



*February 18th, 2009*

## ***DETAILS OF THE COBRA SUBSIDY IN THE ECONOMIC STIMULUS PACKAGE***

The economic stimulus package signed into law by President Obama on February 17, 2009 includes a subsidy of COBRA premiums for up to nine months for certain employees involuntarily terminated between September 1, 2008 and December 31, 2009 and their spouses and dependents. The subsidy, which is set at 65% of the otherwise applicable COBRA premium, will ultimately be funded by the Federal government through an offset of payroll taxes for the entity (in most cases, the employer) that initially bears the burden of the subsidy. The new provisions, which generally become operative on March 1, 2009, will impose notice and other administrative requirements on plan sponsors, in addition to those involved with the reimbursement process.

### **What the New Provisions Do:**

- Provide a 65% subsidy of the COBRA premium for nine months from date of enactment for employees and their eligible COBRA beneficiaries, if the employee was subject to involuntary termination (other than for gross misconduct) at any time between September 1, 2008 and December 31, 2009;
- Allow affected employees and their beneficiaries who did not elect COBRA prior to the effective date of the new provisions to elect COBRA coverage (but only for the remainder of the otherwise applicable COBRA period, based on the date of involuntary termination) and enjoy the subsidy prospectively from the date of enactment under a special enrollment period;
- Allow affected employees to choose a different level of coverage under certain circumstances, if the plan allows for such option;
- Limit the subsidy if the affected individual becomes eligible for coverage under another group health plan or Medicare;
- Provide reimbursement for so-called "mini-COBRA" programs for small employers under applicable State laws;
- Reduce or eliminate the subsidy for certain affected individuals if the income of that person (or their spouse or another person that they are a dependent of) exceeds certain thresholds - modified adjusted gross income of \$125,000 (single filer) or \$250,000 (joint return);
- Impose notice requirements on the employee and employer to implement and administer the subsidy - the Department of Labor must provide model notices

within 30 days (March 19<sup>th</sup>) and employers must provide notices to affected individuals within 60 days (April 18<sup>th</sup>);

- Provide for an expedited governmental appeal process if an affected individual is denied the subsidy or any of the special enrollment rights provided by the new rules.

#### **What the New Provisions Do Not Do:**

- They do not allow an affected individual to elect COBRA coverage for periods prior to the date of enactment, if they have not already done so;
- They do not provide a subsidy or reimbursement for COBRA premiums paid for COBRA coverage prior to the date of enactment;
- They do not extend COBRA coverage, subsidized or not, beyond the COBRA end date based on the termination of employment that is the basis of the COBRA coverage;
- They generally do not provide reimbursement for employer-paid COBRA premiums;
- They do not include House proposal that would have extended COBRA coverage through Medicare entitlement for certain older and longer term employees.

#### **Premium Subsidy.**

The Federal Government will subsidize 65% of the COBRA premiums for a period of no more than 9 months for qualified beneficiaries who are *assistance eligible individuals*. This means that a COBRA qualified beneficiary, or a person (other than the employer) paying the premium on their behalf (e.g., the parent of a qualified beneficiary), will be treated as having paid the COBRA premium in full if they pay 35% of the premium.

A COBRA qualified beneficiary is an assistance eligible individual if:

- The qualified beneficiary elects COBRA coverage,
- The qualifying event with respect to the covered employee is the loss of group health plan coverage due to involuntary termination of employment, and
- The qualifying event occurs during the period beginning on or after September 1, 2008 and ending December 31, 2009.

The subsidy is available to all group health plans eligible for COBRA except a health flexible spending account (FSA).

### “Mini COBRA”.

The new rules extend the premium subsidy to state programs that provide comparable continuation of coverage. This likely includes state programs for small employers that are not currently covered by federal COBRA. In many cases these state requirements are purely insurance requirements (i.e. former employee pays the insurance company directly for continuation of coverage). If there is no employer involvement under these continuation programs, the insurer should be responsible for compliance and eligible for the government reimbursement.

### Reimbursement.

**Employer Payroll Tax Credit.** Generally, the employer (in the case of a group health plan subject to COBRA) will receive a reimbursement for the amount of premiums not paid by the assistance eligible individual by virtue of the new rules. This will be 65% of the COBRA premium (unless the employer directly subsidizes the total COBRA premium).

Upon receipt of the assistance eligible individual’s premium payment, the employer may reduce payroll taxes owed by it in an amount equal to the portion of such reimbursement related to the premium. Payroll taxes include wage withholdings, employee FICA taxes and employer FICA taxes. If the amount exceeds the payroll tax liability, the Internal Revenue Service (IRS) will provide a credit or refund.

**Employer-Funded COBRA.** The availability of the reimbursement is based on the amount of premiums that would otherwise be paid by an assistance eligible individual without the new rules. It appears that arrangements made by the employer to pay a portion of the COBRA premium (e.g., certain severance agreements) are not considered for purposes of the subsidy and reimbursement. Therefore, if the employer agrees to pay a portion of the employee’s COBRA premiums, the subsidy is based only on the employee’s portion of the premium and not the employer’s contribution or the total premium. Employers paying the entire COBRA premium are not eligible for any reimbursement. Employers will need to review any such agreements in light of these changes.

### Duration of the Subsidy.

The premium subsidy is available to an assistance eligible individual for a limited period of time. The subsidy ends on the earlier of:

- The first date that the assistance eligible individual becomes eligible under any other group health plan or is eligible for benefits under Medicare,
- 9 months after the first month that the individual receives the subsidy,
- The end of the maximum COBRA period, or
- The end of the maximum period under any state “COBRA-like” requirement.

The assistance eligible individual has the obligation to notify the group health plan in writing if he or she becomes eligible for other group health plan coverage or Medicare. Failure to do so may result in a penalty imposed on the individual of 110% of the premium reduction unless the failure was due to reasonable cause.

### **Special Election Period.**

There is a special COBRA election period available for individuals who would otherwise be an assistance eligible individual but did not elect COBRA continuation of coverage when it was initially offered (or elected and later dropped coverage). Individuals who were involuntarily terminated on or after September 1, 2008 must be notified of their ability to elect continuation of COBRA coverage and receive the subsidy. They will have the opportunity to elect COBRA under the special election until 60 days after the date a notification of the special election is sent to the individual.

COBRA coverage will be offered from the first period of coverage on or after the date of enactment. The period of coverage is a monthly or shorter period in which premiums are charged. For most plans this will be March 1, 2009.

Under this provision, coverage can be elected back to March 1, 2009, but the duration of coverage is measured from the original qualified event date.

#### *Example:*

Bob was involuntarily terminated and experienced a COBRA qualifying event on November 1, 2008. COBRA premiums were too expensive and Bob did not elect to continue coverage. Under the Act, Bob's former plan will need to notify Bob of his right to elect COBRA and the availability of the premium subsidy. Bob has 60 days from the date of the notification to elect COBRA. If he elects COBRA coverage he pays a premium of 35% of the COBRA rate.

Bob elects coverage and pays the premium starting March 1, 2009. Bob's COBRA coverage is prospective from March 1 (not retroactive for earlier periods), but the 18-months of continuation of coverage is measured from November 1, 2008.

If the assistance eligible individual was without health coverage beginning on the date of the COBRA qualified event and ending with the first period of coverage under the new rules (March 1, 2009), this period will be disregarded for purposes of determining whether the individual had a 63-days break in coverage under the creditable coverage rules.

### **Optional – Alternative Coverage.**

Employers that offer a variety of group health plan may allow the assistance-eligible individual to enroll in COBRA coverage that is different from the coverage held at the time of the qualified event. In order for an individual to take advantage of this option:

- The employer must make the option available,
- The premium associated with the alternative coverage must not be greater than the premium associated with the current coverage,
- The alternative coverage is offered to active employees, and
- The alternative coverage is not a standalone vision or dental plan, a health FSA or HRA plan or an onsite medical facility.

The assistance eligible individual has 90 days after notification of this option to elect to enroll in alternative coverage.

### **Notification Requirements.**

**Election Notice for Qualified Beneficiaries.** The COBRA election notice must now include the following in order to be considered sufficient notice of the premium subsidy:

- Availability of a premium reduction with respect to the COBRA coverage,
- The option (if available) to enroll in different coverage under the employer's plan including a description of the other available coverage options,
- Forms necessary to establish eligibility for the premium reduction,
- Contact information (including name, address and phone number) for the plan administrator and any other person maintaining information in connection with the premium reduction (e.g., COBRA administrator),
- A description of the extended election period,
- A description of the obligations of the qualified beneficiary to notify the plan of eligibility for other group health plan coverage or eligibility for benefits under Medicare and the penalty for failing to provide such notice, and
- A prominent description of a qualified beneficiary's right to reduced premium and any condition on entitlement to the reduction in premium.

This notice may take the form of an amendment to the existing notice forms or by inclusion of a separate document with the election notice.

**Notice in Connection With Extended Election Periods.** The plan administrator must provide notice of the special enrollment period to all individuals who involuntarily terminated on or after September 1, 2008 and are not receiving COBRA continuation of coverage, or who are now entitled to elect the subsidy. This notice should contain the information described above and must be provided by April 18, 2009. A model notice should be issued by the Department of Labor (DOL) on or before March 19, 2009.

Failure to provide this notice is treated as a failure to comply with notice requirements under COBRA.

**IRS Notification.** The employer will need to submit reports to the IRS in a time and manner to be determined that include:

- An attestation of the involuntary termination of employment of each employee claiming the subsidy,
- The amount of payroll taxes offset by the reimbursement,
- The tax identification numbers of all covered employees,
- The amount of the subsidy reimbursed with respect to each covered employee, and
- The type of coverage (one individual or two or more individuals) associated with the subsidy.

### **Overpayment by Employee or Beneficiary.**

As this transition is happening very quickly, it is likely that many participants will pay the full COBRA premium, even though they may be eligible for the premium subsidy. In the event of an overpayment, the employer has the option of reimbursing the individual the difference or applying the overpayment as a credit toward future premium payments. However, when using the credit option the employer must have a reasonable belief that the credit will be used within 180 days from the date the individual made the full payment. If not, the employer must reimburse the individual within 60 days.

### **Special Rules for High Income Individuals.**

Generally, the full subsidy will not be available to certain high income individuals. The limitation appears to apply to any affected individual based on the modified adjusted gross income shown on their income tax return or the return of their spouse or another individual (e.g., a parent) that the individual is a dependent of. If any such return shows modified adjusted gross income of \$145,000 (\$290,000 for a joint return), the affected individual will need to repay the subsidy for all months received during the taxable year. This is handled by an increase in the taxpayer's liability for the year equal to such amount, referred to as the *recapture tax*.

If the taxpayer's modified adjusted gross income is between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for joint filers) the premium subsidy is available on a proportionate basis for the taxable year. The taxpayer will be subject to a reduced recapture tax based on the modified adjusted gross income.

It is important to note that an individual who does not satisfy the income threshold to receive a full or partial subsidy in 2009 may nevertheless be eligible in 2010 assuming the applicable modified adjusted gross income falls below the required levels.

Individuals may waive the right to the premium subsidy for all periods of coverage. This waiver is permanent and the individual must provide written notice to the employer. The waiver avoids the recapture tax should the income threshold be exceeded. However, the waiver applies to all periods of coverage regardless of tax year. Therefore if an individual waives their premium subsidy in 2009 he or she may not claim the subsidy in 2010 even if the income falls below the threshold.

### **Appeal of a Subsidy Denial.**

An individual who requests the subsidy and is denied by the group health plan may appeal the determination to the DOL. The DOL (in consultation with the IRS) shall provide an expedited review of any such denial. The DOL must make its determination within 15 business days after receipt of an individual's application for review.

## What is Next?

Employers should begin preparation for the implementation of the new rules, including.

- Giving consideration to the offering of alternative coverage options,
- Gathering information on individuals that terminated employment on or after September 1, 2008 and providing proper notification of the new subsidy under COBRA. This includes:
  - Developing proper notices – as noted, DOL model notices should be available March 19, 2009,
  - Updating election notices and providing them to qualified beneficiaries with qualifying events going forward,
  - Sending notices to current COBRA qualified beneficiaries that are now eligible for a subsidy, and
  - Sending the special election notice to individuals who are otherwise assistance eligible individuals but are not receiving COBRA continuation of coverage.
- Tracking qualified beneficiaries receiving the subsidy and complying with the proper reporting requirements to the IRS.
- Collecting waivers from individuals affected by the income limitations,
- If applicable, discussing these requirements with your COBRA administrator to ensure they have the proper notices and reporting process in place to assist you in your compliance obligations.
- Reviewing any employment practices that provide employer-subsidized COBRA benefits.

We expect that considerable guidance will be forthcoming in the weeks to come. We will continue to monitor developments and report them to you.

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