

Revised Alert

Ready or Not: New Federal COBRA Subsidy Law Requires Prompt Employer Action

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Tax Act of 2009 (the "Act") into law. The Act includes a subsidy for certain qualified beneficiaries who are entitled to COBRA¹ coverage in connection with an involuntary termination that occurred, or will occur, between September 1, 2008 and December 31, 2009 (the "Program").

Because the subsidy is available for periods of COBRA coverage beginning on or after February 17, 2009, it is important that employers immediately identify the steps they must take to comply with the Act. The following Alert highlights the Program, identifies planning issues employers may wish to consider when employees are being involuntarily severed and recommends next steps for employers to take to comply with the Act.

A. The Program

An "assistance eligible individual" (as defined below) is generally eligible for a 65% COBRA subsidy for nine months of the COBRA coverage period (the "Subsidy"). The Subsidy is provided through a premium reduction to assistance eligible individuals ("AEIs"). Thus AEIs need only pay 35% of the premium that would otherwise be charged to them.

General Eligibility Rules

AEIs include any qualified beneficiary (including the spouse or dependent of an employee) who is eligible for COBRA coverage in connection with an involuntary termination of the employee's employment which occurred, or will occur, between September 1, 2008 and December 31, 2009 and who elects COBRA coverage. AEIs include individuals entitled to continued health coverage under a comparable State law even though they are not entitled to Federal COBRA (due to, for example, the small employer exception to Federal COBRA). However, because the Act limits eligibility for the Subsidy to individuals eligible for COBRA, according to informal, nonbinding Treasury remarks of Treasury representatives, a domestic partner receiving continued health coverage is not eligible for the Subsidy.

In informal, nonbinding remarks Treasury Department representatives indicated that further guidance will be forthcoming regarding what constitutes an "involuntary termination." In the interim, in determining whether a termination may be characterized as "involuntary," these individuals suggested a termination may be considered involuntary if it would be considered involuntary for purposes of state unemployment insurance eligibility. These representatives

¹ As discussed below, certain individuals not entitled to Federal COBRA are eligible for the subsidy. For ease of reference, except as specifically indicated, all references in this Alert to "COBRA" generally also include other governmentally mandated continued coverage, which is comparable to COBRA, under which an individual is entitled to continued group health plan coverage. However, because continued coverage under a health flexible spending arrangement is not eligible for the subsidy, the use of "COBRA" in this Alert does not refer to continued coverage under those arrangements.

also indicated that, unless further guidance is issued on this issue, if an individual is eligible for COBRA as the result of the involuntary reduction of an employee's work hours, the individual would not be eligible for the Subsidy.²

Duration of Subsidy

For an AEI, eligibility for the Subsidy will begin during the first COBRA period beginning after the later of the eligible involuntary termination of employment or February 16, 2009. Thus, for most employers who bill for COBRA coverage on a monthly basis, the first Subsidy will be available March 1, 2009. An AEI will generally be eligible for the Subsidy for a period of nine months; however, the Subsidy period will be shorter under certain circumstances. First, an AEI will no longer be eligible for the Subsidy when the individual becomes eligible for coverage under another group health plan (other than certain group health plans, such as stand alone dental or vision plans and health flexible spending arrangements) or Medicare. An individual's eligibility for the Subsidy therefore will end as soon as the individual becomes eligible for coverage under another group health plan or Medicare, *regardless of whether the individual actually enrolls in the other coverage*. In particular, legislative history indicates that an individual is considered to be ineligible for the Subsidy if the individual is eligible to enroll in his or her spouse's group health plan coverage.

Alternatively, the Subsidy period will end on the *earliest* of: (a) nine months following the date the AEI is first eligible for the Subsidy, or (b) the date the maximum COBRA period ends (generally, 18 months following the qualifying event).

The Act provides that an AEI who fails to timely notify a group health plan that he or she is no longer eligible for the Subsidy, and therefore receives it while ineligible, will be subject to a penalty of 110% of the premium reduction provided after the individual was no longer eligible for the Subsidy.

Church Health Plan Participants' Eligibility for Subsidy

Because church plans are exempt from federal COBRA, individuals participating in church health plans are generally not eligible for the Subsidy. However, individuals covered by church health plans (even if they are self-insured) that are subject to state continuation coverage laws that are comparable to federal COBRA appear to be eligible for the Subsidy. We note that many states do not specifically address whether church plans are subject to state continuation coverage obligations.

Eligibility for Subsidy When Another Individual/Entity Pays for All or a Portion of the COBRA Coverage

An AEI is generally eligible for the Subsidy, even if someone other than that individual pays the COBRA premiums. Therefore, if the parent of an AEI pays the COBRA premium on the individual's behalf, only 35% of the COBRA premium need be paid. However, we understand that if an employer pays for all, or a portion of, the COBRA premium, the Subsidy to which an individual would be entitled would be based on the amount that is actually charged to the individual. For example, if, during one month, an employer were to pay for an AEI's entire COBRA coverage, the individual would not be entitled to

² If an individual believes he or she should be eligible for the subsidy, but the plan or employer refuses to treat the individual as an AEI, the individual can appeal to the Department of Labor (or, in certain circumstances, the Department of Health and Human Services), which is directed to make a binding determination within 15 business days of the receipt of the claim.

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any subsidy for that month. Similarly, if, during one month, an employer were to pay 80% of an AEI's COBRA premium, the individual would be entitled to a subsidy equal to 65% of the remaining premium. Thus, if the COBRA premium were \$1,000 and the employer agreed to pay \$800, the individual would be required to pay \$70 $((\$1,000 - \$800) \times 35\%)$, and would be entitled to a subsidy of \$130 $((\$1,000 - \$800) \times 65\%)$.

Treasury officials have stated in informal, nonbinding remarks that if an employer pays for the entire COBRA premium for one or more months of COBRA coverage, the period of time during which the AEI would be entitled to the Subsidy would only be extended if the plan also extends the maximum period of COBRA coverage. For example, if an AEI is involuntarily terminated on February 28, 2009, his or her COBRA coverage begins on March 1, 2009 and his or her employer agrees to pay for COBRA coverage for the month of March, the individual would only be entitled to eight months of the Subsidy, unless the employer agreed (because coverage is not otherwise lost prior to April 1st) that the maximum COBRA coverage period is to be measured from April 1, 2009. It should be noted that if an employer provides health coverage pursuant to an insured arrangement, the employer should ensure that the insurer has agreed to provide coverage beyond the maximum COBRA period before agreeing to extend the maximum COBRA coverage period.

Involuntary Termination Occurring On Or After September 1, 2008 But Before February 17, 2009

The Act provides a second opportunity for certain AEIs to elect Federal COBRA coverage and receive the Subsidy. If an involuntary termination occurred on or after September 1, 2008 and no Federal COBRA coverage is in effect on February 17, 2009 for a qualified beneficiary who would otherwise be considered an AEI, because either the individual never elected COBRA or because the individual stopped paying the COBRA premium, the individual must be given an opportunity to elect COBRA coverage during the period ending 60 days following notice of the individual's extended election right, and receive the Subsidy. The individual's COBRA coverage would be effective prospectively, and this extended enrollment opportunity would not extend the maximum COBRA coverage period to which the AEI is entitled. For example, if an employee was involuntarily terminated on October 1, 2008, and the individual did not then elect COBRA, the Act would allow the individual to elect COBRA now, but the maximum COBRA coverage period generally will still end on March 31, 2010 (i.e., 18 months after the qualifying event occurred). We note that the extended enrollment opportunity right under the Act only applies to individuals eligible for Federal COBRA and is not mandated with respect to coverage sponsored by employers with fewer than 20 employees who may be subject to state continuation rules. According to the Department of Labor, a state can take action to provide the extended enrollment opportunity to individuals covered by state continuation coverage provisions.

Individuals with Gross Income Above a Certain Threshold May Be Taxed on Subsidy

If an AEI has a modified adjusted gross income ("AGI") which exceeds \$125,000, but is not more than \$145,000 (\$250,000 and \$290,000, respectively, in the case of a joint return), in the year the subsidy is received, the individual will be subject to an additional tax, on a phased-in basis, equal to a portion of the premium reduction. To the extent an individual's AGI exceeds \$145,000 (or \$290,000 in the case of a joint return), the individual will be subject to an additional tax equal to the full amount of the premium reduction.

In lieu of paying the tax on the premium reduction, an individual may elect to *permanently* waive his or her right to the Subsidy. Because the waiver is permanent, if an individual becomes eligible for COBRA in one year, and must pay the tax on the premium reduction because his or her adjusted gross income for the year exceeds the threshold identified above, the individual would not be eligible for the subsidy in the following year, even if his or her AGI no longer exceeded the threshold. For example, if an AEI becomes eligible for COBRA beginning November 1, 2009 and waives his or her right to the Subsidy because the individual's AGI for 2009 exceeds the threshold (and would subject him or her to tax on the reduced premium amount), the individual would not be eligible for the Subsidy for his or her COBRA coverage beginning January 1, 2010, even if his or her AGI in 2010 does not exceed the applicable threshold.

Mechanism for Subsidy and Reimbursement

As discussed above, the Subsidy is provided to AEIs via a COBRA premium reduction. For a multi-employer plan, the plan will be required to (if insured) advance the balance of the premium due to the insurance company, and will then recapture the Subsidy amount (whether fully or self-insured) from the government. For employers sponsoring plans subject to Federal COBRA, the employer will also be required to pay the insurance company (if insured) the balance of the premium when due, but will also be able to recapture the subsidy amount (whether fully or self-insured) from the government. For insured plans not subject to Federal COBRA (such as a small employer plan) but subject only to state COBRA equivalent rules, the premium to be paid to the insurer will need to be reduced, as it is the insurer who will be entitled to recover the Subsidy amount from the government. To recapture the Subsidy amount, the eligible entity generally will be entitled to take a credit against payroll taxes due, in an amount equal to the Subsidy amount for their AEIs. An entity may not take a credit, however, before *actually receiving* the AEI's portion of the COBRA premium.

To the extent that the reimbursement due an entity exceeds the entity's payroll tax liability, the IRS will credit or refund the excess as if an overpayment of taxes had occurred. Conversely, if an entity overstates the amount of reimbursement to which it is entitled, the IRS will treat the entity as having underpaid its payroll taxes.

Claiming the reimbursement will pose some administrative burdens on the entity advancing the Subsidy on behalf of the government. First, an entity entitled to recapture or reimbursement will be required to report on IRS Form 941 the total amount of COBRA premium assistance payments advanced on behalf of the government and the total number of individuals provided COBRA premium assistance payments. We note that the Act also requires an entity to submit reports including the following information: (a) attestations of the involuntary termination of employees' employment on whom the entitlement to the Subsidy and related reimbursement is based; (b) the amount of payroll taxes offset during the reporting period and estimated offsets of these taxes for the next reporting period; and (c) the tax identification numbers of all covered employees and the amount of subsidy reimbursed with respect to each AEI. However, since the IRS did not include this information in the revised Form 941, it is unclear whether or how this information will need to be reported. Second, the entity will be required to generate tax reporting forms (we understand likely, as a W-2 entry) reflecting the Subsidy. Thus, if an individual is terminated in late 2009 and receives a subsidy during 2010, the entity may be required to issue tax reporting forms to the individual for 2010.

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Notice Requirements

COBRA election notices must be provided to all individuals who became or will become eligible to elect COBRA coverage between September 1, 2008 and December 31, 2009 and must include, among other things, the following information: (a) the possible availability of the Subsidy, (b) a description of the extended election opportunity for AEIs who became eligible to elect COBRA on or after September 1, 2008 and before February 17, 2009, (c) notification of the individual's obligation to submit notification when the individual is no longer eligible for the Subsidy due to, for example, eligibility to enroll in another group health plan, and (d) the option to enroll in a different level of coverage (as described below), if applicable. All individuals eligible to elect COBRA coverage during this period must receive notices with this additional information, even if they are not eligible for the Subsidy (because, for example, their loss of coverage is in connection with a divorce or other loss of dependent status). In particular, all individuals eligible for COBRA coverage because they experienced qualifying events between September 1, 2008 and February 16, 2009 must still receive this notice even if their qualifying event was not in connection with an involuntary termination of employment. The Department of Labor has issued model notices for this purpose. The model notices can be found at www.dol.gov/ebsa/cobramodelnotice.html.

Level of COBRA Coverage

Generally, the level of group health plan coverage an individual is entitled to under COBRA is based on the level of coverage the individual was receiving the day before the qualifying event. Any changes to this level of coverage normally can only be made during an open enrollment period. Under the Act, an employer could choose (but is not required) to allow an AEI to, not later than 90 days after the notice described above has been provided, elect to enroll in coverage which is different from the coverage in which the individual was enrolled at the time the qualifying event occurred, so long as the premium for the elected coverage does not exceed the premium for coverage in which the individual was enrolled at the time the qualifying event occurred. It should be noted that the legislative history for the Act indicates that if an AEI chooses to enroll in a different level of coverage, the plan must allow the individual to continue with that coverage even after the expiration of the Subsidy period.

Effective Date

The Subsidy is available for any period of coverage beginning on or after February 17, 2009. In other words, if COBRA coverage is provided based on the first of each month, the Subsidy is available beginning March 1, 2009. If an AEI pays the full COBRA premium during either of the first two periods of COBRA coverage following February 17, 2009, the entity to which such premium is paid generally has the choice to either: (a) make a reimbursement payment to the individual for the amount paid which is in excess of the subsidized 35% premium level, or (b) provide a credit for subsequent premium payments.

³ As discussed above, the Program imposes significant administrative burdens on employers. Where there are very few Subsidy-eligible individuals, by choosing to pay for all of an AEI's COBRA premiums during the Subsidy period, an employer may avoid many (but not all) of these administrative burdens (such as the need to issue tax reporting forms for an individual terminated in a prior year); however, to do so would be to pay a portion of COBRA premiums that might otherwise be subsidized by the government.

B. Considerations When Structuring Severance Programs In Connection with Involuntary Terminations

Many employers choose to pay all or a portion of an employee's COBRA premiums for a period of time following an employee's involuntary termination. Employers should consider the impact of the subsidy Program on those decisions, and may wish to consider changing some prior arrangements. As discussed above, if an employer chooses to pay a portion of the COBRA premium, the AEI will only have to pay 35% of the remaining premium, and thus the governmental subsidy will be less. If an employer chooses to pay the entire COBRA premium for a month, the AEI will generally be entitled to one less month of the subsidy. Given that the US government is providing a 65% subsidy through the Program, employers may wish to reduce severance costs by eliminating some employer-paid COBRA benefits, or may determine to pay an employee severance, or a higher severance amount, in lieu of paying for an employee's COBRA coverage.³

We note that if an employer chooses to pay for all or a portion of an AEI's COBRA premium, the employer should ensure that the documentation is clear as to whether the payment of the premium will delay the commencement of the COBRA period (which may be possible if the employer is paying at least as much of the premium as it pays for active employees), or whether the COBRA period will not be extended (which would serve to reduce some or all of the Subsidy that might otherwise be available). But it is important to note that it may not be best for an employer, from a financial point of view, to agree to delay the start of the COBRA period to the end of the period of post-employment employer-paid coverage, as employer costs (because of self insurance or experience rating) can be adversely affected by medical claims related to that extended period. And, of course, if a plan is insured, an employer must secure the agreement of the insurance company for this arrangement.

C. Next Steps: An Employer Action Plan

In preparation for providing the Subsidy and complying with the Program, we recommend employers take the following steps, in coordination with third-party administrators as appropriate:

1. Identify all qualified beneficiaries who experienced a qualifying event on or after September 1, 2008, so that notices about the Subsidy can be sent to them, which notice, for plans subject to Federal COBRA, will need to include an offer to elect COBRA for Subsidy-eligible qualified beneficiaries who had not done so. The notice is required to be provided, within 60 days of February 17, 2009, to qualified beneficiaries with COBRA-qualifying events between September 1, 2008 and February 16, 2009. The Department of Labor has issued model notices for this purpose.
2. Decide whether to permit Subsidy-eligible individuals who commence COBRA coverage to elect a lower-cost level of COBRA coverage, within 90 days of the notice described above having been sent (which notice should then include information about this election right).
3. Modify COBRA notices to be provided to qualified beneficiaries with COBRA-qualifying events between February 17, 2009 and December 31, 2009 to include information about the Subsidy. The Department of Labor has issued model notices for this purpose.

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4. Identify all employees who were involuntarily terminated on or after September 1, 2008, and if they are eligible for the subsidy, accordingly lower COBRA premium bills as soon as practicable for Subsidy-eligible individuals. If bills go out before the Subsidy is reflected for all or part of the first two months of the Subsidy, determine whether to refund excess payments or apply excess payments to future COBRA premiums.
5. Modify payroll or other administrative systems appropriately to capture information regarding Subsidy-eligible individuals, in order to be able to determine whether individuals are eligible for the Subsidy, to bill appropriately, and to provide the required reporting when offsetting payroll tax payments and for purposes of tax reporting of the Subsidy.
6. Determine whether to modify any severance arrangements in light of the Subsidy.

This alert is for general informational purposes only and should not be construed as specific legal advice.

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