



Stimulus Bill Includes Major COBRA Changes

On February 17, President Obama signed the American Recovery and Reinvestment Act (ARRA) into law. ARRA provides for a subsidy of 65% of the cost of COBRA coverage for certain qualified beneficiaries who have lost health coverage due to an involuntary termination of employment. Although the subsidy is to be paid by the federal government, plan administrators will face significant new administrative and communication challenges. While the COBRA provisions may have a greater impact on employers who have had a significant reduction-in-force, the requirements apply to all involuntary terminations. ARRA also extends COBRA coverage for certain individuals receiving benefits under the Trade Act of 2002.

ARRA is meant to be a fast-acting stimulus to the economy. In keeping with that goal, the new COBRA provisions are effective almost immediately, and plan sponsors must quickly map out a compliance strategy.

Background

The Consolidated Omnibus Budget Reconciliation Act (COBRA) requires group health plans to permit employees, their spouses and their dependent children who lose coverage due to a termination of employment or reduction in hours to elect to continue that coverage for up to 18 months. These “qualified beneficiaries” may be charged for the full cost of the continuation coverage plus a 2% administrative fee. Some employers provide subsidies to help pay the cost of COBRA in certain situations, such as reductions-in-force.

In addition, some states require continuation coverage similar to COBRA. For example, California has a COBRA-like continuation law for employer plans too small to be subject to federal COBRA.

COBRA Provisions in the American Recovery and Reinvestment Act

The stimulus law enacted February 17 provides premium assistance (i.e., a subsidy) from the federal government to help certain “assistance eligible individuals” (AEIs) pay for periods of COBRA or state continuation coverage (collectively COBRA coverage) beginning on and after the date of enactment. Thus, for most group health plans, the subsidy will be available with respect to premiums for coverage beginning March 2009. The subsidy is generally 65% of the amount that the AEI would otherwise be required to pay for COBRA coverage, and is available for medical, dental, and vision coverage and health reimbursement accounts (but not health flexible spending accounts). High-deductible health plans (HDHPs) offered in conjunction with a health savings account (HSA) are eligible for the subsidy, but the HSA is not.

The premium assistance is only available for continuation coverage that is mandated by federal or state law. COBRA-like voluntary extensions of coverage, such as those provided by some church plans, do not qualify.

Eligibility for the Premium Subsidy

Only AEIs are eligible for the subsidy. An AEI is a qualified beneficiary who loses group health coverage due to an *involuntary* termination of employment between September 1, 2008 and December 31, 2009 and who elects COBRA coverage (either when COBRA coverage is initially offered or during the special election period described below). The involuntary termination need not be in connection with a reduction-in-force program.

BUCK COMMENT. *Because AEIs must be qualified beneficiaries, dependents who cannot be qualified beneficiaries under COBRA (such as domestic partners and same-sex spouses) are not eligible. Similarly, dependents added after the qualifying event (other than newborns or children placed for adoption with the former employee) may not be AEIs. This means that separate tracking of these individuals – and the premiums owed by each family unit – may be necessary.*

In addition, the law does not define what constitutes an involuntary termination. Guidance is needed on whether certain terminations of employment (e.g., an employee is given the choice between resigning and being fired) would qualify for the subsidy.

How the Subsidy Works

Under the law, the plan must accept payment of 35% of the amount that the AEI would otherwise be required to pay for that period of COBRA coverage, including the 2% administrative fee if applicable, as payment in full. The employer (or in the case of a multiemployer plan, the plan) must initially cover the remaining 65% of the COBRA premium. The employer/multiemployer plan is then eligible to receive a credit for that amount to be applied against the payroll taxes (employee federal income tax and FICA withholding and employer FICA taxes) required to be remitted to the federal government. If the subsidy amount exceeds the payroll tax liability, the excess will either be paid directly to the employer/multiemployer plan or credited towards the next payroll tax payment. The payroll tax credit may not be claimed until the AEI's payment for COBRA coverage is received by the plan.

BUCK COMMENT. *In many instances, COBRA qualified beneficiaries remit premiums to a third-party COBRA vendor, or directly to an insurance carrier. In these situations, employers will need to work closely with their vendors to ensure both timely payment by the employer of the 65% and accurate recordkeeping to allow for swift recovery of those funds.*

We understand that the IRS is currently revising Form 941 (Employer's Quarterly Federal Income Tax Return) to address the new payroll tax credits.

The subsidy is based on a percentage of the amount that the AEI would normally have to pay for COBRA coverage. Thus, if the employer pays any portion of the premium, no subsidy is payable on that portion, and if the employer pays the full COBRA premium (e.g., under a severance program), no subsidy at all would be payable.

BUCK COMMENT. *Employers should consider this limitation in designing severance programs for employees who might otherwise be eligible for the subsidy.*

Transition Rule

Given the deadlines for providing notices (described below), it is quite likely that some AEIs who are currently on COBRA will continue paying a non-subsidized premium for a few months until they receive information about the subsidy and their new lower rates. Under a transition rule, if an AEI pays the full cost of coverage for March and April 2009, the employer may either refund the amount received that is in excess of 35% of the AEI's cost or credit the amount against future COBRA premiums (if it is reasonable to assume that it will be used by the AEI within 180 days). The employer will be able to claim reimbursement for those months.

Duration of Premium Subsidy

The subsidy is payable for a maximum period of nine months and is not available for any period of COBRA coverage beginning prior to the date ARRA was enacted. Thus, an AEI whose COBRA coverage began November 1, 2008, would pay a full COBRA rate for four months (November 2008 through February 2009), have subsidized coverage available for nine months (through November 2009), and then be required to pay the full COBRA rate for the remaining five months of COBRA eligibility.

Typically, COBRA coverage is cut short if a qualified beneficiary actually enrolls in Medicare or other group health coverage after COBRA has been elected. However, an AEI will lose eligibility for the subsidy if he or she becomes *eligible* for other group health coverage or Medicare, regardless of whether he or she actually enrolls. Coverage for only dental and/or vision care, health flexible spending accounts, health reimbursement accounts, or employer maintained on-site clinics that primarily provide first-aid treatment, preventive or wellness services, do not count as other coverage for this purpose.

AEIs are required to notify the group health plan in writing when they become eligible for other coverage. If they fail to do so, they will be subject to a penalty of 110% of the subsidy after that date.

BUCK COMMENT. *COBRA systems will need to be configured to track an early loss of the subsidy that does not necessarily coincide with the loss of COBRA coverage itself, adding to the complexity of administration. Fortunately, it does not appear that plan sponsors will be penalized for continuing AEIs on the subsidy if the AEI does not notify the plan of the eligibility for other coverage.*

“Second Chance” Election Period

Many AEIs who lost health plan coverage on or after September 1, 2008 may have either failed to timely elect COBRA coverage or maintained COBRA for a short period and then stopped payments. These individuals must now be provided a new 60-day period in which to elect COBRA coverage and obtain the subsidy.

Coverage elected under this special extension will not be retroactive to the original COBRA qualifying event, but will begin with the first coverage period beginning after enactment (March 1 for most plans) and will end on the date coverage would otherwise have ended if it had begun on the date of the qualifying event. The period of

coverage between the date of the qualifying event and the date the newly elected COBRA coverage goes into effect cannot be taken into account in determining whether an AEI has had a significant gap in coverage for purposes of applying any pre-existing condition limitation.

Determining Who is an AEI

Once qualified beneficiaries are notified about the new subsidy program, individuals who believe they are eligible for the subsidy will complete forms establishing that fact. These forms will have to be reviewed to determine whether the individual is, in fact, an AEI. This is an important determination, because only AEIs are eligible for the second chance COBRA election period and the subsidy.

An individual who is determined not to be an AEI may appeal the decision to the Department of Labor or the Department of Health and Human Services (if COBRA is provided under the Public Health Service Act). These agencies, in consultation with Treasury, must rule on the appeal within 15 business days of receipt.

BUCK COMMENT. *While the law does not set out a timeframe in which the plan administrator must make a determination regarding AEI status, it appears that the timeframe applicable to issuing notices of unavailability of COBRA coverage would apply. If so, a written denial of AEI status would have to be provided within 14 days of receipt of the form.*

Option to Change Coverage

Generally, at the time of their initial COBRA election, qualified beneficiaries are only offered the opportunity to elect the coverage in which they were enrolled at the time of the qualifying event. The new law makes it clear that employers *may* allow AEIs to elect an alternate option and still receive the subsidy if –

- The AEI elects the coverage within 90 days after receiving notice of the enrollment option.
- The premium for the alternate coverage is less than or equal to the premium for the coverage in which the individual was enrolled at the time of the qualifying event.
- The alternative coverage is a plan available to active employees at the time the election is made.
- The coverage is not limited to dental, vision, counseling or referral services, a flexible spending account, or an on-site medical facility that provides limited services.

BUCK COMMENT. *During the annual open enrollment period, COBRA beneficiaries must be offered the same health plan options made available to active employees, at which time a more expensive option could be elected. According to recent statements made by IRS officials, the subsidy would follow the new option.*

Phase-Out for Certain High-Income Beneficiaries

The subsidy will be phased out for AEs who have adjusted gross incomes of \$125,000 to \$145,000 (\$250,000 to \$290,000 for joint returns) through a recapture mechanism. These high-income individuals – not the plan – will be required to repay ineligible amounts to the government as additional taxes. To avoid this result, these individuals may elect to permanently waive the subsidy.

BUCK COMMENT. *Thus, employers do not need to consider the income limitations when making subsidy payments or when taking the payroll tax credits discussed above. However, the government will want an accounting of subsidies to determine if any taxpayers are ineligible for the subsidy due to income. Treasury has the authority to and will likely require plan sponsors to report subsidy amounts to the IRS on W-2 or 1099 forms.*

Communications and Disclosures

Under ARRA, administrators must communicate the availability of the subsidy to eligible COBRA beneficiaries within 60 days after enactment, or by April 18, 2009. As drafted, the law requires that notices be provided to qualified beneficiaries with respect to *all* qualifying events that occurred between September 1, 2008 and February 17, 2009 – even those not connected with a termination of employment – to advise of the special election period. This is the case even though many of these individuals will not ultimately be able to elect the subsidized coverage. Notices must advise qualified beneficiaries of the subsidy availability, the requirements to qualify and the forms required to file for the subsidy. DOL is required to provide model notices and forms within 30 days after enactment (i.e., by March 19).

BUCK COMMENT. *Because the timeframe is very short, employers should immediately begin identifying all qualified beneficiaries who have had qualifying events since September 1, 2008. They could begin modifying their existing COBRA communications to make qualified beneficiaries aware of the subsidy, but may want to wait to develop more formal communications and forms until the DOL releases guidance.*

In addition, employers will be required to provide information to Treasury to substantiate the amounts they are claiming as a payroll tax credit, including the number of employees who were involuntarily terminated and elected COBRA, the amounts the employer offset against its payroll and employee income tax withholding obligations, the tax identification numbers of all covered employees and other information. These reports are to be submitted at the same time the employer deposits payroll taxes.

Multiemployer Plans

Multiemployer plans present several issues that are not fully addressed in the new law. As noted earlier, for these plans, the subsidy reimbursement is made to the plan, and not to the employers. Thus, plans would need to

collect and report census data that they may not normally maintain. Treasury is authorized to and will hopefully release regulations on how multiemployer plans are to comply with the new rules.

Special COBRA Extensions in Connection with Trade Act of 2002

ARRA also increases the refundable tax credit for COBRA coverage for certain individuals under the Trade Act of 2002 (see our December 9, 2002 [For Your Information](#)) from 65% to 80%. It also extends the period of COBRA coverage for certain eligible individuals, but generally not beyond December 31, 2010.

What Actions Should Employers Take Now?

As noted above, the COBRA subsidy is generally effective March 1. Although model notices and forms are anticipated and hopefully guidance will be forthcoming on many open issues, employers may want to focus on an initial communication to all current and future COBRA beneficiaries informing them of the availability of the subsidy and the actions the employer is taking. A more formal implementation of new procedures and communications may be put off until more information is received. In any event, employers should begin considering and discussing with their administrators and vendors how they are going to track involuntary terminations and certain other information such as payments received and subsidies paid. They should also review with payroll how to best assure that they apply the subsidy payments as soon as possible.

Conclusion

ARRA gives plan sponsors very little time to implement new administrative procedures and to meet the new notice requirements. Plan sponsors should review the implications of these new requirements and discuss compliance issues with their COBRA administrator. They may also want to consider an audit or review of their COBRA administrators' ability to comply with the new requirements. Careful consideration of these new rules should also be given when planning workforce reductions.

Buck's consultants would be happy to assist you in reviewing the implications of this new law.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.