

### The 15-Day Claims Resolution Procedure

If an individual's request for a subsidy is denied by a plan, ARRA provides for a 15-day expedited review procedure. An appeals form will soon be on the [DOL website](#) and can be completed online, mailed, or faxed as indicated in the instructions. A hotline is available for pre-filing questions at (866) 444-3272.

### RECAPTURING THE EMPLOYER ADVANCE

The IRS has released extensive Q&As, with an update to its website as recent as March 20. [There are four topics, each with its own set of Q&As](#): Administration and Eligibility, Form Preparation, Reporting and Documentation, and Taxability and Recapture. IRS has answered key questions.

- The employer reports the 65% and offsets it against payroll taxes on Form 941, which has just been revised to accommodate this.
- It is not necessary to wait for the filing of Form 941 to offset the taxes against payroll tax deposits. There is detailed guidance at the following [IRS Form Preparation web page](#).
- The employer must have paid the full premium to the carrier (or provided the coverage if the plan is self-insured).
- The employer must have collected the 35% from the AEI (or a third party, such as a parent paying for family coverage).
- The credit cannot be recaptured if the employer pays the AEI's 35% share.

The employer must keep important data in the event of an audit. Fortunately, a lot of this will be on the model DOL forms, which the AEI must return in order to claim the subsidy. The model forms also include places for the employer to verify data that the IRS wants.

If you keep the forms, the remaining data is not overwhelming: (i) in the case of an insured plan, copy of invoice or other supporting statement from the insurance carrier and proof of timely payment of the full premium to the insurance carrier required under COBRA; (ii) in the case of a self-insured plan, proof of the premium amount and proof of the coverage provided to the assistance eligible individuals; and (iii) a record of the SSNs of all covered employees, the amount of the subsidy reimbursed with respect to each covered employee, and whether the subsidy was for one individual or two or more individuals.

What about the Federal Unemployment Tax Return? The IRS says that an employer's percentage contribution or the balance of money in that fund will not change as a result of the COBRA premium subsidy. [See IRS Q&A RD-10.](#)

**Mini-COBRA Note:** Blue Cross, Harvard Pilgrim, and Tufts have confirmed that employers need only advance the 35% collected from AEIs. Thanks to [Eastern Benefits Group](#) for advising us of that. Hopefully, other insurance companies will do the same. At a March 24 webinar, IRS confirmed that if a mini-COBRA employer pays the 65%, it cannot claim the payroll credit. Only the mini-COBRA insurer can claim the credit.

## ADDITIONAL MATTERS

### "Trade-Down" to Lesser Coverage

COBRA rules normally prohibit changes in coverage (except during open enrollments or due to HIPAA family events). Employers may permit AEIs to "trade-down" to a lower, more affordable coverage if the coverage is available to active employees. This makes health insurance even more affordable for the AEI. However, the "trade-down" cannot be just to a Section 125 reimbursement account or stand-alone dental, vision, or counseling coverage that does not include major medical. An employer does not have to permit "trade-downs." There is no subsidy for a "trade-up" to more expensive coverage. If "trade-down" is allowed, an employee will have up to 90 days from the Notice date to make that decision, which is more than the 60 days allowed for the decision to elect COBRA coverage.

**Please Note:** At a March 24 webinar, IRS said the subsidy applies to normal premium increases. Also, the IRS presently thinks that if "trade-up" occurs during an open enrollment period applicable to others, the subsidy applies to the increased premium.

### Stand-Alone Vision and Dental Plans; Section 125 Reimbursement Accounts

IRS has confirmed that the subsidy applies to stand-alone dental and vision plans. [See IRS Q&A AE-9](#). However, plans which allow "trade-down" may not allow trade-down to stand-alone plans that do not include major medical.

The subsidy (and trade-down) are not permitted for flexible accounts under Section 125 plans.

### Billing Transition

For those AEIs who are already getting COBRA, it's likely that COBRA bills for March (and even April) may not show that they only owe 35%. Parties are encouraged just to reduce the payments to 35% even if the billing system has not caught up. [See IRS Q&A AE-15](#). Any overpayments may be credited against future COBRA invoices or refunded, provided that overpayments are not retained more than 180 days.

## SPECIAL ISSUES

### Mini-Cobra

- **Who notifies people about ARRA?** The new law defines "COBRA" for purposes of the 65% subsidy to include state programs that provide comparable continuation coverage. Many states (Massachusetts and New Hampshire, for example) provide for mini-COBRA coverage for employer groups that have less than the 20 employees required for federal COBRA to apply.

The DOL model forms include an [Alternative Notice Kit](#) for mini-COBRA insurers to use to notify COBRA beneficiaries. This may not square with current practice in some mini-COBRA states where the employers send the Notices. Many insurers have not been clear if they will distribute the forms and Notices, contrary to past practice, or if employers will be expected to distribute the forms.

Regardless of who distributes the forms and notices, the question also arises as to who should prepare the forms and Notices for mini-COBRA beneficiaries and AEIs. The DOL employer models are based on federal COBRA. The mini-COBRA kit assumes the insurer would distribute. Hopefully, insurers will get into action and announce who they expect to distribute and also customize the forms.

- **Who pays the 65%?** As noted, the insurance companies seem to accept that it is their duty to pay the 65% and to claim the credit against their own payroll taxes. In states where employers collect premiums, the only duty of the mini-COBRA employer will be to collect the 35% from the AEI (or from a third party paying the AEI) and forward the payment. IRS comments in a March 24, 2009 webinar resolve an ambiguity in IRS guidance ([in IRS Q&A AE-4](#)) that the party collecting the 35% must pay the 65%.
- **"Second chance" enrollment is up to each individual state.** Although the 65% subsidy is available for AEIs covered by mini-COBRA statutes, there is no "second chance" to regain COBRA

election rights as of March 1, 2009, unless as permitted by a state individually. New Hampshire has taken action. Rhode Island has introduced legislation. We assume Massachusetts will follow suit.

### **Paid Severance**

The law specifically requires that the individual (or a person other than the employer of the severed employee) pay 35% to get the 65% credit. IRS has already been clear that if an employer pays the 35%, it will not get the 65% credit. See [IRS Q&A AE-17](#). This means that a severance arrangement is wasteful if it provides 100% paid health insurance under a severance plan. The employer is paying money that the government would have paid with a 65% credit!

If 100% employer payment is no good, and if the employer wants the employee to pay less than 35% (i.e. an 80/20 split during the first six months of severance), it's unclear how to calculate the subsidy in that instance, or if there is any subsidy at all.

Renegotiation of subsidized severance arrangements, possibly with a taxable cash-out or a deferral of the subsidy to 2010, may make sense for arrangements in effect now. Knowledge of 409A is required, and the government may not agree that parties can renegotiate existing deals just to take advantage of the federal credit. For "high income" AEs, this is less important due to the recapture rules.

**Please Note:** At a March 24 webinar, the IRS stated that the subsidy was available if the employer partly subsidized the COBRA cost. This is counter to [IRS Q&A RD-8](#), which implies that there is no subsidy at all unless the employee (or a third party other than the employer) pays the 35%. More IRS guidance is necessary.

### **Involuntary Termination**

What is involuntary termination? The best guidance to date is a [simple statement from the Ways and Means Committee](#) on February 28: "Involuntary termination is a termination that is at the direction of the employer."

An employer that wants to be "nice" actually risks sanctions if it certifies a termination is "involuntary" when it is not. The advantage of the expedited 15-day procedure of DOL is that it allows employers to shift the decision to the DOL in uncertain cases.

**Please Note:** At a March 24 webinar, IRS gave strong hints it would adopt liberal interpretations of the term "involuntary termination."

IRS examples of "involuntary termination":

- Layoff, even if there is expectation that employee will return to work.
- Employee terminates after employer states that layoffs will occur if there are not enough "voluntary" retirements.
- Employee essentially quits due to absenteeism, and Employer terminates.
- Employee quits after hours reduced. (However, if employee stays and loses health insurance because of reduced hours, that is not involuntary termination.)
- Plant shuts down and employee quits rather than accepting relocation offer.

### **Non-Federal Dependents**

The statute provides a 65% subsidy for COBRA coverage related to AEs. Using the COBRA terms required by this statute, the coverage would also be extended to include a heterosexual spouse and a "dependent" (undefined in COBRA) child. Is the full 65% subsidy available to continue coverage for a family unit that includes same-sex spouses, civil union partners, and non-dependent children who are on extended coverage protection due to state law? The IRS simply states that the subsidy is only available for COBRA beneficiaries. Accordingly, the 65% credit may not cover the full continuation coverage cost of non-federal dependents. Employers run the risk of overpaying if they reimburse 65% of the family continuation cost when there are beneficiaries who are not federal COBRA beneficiaries.

At a March 24 webinar, IRS suggested that the disallowed portion of the subsidy should be determined according to an "incremental approach" using methodology of IRS Notice 2005-20. This is more favorable than the single premium approach it apparently favors for imputing taxes.

## Example

- Sally covers her children and former spouse, Tom. She loses her job and Tom has no access to other coverage. The COBRA cost for Sally and children is \$900 per month. There is no additional cost for Tom. A single policy costs \$600 per month.
- Under the incremental approach, there is no extra cost to cover Tom, so Sally may claim the 65% subsidy against the full \$900.
- Under the single premium approach, the cost of single coverage for Tom would not be eligible for the subsidy. Sally would then be able to treat only \$300 as eligible for the subsidy.

## More to Come

We will continue to monitor any new COBRA changes and update you accordingly. This summary is an overview of immediate and important changes as a result of the recently enacted federal stimulus package. As always, employers are advised to review their procedures with counsel and make the necessary changes consistent with the new rules.

## CONTACT

If you have any questions regarding this Client Alert, please contact [George L. Chimento](#), the author, or a [Davis Malm employment attorney](#).

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One Boston Place, Boston, Massachusetts 02108 | phone 617.367.2500 | fax 617.523.6215 | [info@davismalm.com](mailto:info@davismalm.com)  
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