LEGALcurrents®

May 20, 2021

Harter Secrest & Emery LLP

ATTORNEYS AND COUNSELORS

EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

IRS AMERICAN RESCUE PLAN ACT COBRA SUBSIDY GUIDANCE

On May 18, 2021, over two months after the enactment of the American Rescue Plan Act of 2021 ("ARP"), and with less than two weeks before the legal deadline for employers to provide individuals with written notice of their ARP rights, the IRS issued guidance addressing a variety of questions raised by the COBRA subsidy provisions in the ARP. The guidance (Notice 2021-31, located on the IRS website here) is in question and answer format, with 86 questions filling 41 pages. While the guidance is helpful, it leaves some important questions unanswered and, unfortunately, contains a surprising provision that is likely to cause communication headaches for employers, given the late arrival of the guidance and the fact the many employers have already sent notices based on the model ARP notices published by the U.S. Department of Labor ("DOL") on April 7, 2021 (see our LEGALcurrents on the model notices here and original LEGALcurrents on ARP is found here). Below, we describe the most noteworthy parts of the guidance, starting with the surprising position taken by the IRS.

Election of ARP Premium Assistance Under ARP Extended Election Period "Forces" Elections That Were Delayed under Outbreak Period Guidance

The most surprising position taken by the IRS in the guidance is in regard to how the ARP "extended election period" affects individuals who have delayed electing COBRA coverage in reliance on the relief provided in the DOL/IRS "Outbreak Period" guidance that extends certain deadlines (including the deadline for electing COBRA coverage (see our prior LEGALcurrents published March 1, 2021 and May 5, 2020)). Under the Outbreak Period guidance, an individual may delay electing COBRA coverage for up to one year[1] after the normally applicable COBRA election deadline, meaning that individuals who experienced reduction in hour or involuntary termination of employment COBRA qualifying events and lost coverage in May 2020 or later currently still have time remaining to elect COBRA coverage that would be retroactively effective back to the date they originally lost coverage in 2020.

ARP includes an extended election provision that allows individuals who would be assistance eligible individuals, but who do not have a federal COBRA election in effect as of April 1, 2021, or who had elected federal COBRA and then dropped it before April 1, 2021, to newly elect subsidized COBRA coverage beginning April 1, 2021 (or later date; see more below). DOL guidance issued with model ARP notices on April 7, 2021 specified that the Outbreak Period extension guidance does not apply to an individual's election of subsidized coverage under this ARP extended election period and that an ARP assistance eligible individual must make an election within 60 days of receipt of the ARP notice in order to qualify for the

[1] If the Outbreak Period ends before the one-year time frame, the individual will have to elect COBRA after the end of the Outbreak Period. The Outbreak Period ends 60 days after the President declares an end to the COVID-19 outbreak national emergency.

Practice Group Leader
Paul W. Holloway

Health and Welfare
Thomas J. Hurley
John W. Brill

Counsel
Leslie E. DesMarteau
Lisa G. Pelta
Joseph E. Simpson

Associates
Amanda M. Karpovich

Benefits Litigation
Jessica N. Clemente
Erika N. D. Stanat

Retirement
Mark R. Wilson

Executive Compensation
Christopher M. Potash

subsidy. The DOL also noted that the individual's election period for subsidized COBRA "does not cut off the individual's preexisting right to elect COBRA continuation coverage, including under the extended time frames provided under" the Outbreak Period guidance. Based on this DOL guidance (including the DOL model ARP notices), employers believed that an eligible individual could both (1) make an election of ARP subsidized COBRA under the ARP extended election provision, with subsidized coverage beginning April 1, 2021 (or later) and (2) subsequently make an election under the Outbreak Period guidance, for unsubsidized coverage retroactive to the date coverage was originally lost.

Surprisingly, the IRS guidance says that an individual who uses the ARP extended election period to elect subsidized COBRA beginning April 1, 2021 (or later date) "must also elect or decline COBRA continuation coverage retroactive to the loss of coverage, if eligible, within 60 days of receiving the notice of the ARP extended election period." In other words, even if the Outbreak Period guidance would have given the individual more time to make their COBRA election for coverage going back to the date coverage was originally lost, if the individual wants to elect ARP subsidized coverage, their Outbreak Period extension terminates and they must affirmatively elect or decline retroactive coverage going back to the date coverage was originally lost.

This guidance would ordinarily be good news for employers, since it in essence "forces the hand" of individuals who have delayed making their COBRA elections under the Outbreak Period guidance. Unfortunately, it has arrived so late that it may cause more problems for employers. Many employers (or their COBRA service providers) have already sent ARP notices that were based on the model ARP notices published by the DOL on April 7, 2021. As noted above, the DOL model notices did not contain any language notifying the individual that if they had delayed their original COBRA election under the Outbreak Period guidance, they would be required to make that election (electing or declining coverage) at the same time they elect the ARP subsidized coverage. Unless an employer had a crystal ball and predicted this May 18, 2021 guidance from the IRS, it is unlikely that the employer communicated the requirement that the individual is required to elect or decline the COBRA coverage going back to the original date coverage was lost. Employers will need to consider sending an additional communication to potential assistance-eligible individuals who have delayed making their original COBRA elections. Being more favorable to employees than the guidance provides (allowing subsequent elections of retroactive, non-subsidized coverage in accordance with the Outbreak Period guidance) may present issues for employers who provide benefits on an insured basis, because an insurance carrier may choose to strictly follow the guidance and refuse to provide the retroactive coverage. Self-insured employers who purchase stop-loss coverage may face claim denials by their stop-loss carrier if the employer is more generous than what is required by the IRS guidance.

In addition to this "elect or decline" retroactive coverage bombshell, the guidance also addresses a number of other points:

- Qualifying for a Subsidy
  - Unsurprisingly, the guidance confirms that a qualifying event that is a reduction in hours, whether voluntary or involuntary, can qualify an individual for a subsidy.

- Several Q&As address the meaning of an "involuntary" termination of employment. These Q&As are very similar to the guidance the IRS issued in 2009 for the COBRA subsidy under ARRA. The guidance defines an involuntary termination as "a 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." Whether a termination is "involuntary" depends on the "facts and circumstances" of the termination. The guidance addresses the following scenarios:
  - A termination is involuntary if the employer formally terminates employment while the person is not working due to illness or disability, provided there is a reasonable expectation that the employee would be able to return to work after the illness or disability has subsided.
  - Retirements generally do not constitute an involuntary termination, unless the facts and circumstances indicate that if the individual didn't retire, the employer would have terminated the individual's employment and that the individual would have been willing to continue working and had knowledge that the employer would have terminated their employment if the person didn't retire.
  - Terminations "for cause" are involuntary. However, a termination for "gross misconduct" will not qualify an individual for a subsidy (even if the person is entitled to COBRA-like continuation coverage under a State mini-COBRA law).
  - A resignation due to a material change in the geographic location of employment constitutes an involuntary termination.
  - Participation in a "window program" pursuant to which employees with impending terminations of employment are offered a severance arrangement to terminate employment within a specified period of time constitutes an involuntary termination.[2]
  - Resignations due to concerns about workplace safety are not involuntary terminations, unless the employee demonstrates that an employer's actions or inactions resulted in a "material negative change in the employment relationship analogous to a constructive discharge." The guidance goes on to observe that if a person leaves employment due to actions unrelated to an employer, such as a health condition, daycare issue, or having to care for a family member, the termination "generally" will not amount to a constructive discharge and will thus be considered voluntary.
  - A resignation due to the individual's child being unable to attend school due to the COVID-19 National Emergency is not an involuntary termination. However, the guidance clarifies that if the person takes a temporary leave of absence to care for the child (with the employer and employee both expecting the employee to return to work at some later date), the individual could qualify for a subsidy because the qualifying event would be a reduction in hours (which, as noted above, need not be involuntary to qualify an individual for a subsidy).

[2] The window program must comply with longstanding Treasury Regulations in order for termination to qualify as involuntary. See Treas. Reg. 31.3121(v)(2)-1(b)(4)(v).

  - An employee-initiated termination of employment in response to an involuntary material reduction in hours does constitute an involuntary termination of employment.
  - An employee's death is not considered an involuntary termination of employment.
  - An employer's decision not to renew an employee's contract of employment will constitute an involuntary termination of employment, provided the employee was willing to continue the employment relationship. However, if, at the time the employee and employer entered into the expiring contract, and at all times as services were being performed, the parties understood that the contract would not be renewed, the expiration of the contract will not be an involuntary termination.
- The guidance addresses multiple qualifying events (e.g., a termination of employment followed by a divorce within the first 18 months of COBRA) and other ways that COBRA coverage can be extended beyond the normal 18 month maximum COBRA period associated with a termination of employment or reduction in hours (such as the 11-month disability extension or an extension under State mini-COBRA). If the original qualifying event was a reduction in hours or involuntary termination of employment AND if an individual elected and remained on COBRA beyond the original 18 months of COBRA (the maximum COBRA period associated with a qualifying event that is a termination of employment or reduction in hours) due to the occurrence of a second qualifying event, a disability extension, or State mini-COBRA, the individual could qualify for the ARP subsidy, even though some or all of the coverage after April 1, 2021 was coverage beyond the original 18 months of COBRA coverage. Though the guidance does not explicitly say this, the guidance suggests that if an individual's 18 month period would have expired before April 1, 2021 and if the individual did not elect and remain continuously covered as of April 1, 2021, the individual would not be eligible for the ARP subsidy. This is welcome news for employers, because many employers only notified individuals of the ARP extended election right to enroll (or re-enroll) in COBRA as of April 1, 2021 if their original qualifying event occurred within 18 months prior to April 1, 2021. The guidance confirms that this approach is correct, as it would ensure that the ARP extended election notice was sent to all individuals who are eligible for the ARP extended election right as of April 1, 2021.
- An otherwise assistance eligible individual will be ineligible for a subsidy if they are "eligible" for Medicare or another group health plan that doesn't consist only of excepted benefits. The guidance clarifies that if an individual is technically eligible for another group health plan, but doesn't have an effective opportunity to enroll in that coverage as of April 1, 2021, the person can still qualify for the subsidy. For example, suppose an individual had a COBRA qualifying event in October 2020, and then the individual got a new job and declined coverage offered by the new employer. If the person did not have an effective opportunity to enroll in the new employer's coverage as of April 1, 2021 (e.g., because the new employer permits a person to enroll only when initially eligible, during annual enrollment, or after a life event recognized by section 125 of the Code), the individual would not be disqualified from receiving the subsidy. This approach is similar to the guidance issued under ARRA in 2009.

- Employer's Ability to take a Tax Credit
  - To get a tax credit, an employer must retain in its records either (1) a self-certification or attestation from the individual that the person qualifies for a subsidy or (2) other evidence that the individual qualified (such as records concerning a reduction in hours or involuntary termination of employment) for the subsidy. That an employer can rely on a certification or attestation from an individual is welcome news for employers, since, as evident from the IRS's definition of "involuntary" as outlined above, there sometimes there can be "grey areas" as to whether a termination of employment was voluntary or involuntary (many of which are dependent on the subjective intent of the employee). However, if an employer has "actual knowledge" that an individual does not qualify for a subsidy, the employer cannot take the tax credit. The ability to rely on an individual's certification or attestation of eligibility is especially good news for employers who use third party COBRA administrators, many of whom do not in the normal course receive data from employers as to whether a termination of employment was voluntary or involuntary. If the third party COBRA administrator "collects" an individual's certification or attestation of eligibility in some form (and retains it on behalf of the employer), that will provide sufficient support for the employer's tax deduction, unless the employer has actual knowledge that an individual does not qualify for a subsidy. The DOL's model ARP notices contain a form (titled "Request for Treatment as an Assistance Eligible Individual") that can be used as a self-certification/attestation.
  - The guidance confirms that only individuals who are considered COBRA qualified beneficiaries are entitled to the subsidy under ARPA. Thus, if an employer is more generous than what COBRA requires and offers continuation coverage to someone who is not a COBRA qualified beneficiary, that individual would not be ARP subsidy eligible and the employer could not take a tax credit in connection with subsidized continuation coverage offered to that individual. For example, an employee's domestic partner who does not satisfy Internal Revenue Code requirements to be considered the employee's tax dependent for health coverage purposes would not be eligible for the ARP subsidy and the employer could not take a tax credit with respect to subsidized continuation coverage offered to that individual. The guidance contains detailed rules for addressing the amount of tax credit an employer can claim when continuation coverage covers assistance eligible individuals as well as individuals who are not assistance eligible. For example, suppose the continuation coverage covers the former employee, the former employee's dependent children (all of whom were covered at the time of the employee's termination of employment and would be COBRA qualified beneficiaries), along with the former employee's domestic partner, who is not the former employee's tax dependent and would not be a COBRA qualified beneficiary). Depending on the normal COBRA premium for different levels of coverage under the employer's plan (e.g., employee-only, employee-plus one, employee-plus two, etc.), the employer may be entitled to take a tax credit for the full amount of the COBRA premium. Employers with these coverage situations should consult the guidance (Q&A 68).
- State Mini-COBRA
  - Some states, like New York, have "mini-COBRA" laws that provide continuation of coverage rights to individuals enrolled in insured coverage. In some cases, like in New York, these mini-COBRA laws go beyond what is required by federal COBRA, and apply to plans that otherwise would not be

subject to federal COBRA (employer with fewer than 20 employees in preceding year) or provide continuation coverage for a longer period than would be available under federal COBRA (for example, New York mini-COBRA provides for up to 36 months of continuation coverage where the qualifying event is reduction in hours or termination of employment; federal COBRA generally provides for up to 18 months for such events). The guidance addresses the application of the ARP subsidy provision to individuals who may have mini-COBRA continuation rights. In general, ARP subsidies are available to individuals enrolled in coverage pursuant to state mini-COBRA, subject to the following:

- An individual is not eligible for a subsidy unless the individual would have been a qualified beneficiary under federal COBRA. This means, for example, that an individual terminated for gross misconduct would not qualify for a subsidy because such an individual would not be entitled to federal COBRA, even though such an individual might have a right to continue coverage pursuant to a state mini-COBRA law.
- As noted above, an individual who is actually enrolled in state-continuation coverage as of April 1, 2021 will generally qualify for a subsidy, even if the original qualifying event occurred more than 18 months before April 1, 2021 (i.e., even if the person's federal COBRA period would have been exhausted). The guidance suggests that, for plans subject to both federal COBRA and state mini-COBRA, if the person was not enrolled in coverage as of April 1, 2021, and if the person's federal maximum COBRA period would have expired before April 1, 2021, the individual is not eligible for the ARP extended election enrollment right into the plan as of April 1, 2021 and is therefore not eligible for the subsidy.
- If a plan is only subject to state mini-COBRA (e.g., employer with fewer than 20 employees in preceding year), the guidance is clear that an individual will not be eligible for the ARP extended election enrollment right to enroll in the plan as of April 1, 2021, unless the state separately provides for an extended election period with respect to its mini-COBRA.

Effective Date for ARP-subsidized Coverage Elected Under ARP Extended Election Right

As noted above, ARP includes an extended election provision that allows individuals who would be assistance eligible individuals, but who do not have a federal COBRA election in effect as of April 1, 2021, or who had elected federal COBRA and then dropped it before April 1, 2021, to newly elect subsidized COBRA coverage. The ARP law itself provides that COBRA coverage elected pursuant to this extended election right would be effective as of April 1, 2021. The April 7, 2021 DOL guidance suggested that an individual taking advantage of the ARP extended election right could choose to have their subsidized COBRA coverage start prospectively from the date of their election (in other words, after April 1, 2021), but the DOL model ARP notices did not contain provisions addressing such prospective elections. The IRS guidance makes it clear that an individual electing COBRA pursuant to the ARP extended election provision may choose to have COBRA coverage begin on a date later than April 1, 2021. For example, an individual who lost coverage on October 1, 2020 due to an involuntary termination of employment and receives notice of the ARP extended election right on May 1, 2021 may choose to have subsidized coverage begin as of April 1, 2021 or prospectively (for example, as of June 1, 2021). An individual presumably might delay receiving free COBRA coverage if the individual was enrolled in coverage through a health insurance exchange (also

referred to as Marketplace coverage) and qualified for an advance premium tax credit that would need to be repaid if COBRA coverage overlapped with the Marketplace coverage. Employers who use a third party to handle COBRA and/or plan enrollment may have difficulty implementing such prospective coverage elections.

Retiree Coverage May Be Eligible for ARP Subsidy

The guidance says that the ARP subsidy (and employer tax credit) may be available for an assistance eligible individual who enrolled in retiree health coverage instead of electing COBRA coverage. In order for retiree coverage to be subsidy eligible, the retiree coverage must be offered under the same group health plan as coverage made available to similarly situated active employees. It is permissible that the amount charged for the retiree coverage exceeds the amount charged to active employees, provided that the amount doesn't exceed what would be the maximum amount allowed under COBRA.

Eligibility for Retiree Coverage May Make Individual Ineligible For ARP Subsidy

As noted above, a basic requirement in order for an individual to qualify for the ARP subsidy is that the individual not be eligible for coverage under any "other group health plan." Like the IRS guidance in 2009, the guidance clarifies that an individual who is eligible for retiree health coverage may nonetheless qualify for the ARP subsidy if that retiree health coverage is offered under the same group health plan as the COBRA coverage was offered. If the retiree coverage is offered under a separate group health plan, the individual will not be eligible for the subsidy. The guidance specifies that under existing COBRA regulations, all health benefits provided by an organization constitute a single group health plan unless it is clear from the instruments governing the arrangement(s) that the benefits are being provided under separated plans and the arrangement(s) are operated as separate plans. Many employers maintain separate "retiree-only" plans to provide their retiree benefits, with separate ERISA plan numbers, documents, and Form 5500 filings. In such a case, the retiree benefits would be considered provided under a separate plan and eligibility for retiree benefits would make an individual ineligible for the ARP subsidy.[3]

Severance Arrangements

Some employers provide subsidized COBRA coverage to employees in connection with severance arrangements. For example, an employer severance plan might provide a qualifying terminated employee with six months of base pay, plus six months of COBRA coverage at the active employee contribution rate. In such situations, if the individual is also ARP subsidy eligible, what is the amount of the tax credit available to the employer? For example, if employee-only COBRA would normally cost $1,000 per month and the active employee contribution toward the cost of employee-only coverage would be $200 per month, an individual who qualified for benefits under the employer's severance plan would normally be required to pay $200 per month for the first six months of COBRA coverage. If the individual is ARP subsidy eligible,

[3] Keep in mind, though, that if the individual did not have an effective opportunity to enroll in the retiree plan as of April 1, 2021, the individual could be eligible for a subsidy. For example, if a retiree plan operating on a calendar year basis had an open enrollment period in the fall of 2020, with coverage effective January 1, 2021 (if elected), and if a retiree declined coverage under that plan, the retiree could be eligible for an ARP subsidy unless the retiree plan would allow the individual to newly enroll in the plan at any point during the plan year.

the individual will pay $0 for coverage while ARP subsidy eligible. Is the employer's tax credit $200 (the amount that the individual would otherwise have been required to pay) or $1,000, the full COBRA premium amount that the individual would have been required to pay if the employer hadn't (generously) maintained a severance plan providing employer-subsidized COBRA coverage? The guidance is somewhat confusing on this issue, but appears to limit the employer to a $200 tax credit in such a situation. In anticipation of the enactment of ARP, some employers amended their severance plans to specify that the employer-subsidized COBRA coverage is not available to an individual who is ARP subsidy eligible. It appears that the IRS intends the guidance to "override" such amendments and limit the employer to a tax credit in the amount that the individual would have been required to pay if the employer had subsidized the coverage, but other language in the guidance may permit an employer to argue that it is entitled to the full tax credit (i.e., $1,000 in the above example). Additional clarification from the IRS would be helpful.

If you would like more information regarding this guidance, please contact any member of the Employee Benefits and Executive Compensation group at 585.232.6500 or 716.853.1616, or visit www.hselaw.com.

Attorney Advertising. Prior results do not guarantee a similar outcome. This publication is provided as a service to clients and friends of Harter Secrest & Emery LLP. It is intended for general information purposes only and should not be considered as legal advice. The contents are neither an exhaustive discussion nor do they purport to cover all developments in the area. The reader should consult with legal counsel to determine how applicable laws relate to specific situations. © 2021 Harter Secrest & Emery LLP