



April Fool! The new COBRA rules

Updating my earlier article, "March Madness, COBRA Style"

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1 Overview

- The American Recovery and Reinvestment Act of 2009 ("ARRA") includes COBRA help for Assistance Eligible Individuals ("AEIs").
- AEIs are employees who acquire rights to COBRA coverage due to "Involuntary Termination" during the period from September 1, 2008 through December 31, 2009. COBRA beneficiaries at the time of the Involuntary Termination are also considered AEIs, but only if they are not already on COBRA for another reason (like divorce). Children born or adopted after the Involuntary Termination are AEIs.
- AEIs will only have to pay 35% of their COBRA costs for Periods of Coverage starting after February 16, 2009. The subsidy can last for up to nine months.
 - For persons collecting unemployment assistance in MA, the State will reimburse 80% of the 35%, bringing COBRA cost down to 7% for AEIs who earn as much as 4 x the Federal poverty level. See Part 4.
- Periods of Coverage are COBRA billing periods. For the typical plan, the Period of Coverage is a calendar month, so ARRA-COBRA rights are generally not available prior to March 1, 2009.
 - Employers who bill for COBRA for the "stub period" following termination, or who bill based on monthly anniversaries of termination, could have a start date for ARRA-COBRA as early as February 17, 2009. See Part 3.
- Employers must collect 35% from the AEIs and advance the remaining 65% so that the insurer gets the necessary premium. After forwarding the full premium, the employer then may claim a credit for its 65% advance against its payroll taxes, and report this on a quarterly 941 Form, which IRS has revised for this purpose. Employers with self insured plans are deemed to pay the 65% if they provide coverage and collect the 35%.
- No subsidy is allowed after the AEI becomes eligible for other group coverage or Medicare (even if the coverage is not taken). If the other group coverage is not major medical, it will not disqualify the AEI from use of the subsidy. Losing rights to the subsidy does not cancel the right to continued COBRA, provided that the other coverage is not actually taken and that COBRA premiums are paid on time.
- Subsidies are available for vision, dental, and counseling plans. Subsidies are also available for employee-paid "mini-med" plans, employer funded HRAs, and retiree health coverage (if comparable to coverage provided to active employees). Subsidies are not available for section 125 flex-accounts or HRAs that are employee-funded and provide benefits less than 5 x the employee contribution rate.
- "Involuntarily terminated" does not just mean getting fired. It includes resignations because of "material negative changes in the workplace," non-

- renewals of contracts of people who would like to keep working, "voluntary" terminations in situations where an employee reasonably thought he would otherwise have been fired, layoffs (even if there are recall rights), lockouts, window programs where it is clear terminations will follow if not enough subscribe, and terminations for cause (such as absenteeism).
- If COBRA is denied because Involuntary Termination was for "gross misconduct," there are no rights under ARRA for anyone who would otherwise be an AEI.
 - AEs who dropped COBRA or who did not elect it have a "second chance" to enroll as of the first COBRA Period of Coverage starting on or after February 17, 2009 for the balance of the original COBRA period. This will be March 1, 2009 for plans with a billing cycle tied to calendar months.
 - High income AEs are not allowed to benefit from the subsidy. The subsidy rights start to phase out for modified adjusted gross income (line 37 on Form 1040, increased by certain foreign income) at \$125,000 (single and head of household) and \$250,000 (joint filers). The subsidy cannot be claimed at all when these levels reach \$145,000 and \$290,000.
 - The employer does not have to police this and it is perfectly legal for high income AEs to accept the subsidy, provided they pay it back when they file their income tax returns. High income AEs can also waive the subsidy permanently and pay the full COBRA cost.
 - Employers with various levels of coverage may allow, but are not required to allow, AEs to "trade down" to lower levels of major medical coverage within 90 days of getting their ARRA-COBRA Notices. Of course, during normal open enrollment periods, trading down (or trading up) must be allowed under general COBRA rules if active participants have those rights.
 - Subsidies are always allowed for trade-downs. IRS unofficially has said that subsidies for trade-ups will be permitted if the trade-up occurs during an open enrollment period available to active employees.
 - Employers who subsidize COBRA in severance and window arrangements may be wasting money, because the 65% credit only applies to the share the AEI is required to pay. Extensions of the normal 18 month COBRA period in severance arrangements creates additional issues, as described in Part 10.
 - DOL has prepared model Notice and form kits that describe ARRA. Links to the Forms, and a discussion of the distribution requirements, appears in Part 9.
 - ARRA-COBRA affects small employers and individuals covered by state mini-COBRA laws. See Part 13.

MORE DETAIL (references to Q&As are to new IRS [Notice 2009-27](#).)

2 What is an Involuntary Termination?

The new ARRA-COBRA rights -- to pay just 35%, and to opt for "second chance" enrollment -- stem from whether an "Involuntary Termination" has occurred.

The IRS interpretation of Involuntary Termination (Q&As 1-9) includes:

- resignations for good reason because of employer action that causes a "material negative change in the workplace"
- terminations for cause (such as absenteeism)
- non-renewals of contracts of people who would like to keep working
- "voluntary" terminations in situations where an employee reasonably thought he would otherwise have been fired
- employee acceptance of a window program, where it is clear terminations will follow if not enough subscribe.
- layoffs (even if there are recall rights)
- lockouts
- terminations by an employer while the employee is sick or disabled

What about a reduction in hours? Even if it causes a loss in health benefits, a reduction in hours is not an Involuntary Termination. However, if the employee quits due to a reduction in hours, that is an "Involuntary Termination" because the quit is in response to a "material negative change in the workplace."

What about a call to active duty? IRS spokespersons at an April 6 webinar changed positions. They believe this would be an Involuntary Termination.

What about a failure to return after FMLA leave? If the employer initiates the termination, it's an Involuntary Termination. If the employer stopped health insurance first, IRS spokespersons at an April 6 webinar believe the subsequent involuntary termination does not trigger subsidy rights.

What about a termination for gross misconduct? That is also an "Involuntary Termination." An employer may refuse to offer COBRA if a termination is for gross misconduct. If it does that, there are no subsidy or second enrollment rights under ARRA, because the AEI must have COBRA rights to have the ARRA rights.

GC note: Court cases make it so hard to establish gross misconduct that most employers don't hold back COBRA, even for their worst former employees. If COBRA is permitted, an Involuntary Termination for gross misconduct will not disqualify AEIs from the ARRA rights.
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3 What is a Period of Coverage?

This is the key definition, along with Involuntary Termination, for an understanding of COBRA rights added by ARRA.

A Period of Coverage is the one month (or shorter) period for which an AEI is billed for COBRA. Q&A 30. COBRA bills are usually based on full calendar months of coverage, so full calendar months will be the typical "Period of Coverage." However, if a plan bases its billing on monthly anniversaries of the COBRA event, the span between the monthly anniversary dates will be the Period of Coverage.

Most employees don't neatly time their terminations for the last day of the month, so there is often a "stub period" in the month of termination (i.e. from the termination date to the end of the month). Some plans charge for the stub period; others do not. If a plan charges for the stub period, the stub period is considered a full Period of Coverage under ARRA-COBRA, even if it is only one day. If a plan does not charge for the stub period, the first Period of Coverage will be the following month. Q&A 32.

Why is this trivia so important? Keep reading, and refer back to this Part. If you do not understand "Periods of Coverage," you will goof when you administer ARRA-COBRA. Remember:

1. For plans that base COBRA billings on full calendar months, each month following the termination is a Period of Coverage. The stub period in the month of termination is not a Period of Coverage unless the AEI is charged for it.
2. For plans that base billing on monthly anniversaries of the COBRA event, the spans between the monthly anniversary dates will be the Periods of Coverage.

4 65% COBRA subsidy rights

A 65% federal subsidy makes it possible for AEIs to pay only 35% of "COBRA cost." The "COBRA cost" is the amount the AEI is expected to pay for the coverage, including any 2% administrative surcharge and any 50% disability surcharge. The 65% subsidy is tax-free except for "high income" people and is not considered income for welfare entitlements.

Subsidies are available for vision, dental, and counseling plans. Subsidies are also available for employee-paid "mini-med" plans, employer funded HRAs, and retiree health coverage (if comparable to coverage provided to active employees). Subsidies are not available for section 125 flex-accounts or HRAs that are employee-funded and provide benefits less than 5 x the employee contribution rate. Q&A 27.

GC Note: at an IRS webinar on March 24, IRS spokespersons suggested that the subsidy would also apply to normal rate increases. In addition, if coverage changed during regular open enrollment periods available to active employees, IRS suggested (unofficially) that the subsidy would apply to the new premium level. This is still not clear.

An employer gets no credit if it kicks in its own money to further subsidize the COBRA cost. Q&A 20. That's why the design of severance and window plans should be immediately reviewed, as discussed in Part 10.

EXAMPLE

Employer's window program subsidizes \$700 of a \$1000 COBRA bill. The AEI "COBRA cost" for subsidy calculations is \$300 (\$1,000 less \$700). The AEI pays \$105 (35% of \$300) and the employer advances \$195 (65% of \$300). The employer gets no credit for the additional \$700 it subsidizes through the window program.

GC Note for MA: Persons collecting unemployment in MA have always been able to get up to 80% of COBRA costs reimbursed through the State's Medical Security Program. The State has recently decided it will reimburse 80% of the 35% COBRA cost which the AEI must pay. That drives the unemployed employee's cost for COBRA down to 7%. The AEI must be collecting unemployment and must be low income (less than 2x Federal poverty level, although income as high as 4X the poverty level is OK if high expenses are documented for DUA). Clearly, this is not just for the impoverished. At 4 X the federal poverty level, an AEI with a family of 4 can earn \$88,200 and qualify. The income test is based on the prior 6 months and an estimate for the next 6 months. [More information about the program is at the DUA website](#). The employee's right to reimbursement under this program does not affect the calculation of the federal subsidy or the employer credit.

Key limitations

1. ARRA subsidy rights do not apply to Periods of Coverage starting prior to February 17, 2009. Q&A 30.

GC Note: For Plans that bill based on complete calendar months, the first Period of Coverage will be the following month. However, if the Plan bills for the "stub period" during the termination month, the stub period is the First Period of Coverage, so terminations in the period from February 17 through February 27 will have an earlier subsidy starting date than March 1.

2. The ARRA subsidy can last for as long as nine calendar months, starting with the 1st of the month of the first Period of Coverage. As pointed out in Part 3, if an employee is charged for the stub period following a termination of employment, the stub period, which is shorter than a full month, is considered a Period of Coverage, which seems a little unfair for those terminated near the end of a month. Q&A 33.

GC Note: An IRS spokesperson at an April 6 webinar said they might want to change this unfair result, so that everyone can get a full nine months of subsidy.

3. The subsidy stops if the AEI becomes eligible for other group coverage or Medicare.

GC Note: 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.

4. ARRA subsidy rights do not apply if an AEI does not have at least one Period of Coverage starting before January 1, 2010. Q&A 30.

GC Note: If a plan bills for complete months after termination and does not charge for the stub period in the termination month, a person terminated during December, 2009 cannot be an AEI because his first Period of Coverage starts after December 31, 2009. However, if the plan charges for the stub period, a person terminated in December will be an AEI because he will have a Period of Coverage that starts before January 1, 2010.

In an April 6 webinar, an IRS spokesperson acknowledged this rule might change.

EXAMPLE

Rick is terminated involuntarily on May 13, 2009. Because he terminated involuntarily in 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 could last for up to 9 months, i.e. until February 28, 2010.

If Rick was charged for the stub period from May 13 – May 31, the subsidy applies to the premium for the stub period. Unfortunately, the nine months of potential subsidy would then end on January 31, 2010 unless IRS changes rules to allow a full nine months for AEIs who have an initial "short" Period of Coverage.

Rick's 65% subsidy will stop earlier if he becomes eligible for other group coverage, such as through a spouse's plan or Medicare, and even if he does not accept that coverage. He can still continue with COBRA (unless he accepts the other coverage), but must now pay the full cost.

EXAMPLE

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.

Finally, the Trade Act of 2002 allowed "Trade Adjustment Assistance Eligible Individuals" to get a 65% Health Coverage Tax Credit towards COBRA costs. ARRA increases this to 80% for coverage prior to January 1, 2011 and extends the duration of COBRA for participants collecting or entitled to collect from PBGC. A person may not claim this 80% credit and also use the 65% ARRA-COBRA subsidy. The Health Coverage Tax Credit Customer Contact Center has a toll-free hotline at 1.866.628.4282.

5 No benefit for high-income AEs

"High income" people do not get the benefit of the subsidy. They must increase their taxable income for the year in which the subsidy was received by the amount of the disallowed subsidy.

The "high income" test is whether the person's MAGI (modified adjusted gross income) exceeds certain limits. 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 and head of household 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.

GC Note: The employer does not have to police this and it is perfectly legal for high income AEs to accept the subsidy, provided they pay it back when they file their income tax returns.
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High income AEs can also waive the subsidy permanently and pay the full COBRA cost. A high income AEI does this by filing a signed and dated election with the employer (or the insurer if the plan is under mini-COBRA) and marking it "permanent waiver." No filing with the government is necessary. Q&A 46.

GC Note: Permanent waiver is inadvisable except for the very wealthy. It might be helpful to have the subsidy available in 2010, even if it cannot be used in 2009.

EXAMPLE

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. Alternatively, Sybil can file a permanent waiver of the subsidy with the employer.

6 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 or mailed or faxed as indicated in the instructions. A hotline is available for pre-filing questions (1-866-444-3272).

7 "Second chance" enrollment rights

ARRA gives a second chance to AEIs who lost coverage before February 17, 2009, either because they dropped COBRA or did not elect it.

The first COBRA Period of Coverage starting after February 16, 2009 is the "second chance" new enrollment date. That will be March 1, 2009 for plans that bill based on completed months. Q&A 48. However, for a plan that bills on monthly anniversary dates of a termination, it could be a date in the period February 17 through February 28, 2009 for AEIs terminated in the latter half of a month. Q&A 49.

Second chance COBRA coverage will last for the balance of the COBRA period 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 he does not pay timely premiums.

The period between the Involuntary Termination and the "second chance" enrollment date 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

Bill is an AEI who was terminated involuntarily on November 18, 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's employer customarily bills for COBRA based on full calendar months, so Rick's "second chance" enrollment date is March 1, 2009, the first day of the Period of Coverage starting after February 16, 2009.

Rick has 60 days from April 18 to make his decision. He has 45 days after making the election to catch up on premiums for the coverage since March 1 (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. It will last until November 30, 2009 if the plan does not charge for the stub period in the month of termination.

During that period, the subsidy is available for coverage through the nine months ending November 30, 2009. He loses the subsidy if he becomes eligible for other major medical group coverage. Losing the subsidy does not require that he lose the balance of his "second chance" coverage. He can continue that, at full cost without a subsidy, unless he loses it under normal COBRA rules, i.e. he does not pay premiums on time, or he actually accepts other group coverage or he becomes entitled to Medicare, by filing for it or starting Social Security.

8 Recapturing the Employer advance

To recapture the 65% advance, the Employer must follow the IRS rules, which appear in [Notice 2009-27](#), and in Q&As on the [IRS website](#).

- The employer must have collected the 35% from the AEI (or a third party, such as a parent paying for family coverage). Employees who take advantage of the liberal COBRA grace periods delay the employer's recovery of the amounts it must advance.
- If the employee's payment is "pre-tax", (i.e. through a 125 plan) it does not count as an "employee contribution" and the employer may not claim the subsidy credit.
- The employer must have paid the full premium to the carrier (or provided the coverage if the plan is self insured).
- It is not necessary to wait for the filing of the 941 to offset the taxes against payroll tax deposits. There is detailed guidance at [this IRS Form Preparation web page](#).
- The employer will report the 65% payments it has advanced and the payroll tax offset on Form 941, which IRS has revised to accommodate this.

GC note: An employer must claim subsidy credits for a year no later than the 941 filing for the final quarter of the year.
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The employer must keep important data in case it is audited, such as attestations that the termination was involuntary and that alternate coverage is not available to the AEI. 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 which the IRS wants.

If the employer keep the forms, the remaining data is not overwhelming: (i) in the case of an insured plan, a 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, (iii) a record of the SSN's 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 FUTA? 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](#).

9 New Department of Labor ("DOL") model COBRA notices and forms

DOL has prepared three kits for employers under Federal COBRA, each with model Notices and election forms for employer use. The [DOL website guidance is at this link](#) (with links to the forms in WORD format). Customization is allowed, but you will not need much because the forms and notices are already pretty good.

Full General Notice kit. This new General Notice kit is meant for all COBRA beneficiaries 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 who receive the Extended Election Period Notice described below.

GC 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. For plans where the Plan Administrator is different than the employer, the employer notifies the plan administrator within 14 days and the plan administrator notifies the COBRA beneficiaries within the following 30 days.

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.

GC Note: Even though DOL does not say this, treat April 18, 2009 as the deadline to distribute the Abbreviated General Notice. The present DOL view is to send this to all persons currently on COBRA for any type of event (not just involuntary termination) 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 the first Periods of Coverage starting after February 16, 2009 and also advises about the subsidy.

GC Note: On its website and at webinars, DOL has backed away from a [March 20 Notice in the Federal Register](#) which said that all persons who have experienced any type of COBRA event since September 1, 2008 have to get a notice about ARRA or their previously delivered COBRA notice is incomplete.

Example

Joe quit on Sept. 2, 2008 because he accepted a new job. He and his family got pre-ARRA COBRA notices before February 17, 2009 and declined COBRA. They get no additional notices. A conservative employer will send notices anyway because of the IRS view that many "quits" may be disguised "Involuntary Terminations."

if Joe quit after a material negative change in employment, or with knowledge that he would otherwise be laid off or fired, he would be an AEI due to an "Involuntary Termination." Joe and his COBRA beneficiaries should then get the Extended Period Election Notice by April 18, 2009.

Example

Sally died on Oct. 5, 2008. Her family got pre-ARRA COBRA notices before February 17, 2009 and declined COBRA. They get no additional notices. (Death is not an Involuntary Termination, per IRS. Q&A 19.)

Example

Pete quit on Nov. 1, 2008. He elected COBRA and is still on it as of Feb. 17, 2009. He gets the Abbreviated Notice, even though he would not be an AEI.

Example

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. If he was on COBRA, he would get the Abbreviated Notice.

Example

Pete's hours were cut back on Oct. 1, 2008 but he remained employed and is therefore not an AEI. However, 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. This does not entitle him to the subsidy because only AEIs get a subsidy. If he wants COBRA, he must take it as of October 1, 2008 under the normal COBRA rules.

Example (thanks, Louise)

Hi George,

I am getting my letters out! Just a couple of quick verifications from your e-mail:

It looks like Dental is also included as being ARRA eligible. For example, I have one AEI employee who took the COBRA Health but did not elect the Dental, therefore, I am sending two types of letters:

1. Abbreviated General Notice to offer the 35% for COBRA Health.
2. A "Second Chance" notice to offer COBRA for the Dental he did not elect.

Please confirm that I am understanding this correctly.

Thanks, Louise

GC Note: Smart clients help us lawyers to seem smart.

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 want COBRA? If "second chance" enrollment rights are available, does he want them? If he is eligible for the 65% subsidy, does he claim rights to it?

GC Note: An AEI must verify that the termination was involuntarily and that he or she is not eligible for other coverage. AEIs are warned that if they become eligible for other coverage, they must report that to the employer and that a 110% penalty applies if they accept subsidies when ineligible.

10 Paid severance and window programs

Why pay what the government will pay?

No credit may be claimed for anything which the employer subsidizes. Q&A 20. Severance and window plans should be redesigned to pay taxable cash rather than employer-paid coverage.

Examples of paying what the government would pay

Assume that monthly COBRA costs \$1,000 and the employer agrees to pay the first month of COBRA. The employer will spend \$1,000 and get no credit because it subsidized COBRA and the AEI paid nothing.

Assume that monthly COBRA costs \$1,000 and the employer agrees to pay \$600 in the first month. For ARRA-COBRA calculations, the COBRA cost is considered to be \$400, not \$1,000. The employer must advance 65% of \$400 and may claim only \$260 as a credit on its payroll taxes. The AEI pays 35% of \$400. There is no credit for the \$600 subsidy spent by the employer.

That's pretty clumsy. Isn't it smarter for the employer to require an AEI to pay all of COBRA, and to add in a taxable severance payment? The employee now has enough money, after taxes, to pay 35% of full COBRA cost. The employer also gets a payroll tax credit for the 65% it covers.

Example

Assume that monthly COBRA costs \$1,000 and the employer does not subsidize it. Instead, the employer pays the former employee a taxable \$500 severance payment, which is enough, after taxes, to cover 35% of the full COBRA cost. The employer has saved \$500, because it is not providing a subsidy, just a 65% advance of COBRA costs, and it can recover a 65% advance.

In fact, if the employer was willing to pay the full \$1,000 anyway, it could pay that as a taxable severance payment, giving the AEI a much better deal than fully paid COBRA, because the employee only has to pay \$350 for ARRA-COBRA (provided he or she is not eligible for other coverage).

Won't the government get upset? Apparently not. As long as the employee is taxed on the severance payment, it is not taken into account when the 65% credit is calculated. Q&A 14.

Is it that simple just to pay taxable cash instead of covering the premium? That depends. Some terminated employees may not qualify for the 65% credit because they have access to another plan, but would prefer to stay on COBRA. In that event, they will just have some taxable cash and will have to pay the full premium, unless the arrangement is customized for individual circumstances, and few employers want to do that.

The tricky question is what to do if the AEI is a high income person whose income will probably require that he give back the subsidy. For those severance agreements, it will be best just to design the severance without regard to the subsidy. However, for terminations later in 2009, when the nine months of subsidy potentially spills over to 2010, the design of taxable cash rather than employer payment of health insurance makes sense for AEIs who might not have high income in 2010.

Example

Executive Jack will resign to “pursue other opportunities” and it’s clear this is a graceful form of Involuntary Termination. He is an AEI, files jointly, and his severance and other 2009 income exceeds \$290,000, so the subsidy is worthless to Jack in 2009.

However, Jack’s 2010 income will be significantly less unless he lands another position. If his resignation occurs later in the year, so that a substantial portion of the subsidy will occur in 2010, he and the employer may want to structure the arrangement so that he receives taxable cash in 2010 rather than employer-paid coverage. One approach would be to provide fully paid coverage in 2009, and employee-paid coverage after that, with a taxable severance payment thrown in for 2010.

GC Note: don’t fool around with giving people choices between taxable cash and paid insurance unless you have read the 409A regulations and understand them. A discussion of 409A and the still lively “constructive receipt” doctrine is beyond the scope of this article.

Severance arrangements with employer-paid coverage for more than 18 months

Some employers pay some or all of the costs and count these paid months towards the 18 month COBRA requirement.

Other employers who subsidize post-termination insurance do not count the subsidy months as part of COBRA, and tack on a full 18 months of regular COBRA after the subsidized period ends. (If not self-insured, they need the cooperation of their insurer to do this.)

According to Q&A20 of [Notice 2009-27](#):

1. The ARRA-COBRA subsidy applies to the first 9 continuation periods if the 18 month COBRA term is not extended.
2. If the 18 month period is extended, Continuation Periods prior to the start of the last 18 months will not be counted towards the ARRA-COBRA subsidy.

Example

Widget Co. pays for the first three months of COBRA, but does not extend the 18 month COBRA period (probably because its insurance company will not allow that). The first three subsidized months are counted as part of the nine-permitted Continuation Periods for the subsidy. Essentially, the employer has wasted money in the first three months, because there is no subsidy when the employer’s share is ZERO. This also uses up three months of the subsidy, so the AEI will have only six remaining Continuation Periods for the subsidy. Q&A 20, Example 2.

Example

Widget Co. pays for the first three months of COBRA. After that, it has persuaded the insurer to allow 18 months of COBRA at full employee cost. The nine month subsidy DOES NOT apply to the first three months because the first three months are not part of COBRA in this arrangement. After the first three months, the ARRA-COBRA subsidy applies to months four through twelve. Q&A 20, Examples 3 & 4.

11 "Trade-down," billing transition, and multiple subsidies

"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 plan that is not a major medical plan, such as a stand-alone dental, vision, or counseling plan, or a Section 125 reimbursement account or on-site facility that is primarily for first aid, or.

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.

GC Note: At a March 24 webinar, IRS spokespersons suggested that if "trade-up" occurs during an open enrollment period applicable to others, that the subsidy will probably apply to the increased premium.

Billing transition

For those AEIs who are already getting COBRA, it's likely that COBRA bills to them 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.

Multiple subsidies

It's possible for a person to be an AEI more than once. The nine months of maximum subsidy is not a lifetime cap.

Example

John was terminated on March 1, 2009. He qualified for the subsidy as an AEI. On September 1, 2009, he gets a new job with health insurance after six months of subsidy. He drops COBRA with his former employer and signs up for the new plan, but is terminated in October, 2009. He is entitled to up to nine months of subsidy from the plan of his new employer.

12 Non-federal dependents.

The statute provides a 65% subsidy for COBRA coverage related to AEIs.

Is the full 65% subsidy available 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? IRS says "NO." The subsidy is only available for heterosexual spouses and dependent children "under Federal law" at the time of the Involuntary Termination. Q&A 23. Children born or adopted after the termination are also eligible for the subsidy.

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. In Q&A 24, IRS confirmed that the disallowed portion of the subsidy should be determined according to an "incremental approach" using methodology of IRS Notice 2005-20.

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.

GC Note: This is different than the single premium approach IRS apparently favors for imputing taxes for health insurance. What a mess.

13 State mini-COBRA laws

Federal COBRA does not apply to the smallest employers, those with fewer than 20 employees in the previous year. Many states (including MA, NH, and RI) have accordingly adopted Mini-COBRA statutes. Policies issued in those states provide rights which are essentially the same as Federal COBRA.

ARRA-COBRA gives AEIs the same 65% subsidy rights as if they were covered by Federal COBRA. However, mini-COBRA employers do not have to advance 65% and

claim a credit against payroll taxes. Instead, they just forward the 35% collected from the AEI and the insurance company provides coverage and takes a 65% credit against its payroll taxes.

ARRA-COBRA makes "second chance" enrollment optional for state mini-COBRA laws.

GC Note: NH has already added "second chance" enrollment, and we expect RI to follow. I am told (but have not verified) that pending proposals in MA would not require "second chance" elections for mini-COBRA, creating a major difference between MA mini-COBRA and Federal COBRA. This would be surprising if MA does not require "second chance" elections.

There are other unresolved and important mini-COBRA issues.

1. In mini-COBRA states, there is still confusion about distribution of ARRA mini-COBRA Notices and forms. ARRA-COBRA was patterned on mini-COBRA statutes where the insurer distributes the forms and collects the premiums. In many states (like MA) it is legal for the insurer to delegate the notice and form distribution duties to the employer. Collecting premiums is also delegated to employers.
2. The model forms prepared by DOL were drafted as if the insurer was distributing them. At a minimum, mini-COBRA insurers must tailor them for their small employer customers.
3. In Massachusetts, a MA employer with 20 or more employees in 2008 will be under Federal COBRA, even if its employee count in 2009 drops below 20. MA mini-COBRA bases its 19 or less head count on the current year, so what does an employer do if the head count from 2008 to 2009 has shrunk below 20? In the past, that would not have been a problem, because a savings clause in the MA mini-COBRA statute always imports federal law if it provides better rights. However, there has to be guidance for shrinking small employers as to who advances the 65% and who claims the payroll tax credit. Is it the employer (Federal COBRA) or the insurer (mini-COBRA)? Are the second chance enrollment rights required (Federal COBRA) or optional with the state (Mini-COBRA)?

The bottom line is that small employers need help from their carriers, who have understandably been slow off the mark to comprehend what they have to do under this hastily drafted law with its immediately effective dates.

14 Conclusion

ARRA-COBRA is a typical well-meaning effort from Washington which shows ZERO consideration for employers, many of whom are struggling to stay in business. Most will comply, or try to comply, but the expense and aggravation of this law and others, like the new ADA rules that essentially characterize every worker as disabled in some form or other, simply drives home an unfortunate point. Washington has too many people writing rules for the workplace, and they unwittingly have made every employee a potential liability. Only the governments and the largest employers have the resources to handle this pell-mell barrage of new laws and new regulations.

Consider. This little COBRA “subsidy” has engendered an IRS Notice with 58 Q&As, IRS web pages, a one inch thick packet of model forms from DOL with immediate deadlines, and a robust DOL web page that changes weekly. For this little law, guidance is also required from state governments and insurers. The potential fines and the compliance burden are just not appropriate for a country that should be encouraging job growth.

Sorry for the preaching. I’ve written this tome for those who want to keep up. I hope it helps.

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