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## **IRS Guidance Regarding Premium Assistance For COBRA Coverage**

### Executive Summary

The Internal Revenue Service ("IRS") recently issued Notice 2009-27 providing guidance for employers on the implementation of premium assistance for COBRA continuation coverage provided for under the American Recovery and Reinvestment Act of 2009 ("ARRA"). Since the enactment of ARRA, a variety of questions and issues have been raised regarding application of the new COBRA premium assistance/reduction requirements. In an effort to address a variety of these questions, the IRS guidance document is arranged in a question and answer format covering questions ranging from what is considered an "involuntary termination" to how to calculate the premium reduction. Below is a summary and overview of the information addressed in the guidance document.

### Detailed Analysis

#### **1. Involuntary Termination.**

For purposes of ARRA and eligibility for COBRA premium assistance, an individual's employment will be considered involuntarily terminated when the severance from employment is due to the unilateral authority of the employer. This includes situations in which an employer terminates an individual for cause. The one exception is that individuals who are terminated for gross misconduct are not eligible for COBRA, and thus not eligible for premium assistance.

Employees who resign for a good reason due to a material negative change in the employment relationship, *i.e.* a reduction in hours or a change in work location, will also be eligible for premium assistance. Additionally, if an employee elects to accept a severance package or retirement package in light of the possibility that his or her position is going to be eliminated, the employee will be eligible for premium assistance.

The term "involuntary termination" in general refers to an individual's separation from employment; not an involuntary termination of health care coverage. Therefore, instances in which an individual becomes eligible for COBRA coverage for reasons other than termination of employment, such as due to a divorce or a dependant child aging out of eligibility, the individual will not be eligible for premium assistance. To that end, COBRA eligibility resulting from absences due to illness or disability or resulting from the death of an employee does not qualify as an "involuntary termination."

Generally speaking, a determination regarding whether an employee's termination from employment is involuntary will be based on the facts and circumstances surrounding the termination. If an employee's employment will be terminated absent the employee's voluntary resignation and the employee is aware of this, then such resignation will be considered an involuntary termination.

## **2. Assistance Eligible Individual.**

An assistance eligible individual ("AEI") is a qualified beneficiary who is covered under the group health plan<sup>1</sup> on the day before the involuntary termination occurs. Therefore, individuals added to the health plan coverage after the involuntary termination occurs are not AEIs. The one exception is a child who is born or adopted during the COBRA continuation period following the involuntary termination will be considered an AEI.

In addition to being covered by the group health plan the day prior to the involuntary termination, in order to be an AEI, the involuntary termination and the loss of health insurance coverage both must occur between September 1, 2008 and December 31, 2009. If an employee's employment is involuntarily terminated prior to December 31, 2009, but an employer defers the employee's loss of coverage until after December 31<sup>st</sup> (as explained in more detail in the following paragraph), the terminated employee will not be an AEI.

If an employer continues an employee's health coverage following termination of employment and does not classify the continuation of health insurance coverage as COBRA coverage but instead treats it as a deferral of the loss of coverage, the employee as well as dependants covered prior to the involuntary termination will not be AEIs during the period of continued coverage because there has been no loss of health insurance coverage.<sup>2</sup> The employee and covered dependents will only become AEIs once they in fact are classified as having suffered a loss of coverage. If, however, an employer continues an employee's health insurance coverage following termination of employment, *i.e.* through a severance package, and classifies the continued coverage as COBRA, then the employee and his or her dependants who were covered by the plan prior to employee's termination of employment will be AEIs because they will have suffered a loss of coverage, even if the employer is paying for all or a portion of the premium.

Additionally, if an employee first becomes eligible for COBRA for a reason other than involuntary termination of employment, such as an employee's request to go part-time in which the reduction in hours does not constitute (and is not due to an anticipation of) an involuntary termination, the employee will not be an AEI even if his or her employment is later involuntarily terminated because the COBRA qualifying event was not an involuntary termination.

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<sup>1</sup>Generally, premium reduction is available for COBRA continuation coverage of group health plans except a flexible spending arrangement under section 106(c) of the Internal Revenue Code offered under a section 125 cafeteria plan.

<sup>2</sup>An employer's ability to defer the loss of health insurance coverage will be dictated by the group health plan and whether it provides for such optional extension of the COBRA coverage period.

### 3. Calculation of the Premium Reduction.

The premium amount from which the 35 percent share is calculated is based on the total amount being charged to the AEI. If the COBRA premium charged by an employer to an AEI is less than the maximum COBRA premium, then the AEI is only responsible for 35 percent of the amount charged to the AEI. Likewise, the employer is only entitled to a payroll tax credit for 65 percent of the amount charged to the AEI.

If an employer pays for any portion of a COBRA premium, the portion paid by the employer is not considered when calculating the 35 percent share owed by the AEI. For example, if the maximum COBRA premium is \$1000, but the employer only requires AEIs to pay \$500, the AEI is then only responsible for 35 percent of the \$500 (which equals \$175). The employer may claim a payroll tax credit for \$325 (65 percent of the \$500 charged to the AEI).

As depicted in the above example, if an employer pays for any portion of COBRA continuation coverage and excludes it from the AEI's taxable income, then the portion paid by the employer is excluded from the amount for which the AEI is considered responsible (*i.e.* the \$500 subsidized by the employer in the above example is not used to calculate the 35 percent for which the AEI is responsible). However, if family members, state agencies or charities assist an AEI in paying for COBRA continuation coverage, any amount paid for by non-employers is counted towards the AEI's 35 percent share of the premium (*i.e.* if a non-employer pays any portion of the \$175 (35 percent) for which the AEI is responsible, such amount paid will be attributable to the AEI paying the 35 percent share).

### 4. Premium Reduction Period.

The premium reduction period applies as of the first full period of coverage beginning on or after February 17, 2009, for which the AEI is eligible to pay only 35 percent of the premium and be treated as having made full payment. Therefore, determination of the first COBRA premium that is eligible for reduction under ARRA will depend on the standard billing practices for the group health plan. For example, a group health plan that calculates COBRA premiums on a calendar month could apply the premium reduction period no earlier than March 1, 2009.

The premium reduction applies until the earliest of (1) the first date the AEI becomes eligible for other group health plan coverage (with certain exceptions) or Medicare coverage, (2) the date that is nine months after the first day of the first month for which the ARRA premium reduction provisions apply to the individual, or (3) the date the individual ceases to be eligible for COBRA continuation coverage.

In the event an AEI becomes eligible for other group health coverage but

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<sup>3</sup> The premium reduction benefit is not taxable gross income to an AEI with modified gross income less than or equal to \$125,000 (\$250,000 for married filing jointly). However, the premium reduction benefit is recaptured proportionately for single filers earning between \$125,000 and \$145,000 in 2009 (between \$250,000 and \$290,000 for married individuals filing jointly). For AEI's with modified adjusted gross income exceeding these amounts, the premium reduction must be repaid in full to the government as an increase in the individual's tax liability for the year.

does not elect to enroll in the coverage, the AEI may continue COBRA coverage but is no longer eligible to receive a premium reduction starting on the date when the other coverage would have been effective. It is the responsibility of the AEI to provide notice to the employer that he or she is no longer eligible for premium reduction due to eligibility for coverage under another group health plan or Medicare. If the AEI fails to provide notice, he or she may be subject to a Federal tax penalty. The employer who has no knowledge of the AEI's eligibility for other coverage, however, is not required to refund to the IRS the payroll tax credit it received.

An AEI is eligible for up to nine months of premium reduction for each involuntary termination and loss of coverage that occurs between September 1, 2008 through December 31, 2009.

#### **5. Waiver of Premium Assistance.**

If an AEI does not want to receive a premium reduction, such as in the instance where the individual's income for 2009 would require repayment of any premium reduction received,<sup>3</sup> the individual may make an election to waive the right to receive the premium reduction by providing written notification to the party who is reimbursed for the premium reduction. Such an election will be a permanent waiver of the right to receive the premium reduction for any future period of COBRA continuation coverage in 2009 or 2010.

#### **6. Extended Election Period.**

If an employee's employment was involuntarily terminated between September 1, 2008 through February 17, 2009, and/or the employee's spouse or dependent children who were covered prior to the involuntary termination, did not elect COBRA continuation coverage during the original COBRA election period, these AEIs will have a second opportunity to elect COBRA continuation coverage. If these individuals elect COBRA continuation coverage during the extended election period, such coverage will begin on the first period of coverage after February 17, 2009, but the coverage will not be retroactive to the date of loss of coverage.

If an AEI is still in their original COBRA election period as of February 17, 2009, but has not yet elected COBRA continuation coverage, the AEI must receive notice of the extended election period. In such an instance, the AEI will have the choice of either receiving COBRA coverage under the original election period, and thus have coverage that is retroactive to the date of loss of coverage, or the AEI may elect COBRA coverage under the extended election period and receive coverage only for periods on or after February 17, 2009.

#### Conclusion

The above summary of the IRS guidance is only an overview of the main topics addressed in IRS Notice 2009-17. For additional information, please refer to the guidance document available at the following link: <http://www.irs.gov/pub/irs-drop/n-09-27.pdf>.

Should you have any questions, please do not hesitate to contact your regular Hall Render attorney or:

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