

News from our Compensation & Benefits Group

## Changes to COBRA: Subsidized Premiums in the Obama Stimulus Package

The American Recovery and Reinvestment Act of 2009 (“ARRA”) that was signed into law by President Obama on February 17, 2009 contains a number of provisions affecting continued health care coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA”). Under ARRA, certain employees (and their qualified beneficiaries) whose employment is involuntarily terminated between September 1, 2008 and December 31, 2009 will be able to continue health coverage under COBRA by paying only 35% of the ordinary COBRA premiums for up to nine months. The employer, the insurer or the health plan (which we refer to collectively in this *Alert* as the “insurance provider”) will be responsible for the remaining 65% but will recover the subsidy from the federal government through a credit against its payroll tax liabilities or through direct reimbursement. ARRA also imposes new notification obligations upon employers, with penalties for failure to comply.

On February 26, 2009, the U.S. Department of Labor (“DOL”) updated its website to include a page at [www.dol.gov/ebsa/cobra.html](http://www.dol.gov/ebsa/cobra.html) devoted to information about the COBRA subsidy under ARRA. That page will be updated periodically as new information becomes available.

### Background

An employee of an employer with 20 or more employees who loses coverage under the employer’s group health plan due to an involuntary termination of employment may elect to continue health coverage under

COBRA for a period of time (generally 18 months from the date coverage is lost) by paying premiums that may not exceed 102% of the cost of active employee health coverage.<sup>1</sup> Members of the employee’s family who have lost health coverage due to the employee’s termination of employment are also eligible to elect to continue coverage at their expense.

Prompted by the wave of recent workforce reductions and the high cost of COBRA continuation coverage, ARRA makes temporary changes to the COBRA rules applicable to the continuation of health coverage for involuntarily terminated employees (and their qualified beneficiaries), primarily by providing a federal subsidy to enable terminated employees and their qualified beneficiaries to pay premiums for such coverage. ARRA also extends this temporary subsidy to Cal-COBRA, which provides continuation coverage under insured health plans for involuntarily terminated employees (and their qualified beneficiaries) of California employers that employ fewer than 20 employees, as well as to continuation coverage that may be provided under the laws of other states.

### Assistance-eligible individuals

An employee (and any qualified beneficiary) is eligible for the ARRA premium subsidy if the employee is an assistance-eligible individual (“AEI”). To be an AEI, an employee must be involuntarily terminated from employment between September 1, 2008 and December 31, 2009 and be eligible to elect COBRA continuation coverage

as a result. Employees who are terminated other than as a result of an involuntary termination—for example, as a result of gross misconduct, voluntarily resignation or death—are not AEIs and, therefore, are not eligible for the COBRA premium subsidy.

AEIs include not only employees (and their qualified beneficiaries) who are involuntarily terminated after the enactment of ARRA and on or before December 31, 2009, but also employees (and their qualified beneficiaries) who elected COBRA due to an involuntary termination on or after September 1, 2008 but prior to February 17, 2009, and employees (and their qualified beneficiaries) who were eligible to elect COBRA continuation coverage within the same timeframe but who either did not elect such coverage or dropped such coverage because of a failure to pay COBRA premiums. Any such AEI who is not currently covered has a new opportunity to

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elect COBRA, and all AEIs covered by COBRA are eligible for the subsidy (unless they are “high income individuals” as described below). The insurance provider is required to provide notice to the above groups of AEIs. AEIs who did not elect COBRA continuation coverage when it was first offered or dropped such coverage because of a failure to pay COBRA premiums have a 60-day special election period after the date of the notice from the insurance provider to elect COBRA continuation coverage on a prospective basis.

AEIs who are “high-income individuals” will not be eligible for the full COBRA premium subsidy but instead will be eligible for either a partial subsidy or no subsidy depending on their income level. Phase-out of the COBRA premium subsidy begins for an individual with modified adjusted gross income (MAGI) of \$125,000 for the year in which the subsidy is provided to such individual (or \$250,000 if married, filing jointly). Individuals with MAGI greater than \$145,000 for such year (or \$290,000 if married, filing jointly) are not eligible for any subsidy. Any portion of a COBRA premium subsidy received by a high-income individual will be recaptured as an additional income tax payable by such individual. To avoid this tax consequence, high-income individuals may make a permanent election to waive the right to the subsidy by providing a notice to the insurance provider.

### Effective date of subsidy

The COBRA premium subsidy is effective for the first period of coverage for AEIs beginning on or after ARRA’s date of enactment (which was February 17, 2009). Thus, if COBRA premiums are paid on a monthly basis, the premium subsidy applies to COBRA continuation coverage on and after March 1, 2009. However, given the likely administrative challenge to incorporating the new subsidy on invoices for March 2009 COBRA continuation coverage, ARRA provides a grace period of two billing

cycles to credit or refund COBRA premium amounts paid by an AEI if in excess of 35% of the premium. In other words, the full COBRA premium may be charged for two billing periods, followed by a credit in subsequent billing periods equal to the amount paid by an AEI over 35% of the premium or by a reimbursement of the overpayment amount to the AEI.

### Duration of subsidy

An AEI’s eligibility for the COBRA premium subsidy ends on the earliest of:

- ▶ nine months after the first day of the first month during which the subsidy becomes available to the AEI;
- ▶ the date the AEI becomes eligible for coverage (even if the AEI does not actually enroll) under another group health plan (other than certain limited coverage plans) or becomes eligible for Medicare;<sup>2</sup>
- ▶ the end of the maximum continuation coverage period under COBRA (or under a state program, such as Cal-COBRA, providing continuation coverage); and
- ▶ the end of the period of continuation coverage allowed for AEIs entitled to the 60-day special election period described above.

### Ability to elect less expensive COBRA continuation coverage

Under current law, employees (and their qualified beneficiaries) are only eligible to elect continuation coverage that is identical to the coverage that the employee had at the time of the COBRA qualifying event (until the next open enrollment period). Under ARRA, an employer may, but is not required to, allow an individual to elect different coverage than the employee had prior to the COBRA qualifying event if

- ▶ the premium amounts are equal to or less than the premium amounts for the coverage the individual was enrolled in at the time of the COBRA qualifying event,

- ▶ the different coverage elected is available to all active employees, and
- ▶ the different coverage is not limited to a flexible spending account, coverage for only dental, vision, counseling or referral services or coverage only for limited services provided in an on-site medical facility maintained by the employer.

Such election to change coverage must be made within 90 days following receipt of a notice of the option to elect different coverage. Once this election is made, it is effective for the entire COBRA continuation coverage period, even if longer than the 9-month subsidy period.

### Tax treatment of COBRA premium subsidy

An AEI’s receipt of the COBRA premium subsidy is not taxable for federal tax purposes unless the AEI is a high-income individual (in which case, all or part of the subsidy is recaptured as an additional income tax). Under current California law, the premium subsidy is not taxable for state tax purposes (regardless of whether the AEI is a high-income individual) since it qualifies as employer-provided health coverage.

### Entity eligible for reimbursement of premium subsidy

For a single-employer group health plan subject to federal COBRA, whether insured or self-insured, the employer is entitled to reimbursement of the 65% COBRA premium subsidy. In such case, the covered individual pays 35% of the COBRA premium and, except in the case of a self-insured plan, the employer will remit the 35% amount plus an amount equal to 65% of the COBRA premium to the insurance company. Then the employer may reduce its payroll tax liabilities by an amount equal to 65% of the COBRA premium. To the extent that the amount of the premium subsidy exceeds the amount of the employer’s liability for payroll taxes, the IRS will

credit or refund the excess as if it were an overpayment of payroll taxes.

For any insured, single-employer group health plan that is not subject to federal COBRA (e.g., an insured single-employer group health plan subject to Cal-COBRA or other similar state law), the health insurance company is entitled to the reimbursement through the same credit on its payroll taxes as is described above.<sup>3</sup>

Neither ARRA nor its legislative history expressly addresses a situation where an employer is already subsidizing an AEI's COBRA premiums. However, it is reasonable to assume that the ARRA subsidy cannot be claimed if the non-ARRA employer subsidy exceeds 65% of the applicable premium, since the AEI would not be paying the full 35% of the applicable premium, as required by ARRA.<sup>4</sup>

The entity claiming reimbursement must submit reports including the following: (1) an attestation of an AEI's involuntary termination of employment, (2) a report of the amount of payroll taxes offset for a reporting period and the estimated offsets of such taxes for the subsequent reporting period and (3) a report containing the taxpayer identification numbers of all AEIs, the amount of subsidy reimbursed with respect to each AEI, and a designation with respect to each AEI as to whether the subsidy reimbursement is for coverage of one individual or of two or more individuals.

The payroll tax credit or any additional reimbursement of the premium subsidy is not treated as income to the insurance provider but rather as an employee contribution to a group health plan.

### Notice requirements

To comply with ARRA, all insurance providers must amend their existing COBRA notice forms and distribute additional notices to include the following:

- ▶ information on the availability of the COBRA premium subsidy (including

how to establish eligibility and any conditions on entitlement to the subsidy),

- ▶ a description of an AEI's ability to elect less expensive COBRA continuation coverage (if allowed), and
- ▶ a description of the obligation of an AEI to notify the insurance provider if the AEI becomes eligible for coverage under another group health plan or Medicare (including the penalty for failure to do so).

Insurance providers must also give notice to AEIs who were involuntarily terminated after September 1, 2008 but prior to February 17, 2009 of the AEI's right to receive the COBRA premium subsidy on a prospective basis. This notice to AEIs involuntarily terminated prior to enactment of ARRA must be provided by April 18, 2009.

Failure to distribute the required notices is treated as a failure to meet the ordinary COBRA notice requirements. The DOL is to issue model notices by March 19, 2009.

### Extension of COBRA coverage

ARRA also extends the maximum COBRA continuation coverage period for employees (and their qualified beneficiaries) whose qualifying event is a termination of employment or a reduction in hours and who have a right to receive pension benefits directly from the Pension Benefit Guaranty Corporation (the "PBGC") because the PBGC has taken over the pension plan in which such employees were participants. In that case, the maximum COBRA coverage period ends on such employee's date of death, with the maximum period for the surviving spouse and any dependents ending 24 months after such employee's death.

ARRA also extends the maximum coverage period for employees (and their qualified beneficiaries) who are Trade Adjustment Assistance-eligible individuals as of the date the maximum COBRA coverage period would otherwise end.<sup>5</sup> In such case, the maximum COBRA period ends on the date

such employee ceases to be a Trade Adjustment Assistance-eligible individual.

In neither of the above cases, however, can a COBRA coverage period extend beyond December 31, 2010.

### Insurance provider action items

- ▶ Identify all potential AEIs (including their qualified beneficiaries) who were involuntarily terminated on or after September 1, 2008 (including those who elected COBRA coverage, as well as those who either did not previously elect COBRA coverage or did elect COBRA but whose coverage has terminated due to nonpayment of premiums) and set up a system to identify future AEIs (including their qualified beneficiaries) who are involuntarily terminated on or after February 17, 2009 and on or before December 31, 2009
- ▶ Establish a system to limit COBRA charges for AEIs to 35% of the COBRA premium
- ▶ On or before April 17, 2009, provide a special enrollment notice to AEIs (including their qualified beneficiaries) who were involuntarily terminated on or after September 1, 2008 but who either did not previously elect COBRA coverage or did elect COBRA but lost such coverage due to nonpayment of premiums and permit them a 60-day special election period after such notice is provided in which to elect COBRA and receive the subsidy
- ▶ Update the COBRA qualifying event notice (which must be provided to all COBRA-eligible individuals within 14 days after a COBRA qualifying event) to include additional information about the availability of the subsidy for AEIs, conditions on entitlement to the subsidy, etc. and provide the updated notice to all future AEIs
- ▶ On or before April 17, 2009, provide notice of the subsidy to all current AEIs

who were on COBRA coverage as of February 17, 2009

- ▶ Develop a process by which “high-income individuals” can waive the subsidy
- ▶ Determine the amount of reduced COBRA premiums to be paid by AEs and be prepared to charge reduced premiums as soon as administratively possible on or after March 1, 2009
- ▶ Adjust COBRA administration to reflect the maximum 9-month period for subsidy and to monitor maximum COBRA period for AEs electing during the special enrollment period
- ▶ Establish a system whereby individuals who become ineligible for the subsidy (because eligible for other group health coverage, etc.) can provide required notification of such fact
- ▶ Establish an internal process to claim reimbursement for the COBRA subsidy via an offset to payroll taxes (collecting information needed to attest to involuntary termination of AEs, determining amount of offset based on amount of subsidies, etc.)
- ▶ Identify any AEs who will be eligible for the ARRA subsidy after any non-ARRA employer subsidy ceases
- ▶ If a non-ARRA employer subsidy of COBRA premiums is under discussion for a future work force reduction, consider the cost-effectiveness of such subsidy in light of the ARRA subsidy and the feasibility of either paying additional cash severance in lieu of the non-ARRA subsidy or of providing the non-ARRA subsidy after the period of the ARRA subsidy

If you have questions about this *Alert*, please contact one of the attorneys listed above. ■

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#### NOTES

1 A California employer that employs fewer than 20 employees and sponsors an insured health plan is required to offer similar continued health coverage to terminated employees under a California analogue to federal COBRA, commonly referred to as Cal-COBRA. As discussed later in this *Alert*, the ARRA subsidy applies to coverage under Cal-COBRA and similar state laws.

2 An AEI who becomes eligible for coverage under another group plan or Medicare is obligated to notify the insurance provider in the time and manner that the DOL requires. Failure to provide such notice can result in a penalty of 110% of the premium subsidy applicable to periods after the AEI became eligible for other coverage (unless such failure is due to reasonable cause).

3 For a multiemployer group health plan, the plan itself, as the insurance provider, will be entitled to the reimbursement.

4 An alternative approach has been suggested, which is that the amount actually paid by the AEI should be considered to be 35% of the reduced COBRA premium (i.e., the applicable premium reduced by the non-ARRA subsidy) with the insurance provider able to claim a reimbursement for 65% of the reduced premium. However, there is nothing in ARRA or its legislative history to support this approach.

5 A Trade Adjustment Assistance-eligible individual is a worker who lost a job or whose hours of work and wages were reduced as a result of increased imports and who, as a result, is eligible for certain benefits, re-employment services, etc. under the Trade Act of 1974.