

Client
Advisory

Revised COBRA Rule

March 26, 2004

We want to advise you of a recent IRS Revenue Ruling that may impact the administration of COBRA under your group health plan(s). This ruling limits the circumstances under which your plan would be required to extend the COBRA coverage period due to a subsequent “qualifying event.”

Current Rules

The continuation coverage requirements of COBRA provide that if an individual has a COBRA qualifying event that is a termination of employment or reduction in hours, the applicable maximum COBRA period is 18 months (which can be extended to 29 months in the event of certain qualifying disabilities). For any other COBRA qualifying event, including the death or divorce of a covered employee, the employee’s entitlement to Medicare benefits, or an employee’s dependent ceasing to qualify as a dependent under the terms of the plan, the maximum COBRA period is 36 months. In addition, if an individual receiving COBRA coverage pursuant to the 18 or 29-month rule, subsequently experiences a second qualifying event that would entitle the individual to 36 months of COBRA coverage, the individual becomes entitled to a total of 36 months of COBRA coverage which is generally measured from the date of the first qualifying event (i.e., the termination of employment or reduction in hours).

To be a qualifying event for COBRA purposes, it is not enough that an individual experience one of the enumerated qualifying events; it is also necessary that the event be one that would otherwise cause the individual to lose coverage under the group health plan. While the loss of coverage has always been one of the criteria for determining if a first qualifying event has occurred, it has generally not been required for purposes of determining if a second qualifying event has occurred.

Revenue Ruling 2004-22

In Revenue Ruling 2004-22, the IRS held that a second qualifying event only entitles an individual to an extended COBRA period if, absent the occurrence of the first qualifying event, the individual would have lost coverage under the plan when the second qualifying event occurred. The following Examples illustrate how this new holding would apply.

Facts: Employer’s group health plan provides that upon an employee’s divorce, his or her spouse will no longer qualify for coverage under the plan. The plan further provides that if an employee becomes entitled to Medicare benefits, his or her spouse will continue to be eligible to participate in the plan provided that the spouse’s coverage will terminate when he or she becomes entitled to Medicare.

Example 1: Employee X, who covers himself and his spouse under Employer's group health plan, terminates employment on March 1, 2004 and elects COBRA coverage for himself and his spouse. Absent an earlier event terminating their COBRA coverage, the COBRA coverage will terminate on September 1, 2005 (18 months after the termination of employment). On October 1, 2004, Employee X and his spouse are divorced. Since the divorce would have caused Employee X's spouse to lose coverage under the plan if Employee X had not terminated employment, the divorce constitutes a second qualifying event entitling the spouse to a total of 36 months of COBRA coverage, measured from March 1, 2004.

Example 2: Employee Y, who covers herself and her spouse under Employer's group health plan, terminates employment on April 1, 2004 and elects COBRA coverage for herself and her spouse who is 10 years younger than her. Three months later, Employee Y turns age 65 and becomes entitled to Medicare. Since Employee Y's entitlement to Medicare would have had no effect on her spouse's plan coverage if she were still covered under the plan as an active employee, her entitlement to Medicare does not constitute a second qualifying event for COBRA purposes and the spouse is not entitled to an extension of the 18-month COBRA period.

Employers should note the following in connection with the new Revenue Ruling. First, under COBRA, an employer may offer more coverage than is required under COBRA, and thus, an employer's plan is not required to be revised to reflect the provisions of Revenue Ruling 2004-22. However, to the extent a plan is fully insured under a policy which provides that plan coverage will be continued only to the extent mandated under COBRA, the employer will need the consent of the insurer to continue treating a second event as a COBRA qualifying event if that event would not otherwise constitute a second qualifying event under the holding in the Ruling.

In addition, the revision of a plan to reflect the provisions of the new Revenue Ruling will most likely require changes in the provisions of the plan, summary plan description, and any third party administrator agreements, as well as all COBRA notices and election forms.

For further information on the application of Revenue Ruling 2004-22 or for assistance in revising your plan documents and plan materials as necessary, please contact:

David E. Barry

(212) 808-7618

dbarry@kelleydrye.com

Alan J. Laska

(212) 808-7624

alaska@kelleydrye.com

Pamela D. Kaplan

(212) 808-7980

pkaplan@kelleydrye.com