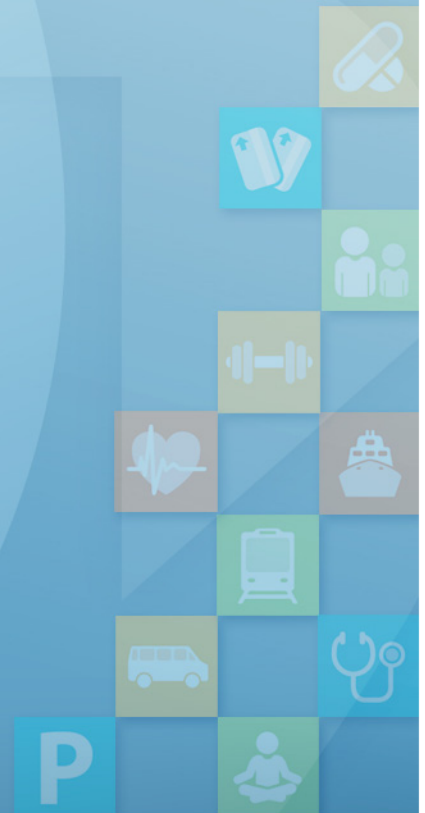


# IRS Notice 2009-27 Highlights



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The IRS released Notice 2009-27 on March 31, 2009 (the “Notice”). Generally, to the extent the Notice addresses issues that have been previously addressed (either formally or informally, by both the DOL and the IRS), the Notice does not materially change our previous interpretation of the American Recovery and Reinvestment Act of 2009 (“ARRA”). The Notice does, however, expand and clarify guidance with respect to several gray issues, as well as provides new, formal guidance on key aspects of ARRA, such as involuntary terminations. This bulletin highlights those issues.

- Extended Election Period (Page 2) — Confirms that only AEIs or “would-be” AEIs that did not have a COBRA election in place on February 17, 2009 are eligible for the extended election period. The employer FAQs and recent DOL instruction to the DOL model notices do not include February 17 as the point of reference for the extended election period, leaving some to wonder whether the DOL intended to expand the class of AEIs eligible for the extended election period. The Notice indicates that the extended election period rules have not been expanded.
- Penalties for failure to accept reduced premiums as full payment (Page 5) — Previously, in informal remarks, the DOL and IRS advised plans to narrowly interpret the term “involuntary termination” because claiming a subsidy offset on payroll taxes for an individual who was not actually an AEI would be treated as an underpayment of payroll taxes, subject to penalties. The Notice, however, states that if a plan fails to treat an AEI who is making reduced payments as having made the full payment, such failure would be a failure under Code Section 4980B and “may result in the imposition of the excise tax” under Code Section 4980B(b).
- Involuntary terminations (Q/A-1 through Q/A-9) —
  - DOL expands on previous House Ways & Means Committee guidance with respect to the meaning of “involuntary termination”. Involuntary termination is “severance from employment due to the independent exercise of the unilateral authority of the employer to terminate employment, other than due to the employee’s implicit or explicit request, where the employee was willing and able to continue performing services.” That said, an employee-initiated termination constitutes an involuntary termination if it constitutes a termination for “good reason” due to employer action that “causes a material negative change in the employment relationship for the employee” (Q/A-1). This is similar to the language as is provided in Code Section 409A, which may be subject to a case-by-case determination and cause problems for employers.
  - Q/A-9 answers the question that has been on everyone’s mind—that is, involuntary termination *does* include a termination initiated by the employee in return for a severance package (*i.e.*, buyout) where the employer indicates that a certain number of employees remaining after the buy-out period will be terminated. Retirement may also constitute involuntary termination if “the facts and circumstances indicate that, absent retirement, the employer would have terminated the employee’s services, and the employee had knowledge that the employee would be terminated” (Q/A-5). As we have noted in the past, termination even for cause (but not something that constitutes gross misconduct) is also involuntary for purposes of ARRA (Q/A-6). Lastly, absence from work due to illness or disability is not involuntary termination *unless* the employer takes action to terminate the employee’s employment status while the employee is absent from work due to illness or disability (Q/A-4).

- AEIs include qualified beneficiaries ONLY (Q/A-25) — The Notice confirms that only individuals who are qualified beneficiaries (employees and eligible spouses and dependent children) are entitled to the premium reduction. The Notice also explains that to the extent a non-AEI is included in the AEI's election and premium calculation, premium amounts paid are allocated first to the cost of covering the AEIs and then to the cost of covering the non-AEI. So for example, if the cost of covering a non-AEI does not add to the cost of covering the AEIs, then the cost of covering the non-AEI is zero, and the premium reduction applies to the full amount paid for the COBRA continuation coverage. If the cost of covering a non-AEI adds to the cost of covering the AEIs, it is the incremental cost that is ineligible for the premium reduction. Q/A-25 provides specific examples.
- Loss of coverage must occur during the "window" (Q/A-14) — If an employer continues to cover an employee after termination as either an active employee or as part of a severance package, and if such continued coverage does not run concurrent with COBRA, then the employee's coverage must be lost within the 9/1/2008-12/31/2009 window in order for the subsidy to apply. If coverage for an employee terminated 7/1/2009 is continued through 12/31/2009, so that the 18-month COBRA period begins 1/1/2010, such employee is not entitled to the premium reduction.
- Individuals can become AEIs more than once (Q/A-17 and Q/A-43) — Individuals can become AEIs more than once so long as they meet the AEI requirements a second time. Such individuals are entitled to an additional 9 months of subsidy for the second round as an AEI (Q/A-43).
- AEIs can elect more expensive coverage (Q/A-26) — AEIs can elect more expensive coverage to the extent similarly situated active employees are entitled to elect such coverage (for example, during open enrollment). The premium reduction will apply to the full amount the AEI is required to pay for the more expensive coverage.
- Premium reduction may apply to retiree coverage (Q/A-28 and Q/A-36) — Generally, the reduced premium may apply to retiree coverage to the extent the retiree coverage is the same coverage under the same plan made available to similarly situated active employees, even if retirees are charged more (Q/A-28). If the retiree coverage is provided under a separate plan, such coverage will not qualify if the AEI's involuntary termination occurred on or after 2/17/2009 (Q/A-36). If the eligibility for COBRA arose on or between 9/1/2008 and 2/16/2009, offering the AEI retiree coverage under a separate plan will render the individual ineligible for the premium reduction so long as the period the individual is given for enrolling in the retiree coverage extends to "at least February 17, 2009". Presumably the DOL is getting at the fact that the individual would be considered "eligible" for coverage under another group health plan and would therefore be ineligible for the COBRA premium reduction. None of the Q/As address a fact pattern whereby an individual eligible for other coverage is eligible to enroll on February 17, 2009, but is no longer eligible by the time they receive the extended election notice. For example, what if February 17 were the last day of the election period for the retiree coverage under the separate plan, and I don't get my extended election notice until April 18?
- Partial-month COBRA premiums (Q/A-32 and Q/A-48) — Plans that require partial-month COBRA premiums for individuals terminated mid-months can use March 1 as the effective date of the premium reduction for AEIs entitled to an extended election period. Such plans are not required to use February 17, 2009 as the effective date of the premium reduction, even if the AEI's COBRA period begins sometime between 2/1/2009 and 2/16/2009.

- Permanent waivers (Q/A-46) — An AEI who wants to make a permanent election to waive the right to the premium reduction makes the election by providing a signed and dated notification (including a reference to “permanent waiver”) to the entity who is reimbursed for the subsidy. *There is no separate additional notification to any government agency.* A curious loophole: the Notice does not explain how “permanent” this waiver is if the individual becomes an AEI again with another employer (see Q/A-17 and Q/A-43). Q/A-46 states that the individual may not later reverse the election and may not receive the premium reduction for “*any future period of COBRA continuation coverage in 2009 or 2010*, regardless of modified adjusted gross income in those years.” [Emphasis supplied] It is unclear whether the individual would be subject to the 110% penalty if the permanent waiver is later discovered.
- Medicare eligibility and repaying the payroll tax offset (Q/A-42) — Generally, an entity does not have to repay the subsidy it receives on behalf of an individual who later becomes eligible for coverage under another group health plan or Medicare but fails to provide notification of such eligibility. However, the employer may be required to repay the payroll credit if the employer “otherwise knew of the eligibility for such coverage”. This opens the question up as to whether the premium reduction should automatically be cut off once the AEI turns 65 (to the extent the employer has this information). In any event, it seems that the IRS expects the employer to take some kind of action if they have reason to believe the individual is eligible for other coverage (although ARRA does not include any such requirements for employers/subsidy-eligible entities).