

Updated April 6, 2009

EBS-RMSCO CLIENT ALERT NEW COBRA PREMIUM SUBSIDY

The American Recovery and Reinvestment Act of 2009 (the “Act”) provides a temporary COBRA premium subsidy for certain individuals. It also imposes related notice and reporting requirements for employer-sponsored group health plans.¹ This Client Alert discusses the COBRA subsidy requirements in Q & A form, and reflects guidance issued by the U.S. Department of Labor (“DOL”) and Treasury through April 6, 2009.

Which health plans must comply with the COBRA subsidy requirements?

The requirements apply to all insured and self-funded health plans subject to Federal COBRA law (generally, plans sponsored by employers with 20 or more employees) or comparable State continuation coverage laws, except health flexible spending accounts under cafeteria plans. Some COBRA subsidy rules for plans subject to Federal COBRA law are different from the rules for plans subject to State continuation coverage laws. This Client Alert focuses on the subsidy rules for plans subject to Federal COBRA law.²

Note: Health reimbursement arrangements (“HRAs”) and dental and/or vision only plans are not exempt from the subsidy requirements.

Who is eligible for the COBRA premium subsidy?

The Act refers to a person who is eligible for the COBRA subsidy as an assistance eligible individual (“AEI”). To be an AEI, a person must satisfy two requirements.

1. He must either be: (i) an employee who became (or becomes) eligible for COBRA coverage between September 1, 2008 and December 31, 2009 due to the involuntary termination of his employment during that same time period; or (ii) the spouse or dependent child of such an employee who became (or becomes) eligible for COBRA coverage during that period due to the employee’s involuntary termination.

Note: For a terminated employee, or his spouse or any of his dependent children, to be eligible to elect COBRA coverage, he or she must be covered under the plan immediately prior to the termination and the termination must not have been because of gross

¹ The Act imposes similar requirements on multiemployer health plans and insurers of fully insured health plans not subject to COBRA. It also extends the maximum COBRA coverage period for some individuals receiving Trade Adjustment Assistance benefits or pension benefits from the Pension Benefit Guaranty Corporation. These COBRA changes are not addressed in this Client Alert.

² As used in this Client Alert, “Federal COBRA law” refers to the COBRA continuation coverage provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”), the Internal Revenue Code (the “Code”), and the Public Health Service Act.

misconduct. Also, if an employee's family member has a COBRA qualifying event that is not an involuntary termination of employment (e.g., divorce) and the employee is later involuntarily terminated, the family member does not qualify as an AEI, because the family member's right to elect COBRA coverage was not due to the involuntary termination. Similarly, an employee who has a COBRA qualifying event that is not an involuntary termination (e.g., a reduction in hours), elects COBRA coverage, and is later involuntarily terminated while on COBRA coverage, is not an AEI because his right to elect COBRA coverage was not due to the involuntary termination.

2. He must have elected COBRA coverage during his original COBRA election period or, if he was eligible to elect COBRA coverage before February 17, 2009 (the date President Obama signed the Act) and did not have COBRA coverage in effect on that date, he must elect COBRA coverage during an extended election period which begins on that date and does not end until 60 days after he receives a new COBRA notice.³

Note: This extended election period is for an individual eligible for Federal COBRA coverage before February 17, 2009 and who did not elect COBRA coverage (even if one of his family members did), or elected, but later discontinued, his COBRA coverage. If COBRA coverage is elected during this extended election period, COBRA coverage starts with the first period of coverage (e.g., calendar month) beginning on or after February 17, 2009. (It is not retroactive to the date the AEI lost plan coverage.) However, the period between the date he lost coverage and the beginning of COBRA coverage must be disregarded for purposes of determining whether there is a 63 day or more gap in coverage and preexisting condition exclusions apply.⁴

Generally, the amount of the subsidy is excluded from the AEI's gross income. However, if an AEI has adjusted gross income over a certain level for a year he receives the subsidy, part or all of the subsidy received that year is recaptured through an increase in his income tax liability. This tax liability is phased in for AEIs filing a single return with adjusted gross income between \$125,000 and \$145,000, and for AEIs filing a joint return with adjusted gross income between \$250,000 and \$290,000. An AEI may avoid the tax by notifying the plan that he is **permanently** waiving the subsidy and wishes to pay the full COBRA premium. The waiver must be written and cannot be reversed, even if the period the subsidy would otherwise be available spans two tax years (i.e., 2009 and 2010) and his adjusted gross income changes.

³ This extended election period required under the Act does not apply to plans subject only to State continuation coverage laws (generally, plans sponsored by employers with less than 20 employees), but a State may choose to provide for this extended election period.

⁴ Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), the maximum period during which a plan can apply a preexisting condition exclusion to a new enrollee is generally 12 months, reduced by any prior period of "creditable coverage" which is not interrupted for 63 or more days. However, if an AEI elects COBRA during the extended election period, the period between the date he lost coverage under the plan and the beginning of COBRA coverage is disregarded for purposes of this 63 day gap rule.

Another reason an AEI may wish to waive the subsidy is that receiving the subsidy for a month disqualifies him from receiving the Health Coverage Tax Credit (which could be more valuable) for that month.

What is an involuntary termination of employment?

Treasury guidance defines an involuntary termination for purposes of the subsidy 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.” The determination whether a termination was involuntary is not controlled by how the termination may be classified by the employer, but is based on all the facts and circumstances. Treasury gives the following examples of involuntary terminations:

- a termination by the employer for cause (but, as noted above, termination due to gross misconduct is not a COBRA qualifying event);
- action by the employer to end employment while the employee is absent from work due to illness or disability;
- the employer’s failure to renew an employment contract when it expires, if the employee was willing and able to execute a new contract, with terms and conditions similar to those in the expiring contract, and to continue providing the services;
- an employee’s retirement, resignation or other voluntary termination if the employer would have terminated him anyway and the employee knew he would be terminated;
- a termination by an employee in return for a severance package or “buy-out” where the employer indicates that, after the offer period for the severance package or buy-out, a number of remaining employees in the employee’s group will be terminated;
- an employee-initiated termination for good reason due to employer action resulting in a material negative change in the employment relationship (e.g., an employee’s voluntary termination in response to a material reduction in his hours or a resignation in response to a material change in the geographic location of his employment);
- a lay-off with right of recall, temporary furlough or other suspension of employment; and
- a lockout initiated by the employer.

Treasury gives the following examples of terminations that are not involuntary terminations:

- death of the employee;
- an employee’s absence from work due to illness or disability; and

- a work stoppage as the result of a strike initiated by employees or their representatives.

How much is the subsidy?

It is 65% of the COBRA premium. Thus, an AEI cannot be charged more than 35% of the normal COBRA premium. Under current Federal COBRA law, the maximum COBRA premium (pre-subsidy) is 102% (or, in the case of an extension of continuation coverage due to a disability, 150%) of the plan's cost for the coverage. Treasury guidance explains:

- if an AEI is charged a reduced COBRA premium without regard to the subsidy, the 65% subsidy applies to (and the tax credit discussed below can be claimed only for 65%) of the amount the AEI would pay without regard to the subsidy;
- any portion of the COBRA premium paid on a pre-tax basis (e.g., from an HRA or by the employee from severance pay under a Code §125 cafeteria plan) is treated as paid by the employer, not the AEI, and must be subtracted from the COBRA premium before computing the subsidy and employer tax credit;
- the subsidy does not apply to the portion of the COBRA premium paid to cover persons who do not qualify as AEI's because they had no independent right to elect COBRA coverage at the time of the employee's involuntary termination (e.g., a spouse or dependent child not covered at the time of the termination but added later, or an employee's domestic partner), and any incremental cost paid by an AEI to provide coverage for these persons must be subtracted from the COBRA premium before computing the subsidy and employer tax credit;⁵
- any amount an AEI pays for continuing non-health benefits (e.g., life insurance) is excluded when computing the subsidy and employer tax credit; and
- if COBRA coverage is elected during the extended election period discussed above, the due date for the initial subsidized COBRA premium payment is determined under normal COBRA rules (i.e., 45 days after the COBRA election).

Recognizing the short time employers have to comply with the subsidy rules, the Act states that, if an AEI pays more than his 35% share of the COBRA premium for either of the first two periods of coverage beginning on or after February 17, 2009 (e.g., March and April 2009 for plans providing coverage on a calendar month basis), the excess payment should either be credited against his future COBRA premiums (if it is reasonable to expect the excess to be exhausted within six months after the overpayment) or reimbursed to him within 60 days.

⁵ Domestic partners have no independent right to elect COBRA coverage under Federal COBRA law. However, an employee who elects COBRA coverage can elect coverage for a domestic partner if active employees can cover their domestic partners, since COBRA coverage must be identical to coverage offered to active employees.

When does the subsidy start and stop?

The subsidy does not apply until the first period of COBRA coverage beginning on or after February 17, 2009 (e.g., March 2009 for plans providing coverage on a calendar month basis). However, if an employer extends health coverage to an employee after termination of his employment, on the same terms as active employees, and does **not** treat part or all of the extended coverage as COBRA coverage, then the subsidy does not apply until the extended (non-COBRA) coverage stops. The subsidy ends (and the normal COBRA premium may be charged) on the earliest of:

- the date nine months after the first day of the first month the AEI was eligible for the subsidy;
- the day after the maximum COBRA coverage period ends (for an AEI who elects COBRA coverage during the extended election period discussed above, the maximum COBRA coverage period is the same maximum period that would have applied if he had elected COBRA coverage when he was first entitled to do so); or
- the date the AEI is eligible for Medicare or coverage under another group health plan (e.g., his spouse's employer-sponsored plan) even if not actually covered, **other than** (i) a plan providing only dental, vision, or counseling coverage; (ii) a health flexible spending plan (including an HRA that qualifies as a flexible spending account under Code §106(c));⁶ or (iii) an employer maintained limited care on-site medical clinic.

Note: Treasury guidance indicates that an AEI is no longer entitled to the subsidy when he becomes eligible under his spouse's employer-sponsored plan even if his spouse refuses to enroll him in her plan.

An individual is subject to a penalty equal to 110% of the amount of any subsidy received after becoming eligible for such other coverage if he failed to give the plan written notice of his eligibility for the other coverage.

An individual may be an AEI and eligible for the COBRA subsidy more than once. For example, suppose an individual becomes an AEI due to his own involuntary termination on March 31, 2009, elects COBRA coverage, and pays the subsidized COBRA premium until July 1, 2009 when he is enrolled in his spouse's employer-sponsored plan. His spouse's employment is later involuntarily terminated and they both lose coverage under her plan on November 1, 2009. He is an AEI again on, and entitled to nine months of the subsidy from, November 1, 2009. (His spouse is also an AEI on November 1, 2009 and entitled to nine months of the subsidy from that date.)

⁶ Under Code §106(c), an HRA is a flexible spending account if the maximum amount of reimbursement reasonably available to a participant (generally his HRA balance) is less than 500% of the value of the coverage (generally the HRA COBRA premium).

Who pays for the subsidy?

The employer must “front” the subsidy, but can claim the subsidized amount as a credit on IRS Form 941 (Employers’ Quarterly Federal Tax Return) against payroll taxes or offset payroll tax deposits by the amount of the subsidy, but only *after* the employer has received the AEI’s 35% share of the COBRA premium. Form 941 has already been revised for the subsidy. The employer must insert on Form 941 the amount of the subsidy and the number of AEIs who received the subsidy. If subsidy payments exceed the payroll tax liability, Treasury will credit or refund the excess as if it were a tax overpayment. The employer is required to keep documentation supporting the credit claimed, including:

- information on the receipt of AEIs’ 35% share of the premium, including dates and amounts;
- for insured plans, a copy of the invoice or other statement from the insurer and proof of timely payment of the full COBRA premium;
- for self-insured plans, proof of the premium amount and coverage provided to AEIs;
- an attestation of involuntary termination for each AEI, including the date of termination;
- proof of each AEI’s eligibility for COBRA coverage between September 1, 2008 and December 31, 2009, and his COBRA coverage election; and
- a record of the social security numbers of all AEIs who receive the subsidy, the amount of any subsidy reimbursed to each AEI (because of an overpayment), and whether the subsidy was for one individual or more than one.

Note: An employer cannot claim the tax credit for any subsidy provided to an individual after the employer has been notified that the individual does not qualify for the subsidy or the employer otherwise knows the individual does not qualify.

Is there any change to the type of coverage which must be provided under COBRA?

Normally, when an individual elects COBRA coverage the plan provides the same health coverage he had before he became entitled to COBRA coverage, until the next open enrollment period. The Act allows (but does not require) a plan to permit an AEI (including an AEI who already elected COBRA coverage), to elect an alternate plan coverage option, provided: (i) the option is available to active employees; (ii) the premium for the alternate option is no greater than the premium for the coverage he had just before he became entitled to COBRA coverage; and (iii) the alternate option is not a health flexible spending plan (including an HRA that qualifies as a flexible spending account under Code §106(c)), coverage limited to dental, vision, or counseling services, or an employer maintained limited care on-site medical clinic. An AEI offered an alternate coverage option must be given at least 90 days to elect the option after he receives notice of his right to elect the alternate option. (This 90 day election period does not

change the normal 60 day period the AEI has to elect COBRA after receiving a COBRA election notice.)

What are the new COBRA notice requirements?

The Act requires that special COBRA notices be sent to employees, spouses and dependents who became (or become) eligible to elect COBRA coverage between September 1, 2008 and December 31, 2009 (“COBRA qualified beneficiaries”).⁷ To help employers comply with these requirements, the DOL has created three model notices for plans subject to the Federal COBRA law.⁸ The model notices can be found on the DOL’s website (www.dol.gov). Each model notice is designed for a particular group of COBRA qualified beneficiaries, and must be customized to include specific information (e.g., a description of the COBRA qualifying event, date of COBRA qualifying event, maximum period of COBRA coverage, COBRA premium information, contact information, and, if applicable, information regarding the availability of any alternate coverage option). Here is a brief description of the notices.

The “Abbreviated Version General Notice” contains subsidy and other information required under the Act, but does not contain information generally required in a COBRA election notice. It should be sent to all COBRA qualified beneficiaries who had ***any type*** of COBRA qualifying event (not just termination of employment) on or after September 1, 2008, ***and*** (i) received a COBRA election notice without the subsidy and other information required under the Act, ***and*** (ii) elected and still have COBRA coverage.

The “Notice in Connection with Extended Election Period” contains subsidy and other information required by the Act, and explains the extended election period. It should be sent no later than April 18, 2009 to all qualified beneficiaries who had a COBRA qualifying event ***that was an involuntary termination of employment*** (either their own or their family member’s involuntary termination) between September 1, 2008 and February 16, 2009, ***and*** (i) received a COBRA election notice without the subsidy and other information required under the Act, ***and*** (ii) did not elect COBRA coverage (even if one of their family members did), or elected, but later discontinued, their COBRA coverage.

The “Full Version General Notice” contains subsidy and other information required by the Act, as well as information generally required in a COBRA election notice. It should be sent as soon as possible to all COBRA qualified beneficiaries who already had ***any type*** of COBRA qualifying event (not just termination of employment) on or after September 1, 2008, ***and*** (i) have not (but should have already) received a COBRA election notice, ***or*** (ii) received a COBRA election notice after February 16, 2009 without the subsidy and other information required under the Act - unless the qualified beneficiary gets the Abbreviated Version General Notice for the

⁷ Failure to comply with the Federal COBRA notice requirements subjects the “plan administrator” to fines of \$110 per day for each failure, as well as possible excise taxes. The employer is the plan administrator for most employer-sponsored plans, and this Client Alert assumes the employer is responsible for satisfying the notice requirements.

⁸ The DOL also issued a fourth model notice which insurers can use for plans subject to comparable State continuation coverage laws.

same plan. It should be sent to all other qualified beneficiaries who have any type of COBRA qualifying event between September 1, 2008 and December 31, 2009 by the deadline for sending the COBRA election notice (generally, 44 days after the COBRA qualifying event).

The DOL has examples explaining which Notice should be sent to particular COBRA qualified beneficiaries. Modified versions of the examples are in the Attachment to this Client Alert.

*Note: There is no model notice, and the DOL has taken the position that no further notice need be given to, COBRA qualified beneficiaries who had a COBRA qualifying event between September 1, 2008 and February 16, 2009 that was not an involuntary termination of employment, and (i) received a COBRA election notice **before** February 17, 2009 without the subsidy and other information required by the Act, and (ii) did not elect COBRA coverage or elected, but later discontinued, their COBRA coverage. See Example 3 in the Attachment.*

The Notices include a form entitled “Request for Treatment as an Assistance Eligible Individual,” which an individual can complete and send to an employer to request the subsidy. The employer must then review the request, determine if the subsidy applies, indicate on the form whether the request is approved or denied (and, if it is denied, indicate the reason), and return a copy of the form to the COBRA qualified beneficiary.

The Notices also include a form entitled “Participant Notification,” which a COBRA qualified beneficiary is supposed to use to notify the employer that he is no longer eligible for the subsidy because he has become eligible for other group health plan coverage or Medicare coverage.

What can an individual do if the employer denies his request for the subsidy?

He can appeal directly to the DOL or, if the plan is not subject to ERISA, to the Department of Health and Human Services (“HHS”). The DOL and HHS are developing a form which can be mailed, faxed or completed over the Internet to appeal a denial. The Act directs the DOL and HHS to establish a procedure under which appeals must be decided within 15 business days. The DOL has stated that employers will have an opportunity during this 15 business day period to provide information relevant to the denial. If a decision on appeal is challenged in court, the court must give deference to the DOL or HHS decision.

What should employers do now?

To comply with the COBRA subsidy requirements, employers should:

- identify all AEIs and determine which of them are entitled to the extended election period;
- establish procedures to adjust the COBRA premium for AEIs, reimburse or credit any excess COBRA premiums paid by them, and track the subsidy period for each AEI;
- review IRS Form 941 and instructions to understand how to obtain the tax credit for the subsidy;

- review the new DOL model COBRA Notices, and prepare and distribute the new Notices by the required dates;
- decide whether to offer alternate plan coverage to AEIs who elect COBRA coverage;
- coordinate compliance efforts with any third party handling COBRA administration and any insurer providing plan coverage;
- contact legal counsel if the employer has any questions; and
- read the current guidance and watch for additional guidance on the DOL and Treasury web sites (www.irs.gov and www.dol.gov). You can subscribe to e-mail updates on the new requirements at www.dol.gov/ebsa/COBRA.html.

This Client Alert is for general informational purposes only, does not cover all issues and details concerning the COBRA subsidy and should not be considered or relied upon as legal advice.

ATTACHMENT

Example 1: A COBRA qualified beneficiary had any type of COBRA qualifying event on September 15, 2008, received a COBRA election notice on October 15, 2008, and elected (and still has) COBRA coverage. He receives the Abbreviated Version General Notice.

Example 2: A COBRA qualified beneficiary had a COBRA qualifying event that was an involuntary termination of employment on October 2, 2008, received a COBRA election notice on October 31, 2008, and did not elect COBRA coverage. He receives the Notice in Connection with Extended Election Period.

Example 3: A COBRA qualified beneficiary had a COBRA qualifying event that was a divorce on January 6, 2009, received a COBRA election notice on January 19, 2009, and did not elect COBRA coverage. He receives no further notice. He does not receive the Full Version General Notice because he received a proper COBRA notice before February 17, 2009. He does not receive the Abbreviated Version General Notice because he did not elect COBRA coverage. He does not receive the Notice in Connection with Extended Election Period because his COBRA qualifying event was not an involuntary termination.

Example 4: A COBRA qualified beneficiary had a COBRA qualifying event that was an involuntary termination of employment on January 11, 2009 and, but for COBRA, will lose coverage on February 1, 2009. He received a COBRA election notice on February 22, 2009 which did not include COBRA subsidy information. He receives the Full Version General Notice *and*, if he does not have a COBRA election in effect on February 17, 2009, he *also* receives the Notice in Connection With Extended Election Period. The information in these two Notices may be combined, provided it is clear that he can choose from two different COBRA coverage start dates (February 1, 2009 or March 1, 2009) and, either way, is eligible for the subsidy beginning March 1, 2009.

Example 5: A COBRA qualified beneficiary had a COBRA qualifying event that was an involuntary termination of employment on January 24, 2009, when he was covered under a medical plan and a dental plan. But for COBRA, he would lose coverage under both plans on February 1, 2009. He received COBRA election notices on February 26, 2009 without COBRA subsidy information, and elected (and still has) COBRA coverage under the medical plan. He did not elect COBRA coverage under the dental plan. He receives the Abbreviated Version General Notice for the medical plan. (Note that he would receive this Notice regardless of the type of COBRA qualifying event he had.) He *also* receives a Notice in Connection with Extended Election Period for the dental plan. The information in these two Notices may be combined, provided it is clear that he can elect COBRA for the dental plan and the subsidy is available under both plans beginning March 1, 2009.

Example 6: A COBRA qualified beneficiary had any type of COBRA qualifying event on February 28, 2009, and received a COBRA election notice on March 17, 2009 which did not include COBRA subsidy information. This person should receive a Full Version General Notice, and his COBRA election period does not end until 60 days after he receives it.

Example 7: A COBRA qualified beneficiary has any type of COBRA qualifying event on April 11, 2009, and receives a COBRA election notice on May 1, 2009, which should be the Full Version General Notice.