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IRS Uncoils COBRA Subsidy Guidance!

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On May 18, 2021, the IRS released its highly anticipated guidance on the 100% COBRA premium subsidies (the "Subsidy") and the related tax credit under the American Rescue Plan Act of 2021 (March 11, 2021) ("ARPA") in Notice 2021-31 (the "Notice"). *See* our previous alert for a more detailed description of the ARPA subsidy provisions along with our previous alert on the preceding Department of Labor guidance (April 7, 2021). The Notice provides extensive guidance in the form of 86 Q&As covering a range of issues related to the administration and implementation of the Subsidy.

The IRS previously published FAQ guidance in 2009 related to a similar 65% COBRA premium subsidy under the American Recovery and Reinvestment Act ("ARRA"). While waiting for the IRS to issue new guidance under ARPA, most employers and insurers looked to the previous ARRA guidance as an indication of how the IRS might land on important issues. While the Notice largely tracks the 2009 guidance, there are certain notable exceptions. Below we provide a high-level summary of the key guidance in the Notice.

Qualifying Events for the Subsidy

Involuntary Termination of Employment

Under ARPA, Subsidy eligibility is tied to having a COBRA qualifying event based on a reduction in hours or an involuntary termination of employment. ARPA does not, however, define "involuntary" termination of employment. The Notice generally defines this as severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employment, other than due to the employee's implicit or explicit request, where the employee was willing and able to continue performing services (Q&A-24). The Notice provides the following as examples of involuntary termination of employment:

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- An employee-initiated termination of employment if the termination constitutes a termination for good reason due to employer action that results in a material negative change in the employment relationship for the employee analogous to constructive discharge (but the IRS does not provide a definition of constructive discharge is provided) (Q&A-24).
- An employer's action to end an individual's employment while the individual is absent from work due to illness or disability (if before the action there is a reasonable expectation the employee will return to work) (Q&A-25).
- Involuntary termination for cause (although if the termination is due to gross misconduct, the termination is not a qualifying event) (Q&A-27).

GROOM INSIGHT: The Notice does not clarify what "gross misconduct" means, which could put employers in a difficult position because many employers offer COBRA coverage without carving out gross misconduct.

- Resignation as a result of material change in the geographic location of employment (Q&A-28).
- Participation by an employee in a window program under which employees with impending terminations of employment are offered a severance agreement to terminate employment within a specified period of time (Q&A-29).

GROOM INSIGHT: The term window program is defined by reference to the regulations under Code section 3121(v), which define window programs for purposes of the application of FICA taxes to nonqualified deferred compensation. Under those regulations, the window program must be for a limited period of time of no more than 12 months, and the employer cannot establish a pattern of repeatedly providing for similar programs "for substantially consecutive, limited periods of time."

- Termination of employment initiated by the employee in response to an involuntary, material reduction in hours (Q&A-32).
- An employer's decision not to renew an employee's contract, if the employee was otherwise willing and able to continue the employment relationship and was willing either to enter into a similar contract or continue employment without a contract (Q&A-34). However, an employer's decision to not renew an employee's contract is a voluntary termination if the parties understood at the time they entered into the contract, and at all times when services were being performed, that the contract was for specified services over a set term and would not be renewed.

GROOM INSIGHT: It may be difficult to determine what both the employer and employee's intention was at the time they entered into the contract.

In addition, the Notice provides that the following are typically not involuntary terminations of employment:

- Voluntary retirement (unless the facts and circumstances indicate that absent retirement the employer would have terminated the employee's employment, the employee was willing and able to continue employment, and the employee had knowledge that the employee would be terminated absent retirement) (Q&A-26).
- Termination of employment by an employee due to general concerns about workplace safety (unless the employee can demonstrate that the employer's actions or inactions resulted in a material negative change in the employment relationship analogous to constructive discharge) (Q&A-30).
- Employee initiated termination because a child is unable to attend school or because another childcare facility is closed due to COVID-19 (Q&A-31).

GROOM INSIGHT: Prior to the Notice, many employers were curious whether the IRS would treat an employee-initiated termination as "involuntary" if the employee left work due to the need to care for a child whose school and/or childcare facility closed due to COVID-19. The Notice confirms this is not an involuntary termination; however, it notes that a voluntary reduction in hours due to school and/or childcare facility closures that resulted in a loss of health coverage is a qualifying event that could render someone eligible for a Subsidy. Thus, in a somewhat odd result, if the employee lost coverage after reducing work hours by 99% to stay home and care for a child because of a COVID-related school closure, that would render the individual Subsidy eligible; however, if the individual decided to quit to care for the child, the individual would not be Subsidy eligible.

- Death of an employee (Q&A-33).

Reduction in Hours

The Notice highlights that a "reduction in hours" may include the following:

- A voluntary reduction in hours initiated by the employee (Q&A-21).

- A furlough, which means a temporary loss of employment or complete reduction in hours with a reasonable expectation of return to employment or resumption of hours such that the employer and employee intend to maintain the employment relationship (Q&A-22).
- A work stoppage as the result of a lawful strike so long as the employer and employee intend to maintain the employment relationship (Q&A-23).

Second Qualifying Events

The Notice provides that, if the original qualifying event was a reduction in hours or an involuntary termination of employment, the Subsidy is available to individuals who have elected and remained on COBRA coverage for an extended period due to a disability determination, second qualifying event, or an extension under state mini-COBRA, to the extent the additional periods of coverage fall between April 1, 2021 and September 30, 2021 (Q&A-17).

GROOM INSIGHT: Although the DOL FAQs stated that employers "generally" need to look at terminations of employment/reductions in hours beginning October 1, 2019, the IRS guidance clarifies that employers may need to look back more than 18 months to determine whether a reduction in hours/involuntary termination of employment took place for those on extended periods of COBRA. However, this Q&A is limited to those individuals "who have elected and remained on COBRA" until April 1, 2021. So, while an employer would need to look back more than 18 months for the initial reason of the qualifying event for those who are still enrolled in COBRA as of April 1, 2021, the Q&As don't appear to require an employer to look back more than 18 months for the extended second election opportunity.

Employer COBRA Subsidies Severance Benefits

The Notice provides that if an employer provides subsidized COBRA coverage by paying for all or part of the premium for an individual absent the Subsidy, the employer may only claim a tax credit for the amount the assistance eligible individual ("AEI") would have actually been required to pay for the premium (Q&A-64) (i.e., the amount in excess of the employer-provided subsidy). Thus, for example, if an employer fully or partially subsidizes coverage as part of an employee severance package, the employer cannot claim the tax credit the portion of the COBRA premium that the employer itself would subsidize absent the Subsidy.

GROOM INSIGHT: Similar to the position the IRS took in 2009, the Notice appears to permit an employer to reduce its severance-related subsidy and increase the COBRA premium charged to the employee, thus allowing the employee to then receive the Subsidy

(in lieu of the employer subsidy if this is done on a prospective basis (Q&A-65)). This would allow the employer to claim the tax credit for the Subsidy. The employer could also provide a taxable severance benefit to the employee for the amount the employer would have subsidized under the severance agreement (Q&A-66). Employers should keep in mind that if an employer has already obtained severance-related waivers from individuals, and the employer-subsidized COBRA provided consideration in support of the individual's waiver of certain claims (e.g., under Title VII, ADEA, ERISA, etc.), changing course could jeopardize the validity of the existing waiver.

Employee Attestation and Self-Certification

The Notice provides that employers can either determine whether an employee had a reduction in hours or involuntary termination of employment or require individuals to provide a self-certification or attestation confirming that they are Subsidy-eligible because they lost coverage due to one of these reasons (Q&A-4). In addition, employers can require individuals to provide a self-certification or attestation regarding their eligibility for other group health plan coverage or Medicare (which will result in their loss of Subsidy eligibility) (Q&A-5). Employers may rely on the individual's attestation, unless the employer has actual knowledge that the individual's attestation is incorrect. If an employer is relying on an individual's attestation, it must keep a record of the attestation in order to substantiate eligibility for the tax credit. However, an employer may also rely on other evidence to substantiate eligibility, such as records concerning a reduction in hours or involuntary termination.

GROOM INSIGHT: Many employers were hopeful that the IRS would permit them to rely on an employee's attestation rather than having to go back and making termination determinations themselves. However, with the upcoming May 31, 2021 deadline for certain Subsidy notices, many employers already have made the determination of whether an employee's termination of employment was voluntary or involuntary.

Eligibility for Other Coverage

The Notice outlines the ways eligibility for other health plan coverage impacts Subsidy eligibility. Specifically:

- If a potential AEI was eligible for other group health plan coverage before April 1, 2021, but is no longer permitted to enroll in that other group health plan coverage (for example, if the enrollment period is over), then the AEI is eligible for the Subsidy until he/she may enroll in another group health plan (including during a waiting period for any other plan) (Q&A-9).

GROOM INSIGHT: The Notice notes that if a former employee is eligible to enroll in a spouse's employer's plan under a HIPAA special enrollment window, the former employee is not eligible for the Subsidy (Q&A-9, Example 3). Due to the COVID-19 Outbreak Period extensions that apply to the notification requirement for HIPAA special enrollment events (see below for more information about these extensions), this means in many cases, the HIPAA special enrollment period under the spouse's employer's plan is still open, and thus, the employee is not eligible for the Subsidy.

- Similarly, if a potential AEI did not elect COBRA coverage and enrolled in another group health plan, but is no longer covered by the other group health plan as of April 1, 2021, that individual may still be an AEI eligible for the Subsidy (Q&A-10).
- If an individual becomes eligible for and able to enroll in other group plan health coverage or Medicare beginning on or after April 1, 2021, that individual would not be eligible for the Subsidy (Q&A-11).
- If retiree health coverage is under the same group health plan as the COBRA coverage, the offer of the retiree health coverage has no effect on Subsidy eligibility (Q&A-18). However, an individual is not eligible for the Subsidy if the retiree health coverage is under a separate group health plan.
- The Subsidy is only available with respect to premiums attributable to COBRA coverage for AEIs, which is limited to the employee's spouse and dependent children who were covered under the plan as of the qualifying event (and a child who is born to or adopted by the covered employee during the period of COBRA coverage) (Q&As 19 & 68). Any other individuals covered are not AEIs, and no Subsidy is available for the portion of the premium attributable to them. The Notice provides a formula for bifurcating the premium.

GROOM INSIGHT: Note that this means that spouses and dependent children who were not enrolled at the time of the qualifying event and who the employee subsequently added/adds to COBRA coverage at open enrollment are not eligible for the Subsidy. Also, because domestic partners are not covered as spouses, they cannot be AEIs and are not eligible for the Subsidy (however, the domestic partner's child may be assistance-eligible) (Q&A-67).

- Eligibility for an HRA that qualifies as a health FSA under the Internal Revenue Code does not impact subsidy eligibility; however, eligibility for an HRA that does not qualify as a health FSA renders an individual as ineligible for the Subsidy (Q&A-37).

Payments to Insurers Under Federal COBRA

Under Federal COBRA, an employer-sponsored plan generally is responsible for administering the Subsidy, and the employer will claim the tax credit. The Notice provides, however, that if the coverage is insured, and the employer and insurer have agreed that the insurer will collect the COBRA premiums directly from qualified beneficiaries, the insurer must treat the AEIs as having paid the full premium (Q&A-60). If the insurer fails to do so, the insurer may be liable for the $100/day excise tax for COBRA violations under the Code. Notwithstanding any agreement between the employer and the insurer, however, the employer is still required to pay the subsidized premiums to the insurer.

Interaction With the Outbreak Period Extensions

The Notice confirms that the Outbreak Period extensions do not apply to notices or elections under ARPA, but continue to apply to retroactive periods of COBRA (Q&A-56). *See* our prior alert on the outbreak period extensions. However, surprisingly, the Notice provides that an employer can require that an individual making an election for subsidized COBRA also elect or decline the retroactive COBRA at that time. If the individual declines the retroactive COBRA, he/she loses the right to elect it later. If, however, the individual elects the retroactive COBRA, the deadline for payment of the retroactive periods continues to be subject to the Outbreak Period tolling.

GROOM INSIGHT: The Q&As and model notices that DOL issued last month do not reflect that an employer can require that an individual either decline or elect retroactive COBRA when electing the Subsidy and that this election with respect to retroactive COBRA is binding and no longer subject to the Outbreak Period extensions. Because many employers were concerned about meeting the May 31 deadline for distributing the notice regarding the ARP extended election period, they have already sent their ARPA notice based on the DOL model -- now there may be questions about this limit related to retroactive elections and whether the employer should provide notice of it before imposing the limit. Employers should understand their options for limiting retroactive elections under this Q&A and be able to explain them to qualified beneficiaries, who likely will have questions.

State Continuation Coverage

The Notice is largely consistent with the ARRA guidance on state continuation coverage and provides that the ARPA extended election period does not apply with respect to state continuation coverage (Q&A-52). However, a state law or program may provide for a similar extended election right, which certain states did back in 2009.

GROOM INSIGHT: Many insurers were hopeful that where the state continuation coverage law requires administration and full payment of premiums by employers, that the employer could be responsible for applying the Subsidy and claiming the tax credit. The IRS, however, took the same position that it did in 2009 and will only permit the insurer (and not the employer) to claim the tax credit for insured plans subject only to state law (Q&A-62). However, the IRS did highlight they are continuing to consider this issue.

Significantly, the Notice does not address which entity should/can deliver the Subsidy and claim the corresponding tax credit for an insured plan that is subject to both Federal and state COBRA – e.g., whether the employer claims the credit for the entire COBRA period (regardless of whether the continuation coverage is by reason of Federal COBRA or state continuation coverage) or whether the employer claims the credit for the Federal COBRA period and the insurer claims the credit for the state continuation coverage period.

Tax Credit

The multiemployer plan, employer, or insurer (the "Premium Payee") is entitled to the tax credit for premiums not paid by an AEI after it has received the potential AEI's COBRA election.

- The Premium Payee claims the credit by reporting the credit and the number of individuals receiving COBRA premium assistance on the Form 941 (Q&A-75) .
- In anticipation of receiving the credit, the Premium Payee may (1) reduce the deposits of the Medicare hospital insurance tax up to the amount of the anticipated credit, and (2) request an advance of the amount of the anticipated credit that exceeds the federal employment tax deposits available for reduction by filing a Form 7200 (Q&A-75).
- If the Premium Payee does not have any employment tax liability (such as a multiemployer plan with no employees), the Premium Payee should still claim the credit on the Form 941 for the quarter when the Premium Payee becomes entitled to the credit (Q&A-77). The Premium Payee should also report any advance payments received in anticipation of the credit on the same Form 941, and enter zero on all remaining non-applicable lines so that the overpayment amount on the Form 941 is the amount of the credit reduced by any advance payment received.

Third-Party Payer Guidance

The Notice highlights that the Premium Payee is entitled to the tax credit, regardless of whether it uses a third-party payer (such as a reporting agent, payroll service provider, PEO/CPEO, or Code section 3504 agent) to report and pay its federal employment taxes (Q&A-81). The third-party payer, however,

can report the tax credit on behalf of its client. Further, in certain instances where the third party payer maintains the group health plan (e.g., in the PEO/CPEO context), a third-party payer may be treated as the Premium Payee and claim the tax credit.

Conclusion

This Alert summarizes some of the key issues covered by the dense and highly technical Notice. Undoubtedly, questions will arise as employers, insurers, and COBRA administrators seek to comply with the complex requirements under the ARPA. Please contact your Groom attorney with any questions, and we would be happy to discuss these issues with you further.