

DÉJÀ VU ALL OVER AGAIN: COBRA SUBSIDY PROVISIONS REQUIRE IMMEDIATE ATTENTION

Legislation enacted on March 2, 2010 extends the time to qualify for the COBRA subsidy from February 28, 2010 to March 31, 2010. While requiring immediate attention, this short extension is straightforward, and will cause few compliance headaches. No special notice of this change is required for existing COBRA participants. In most situations, all it does is extend the COBRA subsidy to those whose involuntary termination of employment occurs during March 2010, provided other conditions for receiving the subsidy are met.

CAVEAT

Congress is considering legislation that would further extend the time to qualify for the subsidy, so references to March 31 as a cut-off date should be read in light of that possibility.

There's More to It Than Just an Extension

Unfortunately, the March 2 legislation (the Temporary Extension Act of 2010 or TEA) also included several changes besides the extension. Those include a provision making the COBRA subsidy available to individuals who lose coverage due to an employee's reduction of hours if the employee is later involuntarily terminated from the reduced-schedule employment. This change carries a new notice requirement and, if past DOL guidance is an indicator, it also may necessitate extensive revisions to election notices issued on or after March 2. Besides adding a new group of potential subsidy recipients, the TEA imposes a new penalty, adopts a reasonable interpretation standard for employers' involuntary termination decisions, and adjusts some existing COBRA subsidy rules.

BACKGROUND

The COBRA subsidy program was first enacted in February 2009 and generally applies to individuals who, among other things, have COBRA coverage because of an involuntary termination of employment. For assistance eligible individuals, the program requires health plans to accept 35% of the required COBRA premium as full payment for the coverage. After receiving the 35% payment, the employer maintaining the group health plan may recover the remaining 65% of the COBRA premium through offsets to payroll tax deposits or direct payment from the government.

REDUCTION OF HOURS IS NOT TERMINATION OF EMPLOYMENT

When the COBRA subsidy was first enacted, many speculated that those losing coverage due to an involuntary reduction of hours would be eligible for the COBRA subsidy. (Like termination of employment, a reduction in hours is a COBRA qualifying event if it results in loss of coverage.) IRS guidance clarified that a reduction of hours, by itself, is not termination of employment, and the COBRA subsidy would not apply to those losing coverage due to the reduction, even if it was involuntary. The guidance also noted, however, that a reduction in hours could affect availability of the subsidy in other ways.

- If the reduction of hours effectively ends employment (i.e., it leaves the employee with zero hours of employment), then it is a termination of employment and the subsidy will apply if the reduction is involuntary and causes loss of coverage. For example, an involuntary lay-off, furlough or other suspension of employment will qualify as involuntary termination.

The logo for Willis, featuring the word "Willis" in a white, serif font on a dark blue background.

- If a reduction in hours to zero is due to illness or disability, the reduction is not, by itself, termination of employment. If, however, the employer takes action to end the absentee's employment status, that action will be an involuntary termination of employment.
- Resignation in response to a material employer-imposed reduction of hours is involuntary termination. If the employee continues to work for the employer after the reduction, however, the subsidy will not apply.

Under the rules in effect before March 2, 2010, an individual who lost coverage due to a reduction in hours would not be entitled to the COBRA subsidy, but would be entitled to elect COBRA. A later involuntary termination of employment would not make the COBRA subsidy available.

- If the individual elected COBRA following the reduction of hours qualifying event and the employee working the reduced schedule were later involuntarily terminated, the COBRA subsidy would remain unavailable because the qualifying event was the reduction of hours – not the later termination of employment.
- If the individual who lost coverage due to the reduction of hours did not elect COBRA (or elected and then lost it), the later involuntary termination of employment would not be a qualifying event because the individual had already lost coverage due to the reduction in hours and did not lose coverage due to the involuntary termination.

The TEA addresses situations like these, making the COBRA subsidy available in some cases.

Reduction of Hours Gets More Complicated

Under the TEA, a reduction of hours still is not a termination of employment; the TEA does not extend the COBRA subsidy to an individual based solely on a reduction of hours. In addition, the TEA does not change any of the previous guidance regarding the effect of a reduction of hours. If, however, a reduction of hours qualifying event is followed by an involuntary termination of employment, the TEA provides that the COBRA subsidy may become available.

New Definition of Assistance Eligible Individuals

With the change made by the TEA, the assistance eligible individuals who may receive the COBRA subsidy are those who:

- Elect COBRA coverage that is available to them because of a qualifying event that occurs during the period starting on September 1, 2008 and ending with March 31, 2010
- But only if the qualifying event consists of either:
 - Involuntary termination of employment
 - Reduction in hours of employment, provided that the reduction in hours is followed by an involuntary termination of employment that occurs during the period starting on March 2, 2010 and ending with March 31, 2010

EXAMPLE

In order to preserve as many jobs as possible, ABC Company has reduced some employees' hours. Effective January 1, 2010 ABC reduced Terry's hours and she lost eligibility for health coverage under ABC's plan. ABC offered and Terry elected COBRA coverage following her reduction of hours qualifying event. Terry continued to work for ABC, and did not qualify for the COBRA subsidy because no termination of employment had occurred. She paid the full COBRA premium for coverage during January, February and March and still had COBRA coverage in effect on March 5, 2010 when ABC terminated her employment.

Terry's involuntary termination of employment made her eligible to receive the COBRA subsidy for up to 15 months. Because ABC's plan collects COBRA premiums on a calendar month basis, with all payments due on the first of the month, it appears that Terry's first reduced premium payment will be the one due on April 1, 2010, and that will start the maximum 15-month subsidy period. Terry's 18-month maximum COBRA coverage period will still be measured from the date of her reduction of hours qualifying event, January 1, 2010.

It appears that the reduction of hours need not be involuntary for an individual to qualify as an assistance eligible individual based on a later involuntary termination of employment.

Another COBRA Notice Requirement

Employers are required to notify COBRA participants who may qualify for the subsidy under this new rule within 60 days after the involuntary termination of employment. It is expected that the DOL will issue a model notice for this purpose. If the DOL's extends its previous COBRA subsidy guidance to this situation, employers will be required to provide this notice whenever an employee terminates employment – whether voluntarily or involuntarily – if that employee has had a reduction of hours qualifying event.

A SECOND-CHANCE ELECTION OPPORTUNITY

If an individual who was entitled to elect COBRA following a reduction in hours qualifying event does not elect (or elects and then loses) COBRA coverage, there would be no coverage to apply the COBRA subsidy to at the time of a later involuntary termination of employment. To preserve such individuals' ability to receive the COBRA subsidy, the TEA provides a second-chance COBRA election. For this election opportunity to apply, the reduction of hours qualifying event must occur during the period starting on September 1, 2008 and ending with March 31, 2010 and the later involuntary termination must occur on or after March 2, 2010 and no later than March 31, 2010.

Effective Date of Second-Chance Election

COBRA coverage elected under the second chance provision is not retroactive to the date of the original qualifying event – it becomes effective with the first period of coverage beginning on or after the involuntary termination of employment. Because an individual who makes a second-chance election does not have coverage in effect at the time of the involuntary termination, it is unclear whether the first period of coverage begins on the termination date or on some later date. In the case of a plan that collects COBRA premiums on a calendar month basis, with all payments due on the first of the month, it seems likely that the first period of coverage would begin April 1, 2010 for involuntary terminations occurring during March 2010. The COBRA subsidy would also begin on that date and could continue for up to 15 months. Any gap in coverage for those who make the second-chance election would be disregarded for purposes of applying a preexisting condition exclusion.

Even though the effective date of COBRA coverage would not be retroactive to the original qualifying event, the COBRA period of coverage (generally 18 months) would continue to be measured from the date of the reduction of hours qualifying event. Availability of the subsidy would do nothing to extend the maximum COBRA coverage period. If an individual reached the end of his or her maximum COBRA coverage period, the subsidy would end along with the COBRA coverage, even if that results in receiving the subsidy for less than 15 months.

EXAMPLE

The XYZ Company health plan requires employees to work at least 30 hours per week to maintain eligibility. Tom, an XYZ employee, was reduced to 30 hours on October 1, 2009, and continued work for XYZ but dropped his son Mark from his coverage during open enrollment, effective November 1, 2009, to save on the premium. Effective December 1, 2009, XYZ had to make further cutbacks, and Tom's hours were cut to 25 per week. Tom and his wife Millie lost coverage under XYZ's health plan due to the reduction below 30 hours per week. XYZ offered COBRA to Tom and Millie as required, but Tom continued to work for XYZ, so neither Tom nor Millie qualified for the COBRA subsidy.

Tom did not elect COBRA but Millie did. She paid the full COBRA premium for coverage during December and January, but then could no longer afford it. Her COBRA coverage ended on January 31, 2010. Neither Tom nor Millie had COBRA coverage in effect on March 5, 2010 when XYZ terminated Tom's employment.

Both Tom and Millie are entitled to a second-chance election and, if they elect COBRA, they will be entitled to the subsidy. XYZ's plan collects COBRA premiums on a calendar month basis, with all payments due on the first of the month, so it appears that Tom and Millie's COBRA coverage and the COBRA subsidy would start on April 1, 2010. The subsidy could continue for up to 15 months from that date, while the COBRA coverage could continue until 18 months after the reduction in hours qualifying event date, December 1, 2009. Mark's coverage was dropped voluntarily November 1, 2009, before the reduction of hours qualifying event on December 1, 2009. He is not entitled to the second-chance election or the COBRA subsidy.

Offering the Second-Chance Election

When the second-chance election applies, a notice of this election opportunity must be provided within 60 days after the involuntary termination of employment. It is expected that the DOL will issue a model notice for this purpose and will direct that it only need be provided to individuals who:

- Lost coverage under the plan due to an employee's reduction of hours qualifying event
- Did not elect (or elected and then lost) COBRA coverage when it was offered due to the reduction of hours qualifying event
- Do not have COBRA coverage in effect when the employee's reduced-hours employment is involuntarily terminated

Identifying this group will be a problem for employers for several reasons, including the involuntary termination of employment requirement. It is not always clear which terminations are involuntary.

To address this, an employer may be overly inclusive when providing the required second-chance election notice, perhaps providing it whenever an employee who works less than full time terminates employment, even if the termination appears voluntary. The second-chance election notice provided to this overly inclusive group, however, should leave open the possibility that the recipient may not qualify for the second-chance election and indicate that the plan will make a determination about the recipient's eligibility for the second-chance election when and if the recipient responds. It is unlikely that the DOL's model notice will include such provisions.

REVISIONS TO ALL ELECTION NOTICES

In addition to the new notices required by the TEA, it is likely that employers will need to revise their COBRA election notices. Assuming that the DOL's previous guidance is an indicator, it is likely that all election notices provided on or after March 2, 2010 – regardless of the type of qualifying event – must include information on the availability of the subsidy as revised by the TEA and the second-chance election. Therefore, while the extension of the COBRA subsidy to March 31 requires only a small change to an election notice (substituting March 31 for February 28), the addition of the new group of assistance eligible individuals and a second-chance election for them is likely to require major revisions to a plan's election notices. In addition, the DOL may require that any election notices provided on or after March 2, 2010 be replaced and the election period restarted if information about the TEA changes was not provided. To avoid sending two election notices to one individual, employers may want to delay sending election notices until they determine, based on DOL guidance, what information now needs to be included in those notices.

CAVEAT

Employers should make sure that waiting for DOL guidance and model notices does not cause them to miss the legally required deadline for providing an individual's election notice.

NEW PENALTY FOR FAILING TO EXTEND SUBSIDY

Since its original enactment, the COBRA subsidy program has included an expedited appeal process. If an individual claims entitlement to the subsidy, but the group health plan refuses to provide it, the individual may appeal to the DOL (or, in some cases, the Department of Health & Human Services (HHS)) for a decision within 15 business days. The TEA makes two changes in connection with this appeal program:

- Clarification that the DOL or HHS, as applicable, or an affected individual may bring a civil action to enforce a determination that the subsidy should be provided
- Authorization for the DOL or HHS, as applicable, to assess a penalty up to \$110 per day against an employer if it fails to extend the subsidy within 10 days after receiving the agency's determination through the appeal program that the subsidy is required.

These new enforcement provisions apply in addition to other penalties available for COBRA violations under ERISA, the Internal Revenue Code and the Public Health Service Act.

PROTECTING EMPLOYER'S INTERPRETATION OF "INVOLUNTARY"

A key determination that employers must make when administering the COBRA subsidy is whether a termination of employment is involuntary. If an employer is generous, and decides all doubtful cases in favor of the subsidy applying, it may provide the subsidy to individuals who are not entitled to it because termination was voluntary. This, in turn, may result in the employer overstating the payroll tax reductions (or direct reimbursements) due to it for providing the COBRA subsidy as well as underpayment of payroll taxes. The possibility of substantial penalties for failure to deposit payroll taxes has caused concern that the IRS will second-guess an employer's decision that a termination was involuntary.

The TEA provides some assistance with this issue, providing that the IRS will defer to an employer's decision that a termination was involuntary if the employer's determination is:

- Reasonable
- Based on applicable law and administrative guidance
- Documented in writing, including an employer attestation that the termination was involuntary

OTHER ADJUSTMENTS TO THE COBRA SUBSIDY

There is a small change in how the maximum 15-month subsidy period is counted when COBRA coverage and the subsidy begin on a day other than the first of a calendar month. It is best explained by an example.

EXAMPLE

The LMN Company health plan terminates coverage immediately when an employee terminates employment. LMN terminated Tina's employment on March 10, 2010 and her health plan coverage ended the same day. The health plan offered COBRA coverage and Tina elected it and qualified for the COBRA subsidy. Tina's COBRA coverage, the COBRA subsidy, her maximum 15-month subsidy period, and her maximum 18-month COBRA coverage period all begin on March 10, 2010.

Although the LMN health plan generally collects COBRA premiums on a calendar month basis, with all payments due on the first of the month, it pro rates COBRA premiums when COBRA coverage begins or ends mid-month. Before the TEA amendments, the period from March 10 through March 31, 2010 would have counted as the first of Tina's maximum 15 months of COBRA subsidy, and her subsidy would have ended May 31, 2011. Now, the maximum 15-month period is counted starting on March 10, 2010 (the day that COBRA and the COBRA subsidy begin) and ends exactly 15 months later, on June 10, 2011. The LMN plan will need apply its pro ration formula to the June 2011 COBRA premium so that premium for June 1 to June 10, 2011 is treated as subsidized and the premium for the remainder of that month is treated as unsubsidized.

The TEA makes several other refinements and conforming changes to the statute. These changes are unlikely to affect administration of the COBRA subsidy. It is noteworthy that some of these changes appear to adopt previous DOL interpretations of the statute.

WHAT TO DO NOW

- If possible without missing the legally required deadline for providing an individual's COBRA election notice, delay sending election notices until it is determined, based on DOL guidance and model notices, what information now needs to be included in those notices. In any election notices that must be sent earlier, make sure that the "February 28" date is changed to "March 31" wherever it appears in reference to an involuntary termination of employment.
- Determine when the first coverage period after March 2, 2010 begins. The new assistance eligible individuals resulting from the reduction of hours rules and second-chance election will be entitled to have COBRA coverage and the subsidy begin on that date.
- Identify individuals who are currently receiving COBRA coverage due to a reduction of hours qualifying event and the covered employee whose reduced hours resulted in that COBRA coverage. If that employee remained employed on March 1, a later involuntary termination of employment may result in the COBRA subsidy applying.

- Identify individuals who previously were offered COBRA coverage due to a reduction of hours qualifying event but who do not currently have COBRA coverage, and identify the covered employee whose reduced hours resulted in that offer of COBRA coverage. If that employee remained employed on March 1, a later involuntary termination of employment may trigger a second-chance election and result in the COBRA subsidy applying.
- Contact third-party COBRA administrators (TPAs) to determine what steps they plan to take to implement the new provisions and whether they will provide the additional notifications to required recipients, as well as what information they will need from the employer to do so.
- Review the documentation retained in the employer's records for individuals who receive the subsidy. Make sure that it includes an explanation of the reasons for treating a particular termination as involuntary, as well as a statement that the employer has determined that the termination was involuntary which is signed by an appropriate employer representative (e.g., the manager that made the decision to terminate the employee).

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