Compliance Services Alert

LOCKTON

May 24, 2021

IRS weighs in on ARP COBRA subsidies, and offers some surprises

Executive summary

- The IRS has issued its first interpretive guidance on the American Rescue Plan Act's (ARP) COBRA subsidies.
- The Service has offered a definition of "involuntary termination of employment," which largely comports to conventional wisdom but includes a couple head-scratching comments.
- Good news: The IRS effectively eliminated the possibility of a more-than-18-month lookback for individuals with COBRA extensions by requiring that any subsidy-eligible individual riding an extension into the April 1 – Sept. 30 subsidy window must have elected COBRA when first offered, and kept that coverage in force.
- Although an otherwise subsidy-eligible individual who is eligible for *other* group coverage (other than dental, vision and health flexible spending account coverage) loses eligibility for ARP subsidies, the IRS has articulated much nuance around the "eligibility" issue, perhaps more nuance than called for with respect to a subsidy window that closes four months from now.
- Subsidy-eligible individuals entitled to a "second bite at the COBRA apple" must, if electing COBRA to gain access to ARP subsidies, either elect or decline COBRA for periods between the qualifying event and April 1, 2021; if they decline COBRA for that prior period, they do *not* get another opportunity to elect COBRA for that period, notwithstanding federal authorities' "outbreak period" guidance.
- For employers who *already subsidize* COBRA coverage without regard to ARP, including under severance agreements, the ability to take the maximum tax credit under ARP for any given individual turns on whether the employer subsidizes just those individuals who could qualify for ARP subsidies, or subsidizes a broader category of COBRA-eligible individuals.

Almost two months into the six-month, April 1 – Sept. 30 COBRA subsidy period under the American Rescue Plan Act (ARP), the IRS has weighed in with the first piece of guidance on the substantive aspects of the ARP scheme, with the Department of Labor (DOL) having weighed in last month on the procedural or notice requirements.

The IRS guidance, in the form of 86 frequently asked questions over 41 pages, confirms much of what we suspected regarding terms such as "involuntary termination of employment," but also offers a few surprises. We summarize the key aspects of the FAQs below, and will explore them in greater detail in our webcast scheduled for next Wednesday, May 26. Register for the webcast here.

> **Lockton comment:** While arriving a bit later in the game than we hoped, the IRS's guidance is, for the most part, generally nicely thought out, well-organized and explained. If you care to troll through the FAQs themselves, they are here.

A note on style: In this alert, for the sake of expediency, we use the term "he" and "his" to refer to any individual, regardless of gender or gender identity.

Background

ARP authorizes the government to provide 100% COBRA subsidies for up to a six-month "subsidy window" running from April 1 - Sept. 30, 2021, for individuals – not just the employee – who lost or lose employer coverage due to a voluntary or involuntary reduction in hours, or an involuntary termination of employment (a "requisite qualifying event"). Subsidies are available for all healthcare coverage, other than coverage under a health flexible spending account (FSA), lost due to a requisite qualifying event. If the individual is, or during the subsidy window becomes, eligible for Medicare or other group coverage other than "excepted benefits" – e.g., most dental, vision and health flexible spending account programs – he is no longer eligible for the subsidy.

The most unique aspect of the ARP subsidies is that they're available not just to individuals who had or have a requisite qualifying event *during* the subsidy window, but also to those whose qualifying events occurred *prior* to – even many months prior to – April 2021 and who either never elected COBRA at the time, or elected COBRA and dropped it. As a general rule – there are some caveats noted below for some extended COBRA periods under federal or state law – if these individuals' maximum COBRA periods extend into the subsidy window, they are offered a "second bite at the COBRA apple" to allow them to take advantage of the ARP subsidies.

ARP COBRA subsidies are, in most cases, fronted by the employer/plan sponsor, who then claims a federal tax credit to reimburse itself. In situations where the employer is not subject to federal COBRA and buys group insurance subject to state COBRA-like laws, the insurer fronts the subsidy and claims the tax credit. For detailed background on the ARPA COBRA subsidy requirements, see our earlier alert.

Below we summarize key aspects of the IRS guidance. We've organized our comments into several categories: what we suspected or already knew, what surprised us, and what is just plain interesting. We reference for each comment the FAQ(s) on which the comment is based, in the event you care to review the FAQs.

Confirming what we suspected

Involuntary terminations of employment: Pretty much (but not entirely) what we thought (Q&A 24-34)

The IRS defines an involuntary termination of employment as a:

- Severance of employment
- Via the unilateral decision by the employer exercising its independent authority
- Under circumstances where the employee hasn't expressly or implicitly asked to be terminated
- And the employee was ready, willing and able to continue performing services

It doesn't matter, for subsidy eligibility purposes, if the termination was for cause, although termination for gross misconduct strips the employee of subsidy eligibility.

> **Lockton comment:** "Gross misconduct" is not defined. Conventional wisdom says gross misconduct is conduct bad enough to deny the employee unemployment compensation benefits. This is a high bar. Think instances similar to an employee embezzling funds from the employer or setting the workplace on fire.

In the vast majority of involuntary terminations, the involuntary nature will be obvious. Around the edges, however, there are the situations that vex us. Here's what we know:

- Termination of an employee who is absent from work due to illness or disability is considered *involuntary,* even though the employee isn't ready, willing and able to continue performing services, if "there is a reasonable expectation the employee will return to work after the illness or disability…." The IRS does not say *who* – the employer, the employee or both – must hold that reasonable expectation.
- An employee who quits based upon a material change in the geographic location of the employee's work site, or in response to a reduction in work hours (that does not itself cause a loss of coverage), is an involuntary termination.
- An employee who quits because a child can't attend school or day care due to the pandemic has not been involuntarily terminated, but if the employee and employer would like to maintain the employment relationship (i.e., the individual maintains employment status during their leave) and the employee's absence is viewed as a temporary leave, a resulting loss of coverage would be on account of a *reduction in hours*, which makes the employee subsidy eligible anyway (remember that involuntary and voluntary reductions in hours are subsidy triggers).
- The employer's decision not to renew a contract, where the employee (even a temporary employee employed by a staffing agency) is ready, willing and able to continue, is an involuntary termination unless the employer and employee had an "understanding" when the contract began and through the duration of the contract that it would not be renewed.
- An employee's retirement or acceptance of an "early out window," under circumstances where it was made clear to the employee that he was going to be terminated anyway, is an involuntary termination.
- There's an odd, vague and largely unhelpful FAQ, number 30, in which the IRS says that if an employee quits due to *general concerns* about workplace safety there is not an involuntary termination, but it *becomes* an involuntary termination "if the employee can demonstrate that the employer's actions (or inactions) resulted in a material negative change to the employment relationship analogous to a constructive discharge." The IRS offers no example reflecting what it means by such a materially negative change.
- What about an employee who simply fails to show up for work? Informal comments to us by DOL officials indicate federal regulators consider the employee's termination by the employer to be *involuntary*, not a quit, even though the employee is not "ready, willing and able" to work.

  Lockton comment: This position baffles us. Yet in our internal debate on this issue, our colleague Jay Kirschbaum correctly pointed out, "Do you know how many times employees will just not show up for a few days or weeks, fully expecting they can simply walk back in to work and pick up where they left off, and be utterly shocked to learn they've been terminated?"

  So, we urge the reader to proceed with caution here. Lockton's default position in close cases is to treat the termination as involuntary. The chance of getting slapped with a COBRA penalty for *not* having offered the subsidy opportunity is greater than the IRS second-guessing you on having offered it.

Subsidies for months of COBRA coverage provided other than on a calendar-month basis can begin after April 1 and extend beyond Sept. 30 (Q&A 43)

ARP is clear that subsidies are available for monthly (or shorter) periods of COBRA coverage, whatever intervals the plan uses, beginning on or after April 1, 2021. Although the statute is equally clear the subsidy window closes on Sept. 30, we presumed that if a non-calendar-month period of COBRA coverage began in September and extended beyond Sept. 30, subsidies would nevertheless apply to that entire period. The FAQs confirm that.

> Example: The plan terminates coverage on the date of the qualifying event, not the last day of the calendar month. The employer involuntarily terminates an employee on March 18, 2021. The *subsidized* months of the

former employee's COBRA coverage began April 18, 2021, and runs through Oct. 17, 2021, assuming the employee remains subsidy-eligible for that entire period.

Employers may rely on the COBRA beneficiaries' attestations that they're not eligible for other group coverage… but keep a record of the attestations (Q&A 6, 7, 78)

An otherwise subsidy-eligible individual (the ARP law refers to these individuals as "assistance eligible individuals," or AEIs) isn't eligible for subsidies if the individual is or, during the subsidy window becomes, eligible for Medicare or other group coverage other than merely excepted benefits. The employer will rarely know if this is the case but should obtain, on the individual's COBRA election form, an attestation as to the individual's eligibility or ineligibility for other coverage. The employer may rely on that representation unless the employer is aware of facts to the contrary, and may rely on it both for purposes of fronting the subsidies and claiming the federal tax credits that reimburse the employer.

"Eligibility" for other group coverage (or Medicare) means just that… it does not mean *covered* (Q&A 11, and example 2)

As noted above, ARP says that eligibility for Medicare or other group coverage strips an individual of access of subsidies. The IRS takes the ARP language literally; mere eligibility, not actual coverage, is all that's required to deny the individual access to subsidies. But an individual in an eligible class for coverage who is subject to a waiting period is viewed as not "eligible" for coverage until the waiting period is exhausted and coverage could actually begin, meaning the individual is subsidy eligible for the duration of the waiting period if otherwise an AEI.

> **Lockton comment:** See also the discussion under, "Things that surprised us," below, regarding how an individual who is in an eligible class for other coverage and *could* be covered today, but who passed on a previous enrollment opportunity, might still be considered "ineligible" for subsidy purposes, but how that is unlikely in many cases due to the feds' "outbreak period" guidance.

"Second bite at the apple" COBRA beneficiaries can get the ARP subsidies whether or not they retroactively elect COBRA for periods prior to April 1 (Q&A 53)

This we already knew; COBRA beneficiaries who suffered a requisite qualifying event and earlier declined COBRA, or elected and then dropped it, and who under ARP get a second chance to elect COBRA for at least part of the Apr. 1 – Sept. 30 subsidy window, are not *required* to elect and pay for periods of COBRA coverage *prior* to April 1; they may choose to elect COBRA only for the subsidy window.

> **Lockton comment:** See the discussion under, "Things that surprised us," below, regarding how these "second bite at the apple" beneficiaries who elect COBRA to avail themselves of ARP subsidies are *required* to either accept or decline COBRA coverage for periods prior to April 1; if they decline it, they do <u>*not*</u> get a later opportunity, notwithstanding the feds' "outbreak period" guidance that has suspended the running of the beneficiaries' original 60-day COBRA election period.

"Second bite at the apple" COBRA beneficiaries who may have earlier elected COBRA coverage for some benefits but declined it for others can get a second bite at COBRA for those others (Q&A 55)

This is simply a logical extension of the result described immediately above.

An AEI who is entitled to subsidies but elects and pays COBRA premium for periods where the employer or insurer should have fronted that premium must be reimbursed by the employer or insurer, as applicable, and the employer or insurer is then entitled to the tax credit (Q&A 85)

The ARP statute is clear about the premium reimbursement obligation; the IRS further emphasized that once the reimbursement to the AEI is made the employer or insurer is entitled to the tax credit.

> **Lockton comment:** FAQ 86 notes that if some *third party*, such as a charity, pays the subsidy-eligible individual's premium that should have been fronted by the employer or insurer, the reimbursement should still go to the individual unless the plan is aware he has assigned his rights to reimbursement to the third party.

The surprises

An AEI who could be covered under other, subsidy-disqualifying group coverage but passed on the opportunity prior to April 1 is nevertheless not considered "eligible" for that other coverage if he can't enroll in that other coverage now (Q&A 9)

This FAQ surprised us, but there are three possibilities in a case like this, two of which can trigger a different result.

In the FAQ, the IRS says that if an individual had an opportunity to enroll in subsidy-disqualifying other group coverage prior to April 1 but passed on the opportunity, *and now can't force his way onto that coverage* (because, for example, there's no special enrollment or qualifying event, such as a "change in status"), the individual is not treated as eligible for that other coverage.

But if the enrollment opportunity occurs *during the subsidy window* (say, open enrollment is in June for a July 1 effective date) and the individual passes on *that* opportunity, the individual is considered eligible for the other coverage – and ineligible for subsidies – beginning on the date his coverage could begin (in this example, July 1).

In a similar vein, if in fact the individual *could* force his way onto the other coverage now due, for example, to a HIPAA special enrollment event that may have happened months ago but, with respect to which the 30-day election window, is held open under the feds' "outbreak period" guidance, that individual is also considered eligible for the other coverage, and ineligible for subsidies.

> **Lockton comment:** The complexities around when a potential AEI is or is not eligible for other coverage, and therefore is or is not eligible for subsidies, is another good reason to have potential AEIs who claim ARP COBRA subsidies to simply attest to whether or not they're eligible for other coverage. The employer can rely on the attestation unless it has knowledge of facts to the contrary.

An individual on *extended* COBRA due to disability, a second qualifying event, or state rules (like Cal-COBRA) is eligible for subsidies during the *extended* coverage period that overlaps at least a portion of the subsidy window *only* if the individual originally elected and has *remained* on COBRA (Q&A 17, 52)

This is beautiful news. It was not at all clear under the ARP statute whether a plan would have to look back up to, say, 36 months (to accommodate some state laws like Cal-COBRA, or disability extensions or second qualifying events under federal COBRA) prior to April 1 to determine who might have had a requisite qualifying event *way* back then, didn't elect COBRA (or elected it and dropped it), then qualified for an extended COBRA coverage period that would have edged into the subsidy window. Is the employer required to find these individuals and offer *them* a "second bite at the COBRA apple?"

The IRS says no. For an individual to qualify for ARP subsidies during a portion of his *extended* COBRA coverage period, or pursuant to comparable state continuation coverage, he must have elected federal COBRA or the state law equivalent shortly after his qualifying event and *kept that COBRA or state continuation coverage in force*, into the subsidy window.

An employer who is no longer big enough to be subject to COBRA must (in many cases) still offer the second bite (Q&A 45)

Well, this is a buzzkill. If the employer was subject to COBRA back in 2020, or perhaps even earlier, and an individual suffered a requisite qualifying event way back then but didn't elect COBRA (or elected it and dropped it), must the employer offer the "second bite at the COBRA apple" to the individual, even if the employer is now, in 2021, too small to be subject to federal COBRA?

The IRS says, "yes," as long as the employer continues to maintain a group healthcare plan.

> **Lockton comment:** This seems a bit harsh. An employer no longer subject to federal COBRA *probably* doesn't have a COBRA administrator in place to handle any of this, nor an HR department anymore.

"Second bite at the apple" COBRA enrollees who choose to enroll in COBRA to take advantage of the ARP subsidy must accept or decline COBRA for periods prior to April 1, or lose the right to elect coverage under the "outbreak period" guidance at a later point (Q&A 56, 58-59)

This was a surprise, although a pleasant one.

Where the employer offers a "second bite at the COBRA apple" to an individual whose requisite qualifying event occurred prior to April 1 and who either declined COBRA or elected it and dropped it, if the individual elects COBRA to gain access to the ARP subsidy, he must *also* either accept or decline COBRA for the period from the qualifying event to April 1.

If the individual *elects* the retroactive COBRA coverage he must pay the back premium, but at the moment, of course, any COBRA premium payment deadlines are suspended under the feds' "outbreak period" guidance. Once the outbreak period ends and premium payments for retroactive COBRA coverage come due, if the individual fails to pay those premiums the employer can retroactively cancel COBRA coverage for periods for which the premium is not paid, but of course COBRA coverage during the subsidy window cannot be cancelled because no premiums are required from the individual for that period.

If on the other hand the individual *declines* retroactive COBRA coverage, the individual does not get another chance to elect it later, notwithstanding the outbreak period guidance that has otherwise held open that election opportunity.

Just plain interesting

An AEI must be a qualified beneficiary as defined under federal COBRA rules (Q&A 67)

The ARP law provides for subsidies, for requisite qualifying events, under state COBRA-like laws. But to qualify for subsidies, an individual must meet the *federal* definition of a COBRA beneficiary. Thus, for example, while a state COBRA-like law might treat domestic partners as a qualified beneficiary for state-imposed continuation coverage, federal law does not. The domestic partner does not qualify for ARP subsidies. In a case like that, where a non-qualified beneficiary is covered under the employee's continuation coverage, the subsidy is available only with respect to the premium amount attributable to those who are qualified beneficiaries under the federal COBRA law.

> **Lockton comment:** In a similar vein, if a dependent of an employee who suffered a requisite qualifying event under federal COBRA is not a COBRA qualified beneficiary, such as a new spouse where the employee marries during the COBRA coverage period, or a foster child acquired during the COBRA coverage period, the dependent is not eligible for ARP subsidies.

If a reduction in hours or involuntary termination of employment is a second qualifying event, it doesn't make the spouse or children who suffered the *initial* qualifying event eligible for subsidies (Q&A 14)

This is best explained in an example. Assume an employee and spouse divorce, which is a 36-month COBRA qualifying event for the spouse. Ten months later, the *employee* suffers an involuntary termination of employment. Only the employee is potentially eligible for ARP subsidies. The spouse, who experienced a COBRA qualifying event based on the divorce, is not eligible for the ARP subsidy.

ARP subsidies do not apply to "voluntary COBRA" provided by a plan not subject to federal or state COBRA (Q&A 15)

This is a question we've received a few times. Say a self-insured church plan, which is subject neither to federal COBRA nor state COBRA-like laws, nevertheless offers under the written terms of the plan a COBRA-like benefit to individuals who lose coverage due to reduction in hours or an involuntary termination of employment. Under the "no good deed goes unpunished" category, the IRS says ARP subsidies are not available to these individuals.

> **Lockton comment:** Along similar lines, if the relevant coverage continuation law is a state law requiring the insurer to provide continuation coverage – so the insurer should forgive the coverage continuation premium and take the tax credit to reimburse itself – and the *employer* nevertheless pays the COBRA premium on behalf of the AEI, the employer cannot take a tax credit for having done so.

If a family experiences a requisite qualifying event, but only the employee or former employee elected COBRA, the other family members are eligible for the "second bite at the COBRA apple" to gain access to subsidies (Q&A 51)

This result makes sense and serves best as a reminder to plan sponsors and COBRA administrators to not consider only the employee or former employee when offering a "second bite at the COBRA apple." Sometimes *that* individual might already be on COBRA, but the second bite must be offered to the spouse and dependent children who also lost coverage due to the requisite qualifying event, if their maximum COBRA coverage period would extend into the ARP COBRA subsidy window.

An AEI's leap to more expensive COBRA coverage might – or might not – allow the employer to take the tax credit for the more expensive COBRA premium (Q&A 41, 42 and 69)

ARP allows, but does not require, an employer to permit an AEI to move to a different, no-more-expensive COBRA coverage option; if the option to which the AEI migrates has a larger COBRA premium, the employer is entitled to *no* tax credit whatsoever, not even for the amount of the less expensive COBRA premium, with respect to that AEI's COBRA coverage.

On the other hand, if the AEI moves to a pricier COBRA option at open enrollment, or due to a special enrollment event (i.e., newly acquired dependent due to marriage, birth or adoption), the employer may claim the entire tax credit for the AEI's premium for that more expensive coverage.

> **Lockton comment:** Some "second bite at the COBRA apple" enrollees might not be able to enroll in the coverage they had at the time of their qualifying event because that option no longer exists; in that event they must be offered the most analogous option still in play, even if more expensive. Here, too, the employer may take the entire tax credit for the AEI's premium for that more expensive coverage.

Employer subsidization of COBRA premium, via a severance or other arrangement, creates ARP wrinkles (Q&A 63-66)

The IRS devoted several FAQs and examples to calculating the amount of the tax credit the employer can claim for fronting the ARP COBRA subsidies. Several of these FAQs address what the employer is entitled to claim where it subsidizes COBRA coverage without regard to ARP subsidies, such as under a severance agreement:

- If the employer subsidizes COBRA coverage (we mean a pure employer subsidy, not the fronting of the ARP subsidy) for AEIs but not for non-AEIs who are similarly situated, the tax credit to which the employer is entitled (for any given AEI) is the amount charged for the COBRA premium under normal circumstances (i.e., up to 102% of the cost of the plan).

  Lockton comment: It appears the notion here is that if the employer is doing, in whole or in part, what the ARPA subsidy is designed to do, the employer is entitled to a tax credit for its contribution.

- If, on the other hand, the employer subsidizes COBRA not only for potential AEIs but also for similarly situated non-AEIs (e.g., the employer has an existing program for subsidizing COBRA coverage for COBRA enrollee without regard to the nature of the qualifying event), the employer can claim no tax credit – with respect to an AEI – for COBRA premium amounts the employer would have subsidized anyway.

  But there's an exception: if the employer, because ARP subsidies are now in play, reduces the COBRA subsidy provided to ***all*** similarly situated COBRA enrollees (the employer might do this to increase the amount of the tax credit it can claim for AEIs), the employer can take a tax credit for the increased premium now charged to AEIs. This result remains true even if the employer, after reducing its subsidy it would otherwise have paid, gives the AEI additional taxable cash equal to the reduction in the employer's subsidy amount.

- If pursuant to a severance agreement the employer continues eligibility of a former employee for a period of time and treats the COBRA coverage period as beginning *after* the extended eligibility period, then the employer is entitled to no tax credit for any subsidy provided to the former employee during that pre-COBRA extended eligibility period.

  Lockton comment: This makes sense because the ARP subsidies and related tax credits aren't available for non-COBRA coverage.

Where an AEI's COBRA coverage also covers non-AEIs, premium otherwise payable by the AEIs is allocated first to the AEIs (Q&A 68)

The intent of this is to ensure that, if there's no step-up in the COBRA premium for adding an individual to the AEI's COBRA coverage (such as a foster child acquired during the COBRA coverage period where the addition doesn't increase the COBRA premium), the employer's tax credit is not reduced on account of adding the additional individual.

Ed Fensholt, JD
Director, Compliance Services

Rory Kane Akers, JD
Senior ERISA Attorney

Lockton Benefits | 444 West 47th Street | Suite 900 | Kansas City | MO | 64112