

## *New COBRA Subsidy Requires Prompt Action by Employers and Plan Administrators*

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The stimulus legislation, the American Recovery and Reinvestment Act (the "Act"), signed by President Obama on Tuesday creates a taxpayer-funded COBRA<sup>1</sup> subsidy that imposes new notice, election and reporting requirements that require prompt action by employers and plan administrators. Employers that charge at least a portion of the COBRA premium – virtually all employers who provide COBRA coverage -- do not have the option of offering COBRA without the subsidy. Consequently, virtually every employer that provides COBRA health coverage will have to take steps to implement the Act's COBRA subsidy provisions.

Specifically, employers and plan administrators will need to promptly:

- Identify employees who were covered by the plan and who lost coverage due to an involuntary termination of employment (other than for gross misconduct) on or after September 1, 2008, and their plan covered spouses and dependents ("qualified beneficiaries").
- Of these individuals, identify who is receiving COBRA coverage as of the date of enactment of the Act. Those who aren't will be eligible for a special election opportunity described below.

- Implement administrative procedures to permit high income earners to opt out of the subsidy in lieu of paying it back through increased taxes imposed by the Act.
- Determine whether to implement the optional opportunity to elect different COBRA coverage.
- Develop and provide notices required by the Act.
- Coordinate the employer's payroll and human resources functions to implement systems for obtaining the federal subsidy.

The remainder of this Client Alert describes the key provisions of the COBRA subsidy.

### **Effective Date**

The COBRA subsidy applies to premiums paid for a period of COBRA coverage that begins after the date of the Act's enactment, February 17, 2009. A "period of coverage" is the monthly or shorter period with respect to which the premiums are charged for coverage. Therefore, monthly premiums payable for coverage beginning in March would be eligible for the subsidy.

The Act anticipates that plan administrators may not be able to timely notify all eligible qualified

beneficiaries of the premium subsidy before March 1, 2009. If an eligible qualified beneficiary pays the full COBRA premium for the first or second period of coverage beginning after the date of enactment of the Act (e.g., monthly periods of coverage for March and April 2009), the plan administrator must either credit the subsidized portion of the premium against future COBRA premiums or refund the subsidized portion within 60 days.

### Eligibility for Subsidy

Qualified beneficiaries are eligible for the subsidy if they (i) lose health plan coverage due to involuntary termination (other than termination for gross misconduct) of employment during September 1, 2008 through December 31, 2009 and (ii) are eligible for and elect COBRA continuation coverage. As discussed below under "Tax Consequences of Subsidy", the subsidy phases out for higher income former employees.

*Note: The Act does not define involuntary termination of employment. But, as described below, an employer must attest that each qualified beneficiary for whom it requests government reimbursement was involuntarily terminated. In addition, as described below, the plan administrator must notify each qualified beneficiary who is eligible for the subsidy. The determination of whether an employee's termination was involuntary can be complicated by questions such as constructive discharge or an agreement between the employer and the employee to terminate employment.*

### Amount of the Subsidy

The Act treats eligible qualified beneficiaries as paying the full COBRA premium if such individual pays at least 35% of the premium that the individual would otherwise be required pay but for the Act. If an employer subsidizes the cost of COBRA coverage, it appears that the 35% will be applied against the portion paid by the employee and the employer paid portion will be disregarded because the employee would not have been required to pay that portion. For example, if the COBRA premium is \$500, the employer pays \$400 and the employee is required to pay \$100, then the employee will be treated as paying the full premium if the

employee pays \$35 and the employer's tax-funded subsidy will be limited to \$65 rather than the full \$465 paid by the employer. Employers considering implementing subsidized COBRA as part of reductions in force or other programs should consider redesigning them in light of the subsidy.

### Duration of Subsidy

The subsidy is available for the earliest of 9 months, the expiration of the maximum COBRA coverage period applicable to the qualified beneficiary or the date the qualified beneficiary becomes eligible for Medicare or coverage under any other group health plan.<sup>2</sup> The Act requires a qualified beneficiary to notify the plan providing COBRA if he or she becomes eligible for Medicare or other group health coverage. Qualified beneficiaries who fail to provide notice are subject to a penalty equal to 110 percent of the amount of the subsidy provided after their eligibility for the subsidy terminates, unless the failure to notify is due to reasonable cause and not willful neglect.

### Tax Consequences of Subsidy

The subsidy generally is excludible from the gross income of the qualified beneficiary, but this exclusion phases out ratably if the former employee's modified adjusted gross income for the taxable year is between \$125,000 and \$145,000 (\$250,000 and \$290,000 in the case of a joint return). Tax credits may not be used to offset this liability. The Act defines "modified adjusted gross income" as adjusted gross income" determined under Section 62 of the Internal Revenue Code ("Code") increased by any amount excluded under Code Sections 911, 931 or 933.

To avoid this, the Act permits qualified eligible qualified beneficiaries to irrevocably elect to waive the COBRA subsidy for all periods of

coverage. The legislative history states that each qualified beneficiary must separately waive the subsidy.

### **Reimbursement**

The U.S. government will reimburse an employer for the 65 percent of the COBRA premium. To obtain this reimbursement, the employer must claim it as a credit against its payroll tax (income tax and FICA withholding) liability. If the credit exceeds that liability, the Treasury will reimburse the employer directly. To qualify for reimbursement, the employer must furnish reports containing information the Treasury may require for such reimbursements, including an attestation of the involuntary termination of employment of each covered employee, the amount of payroll taxes offset for a reporting period and the estimated offsets for the next reporting period, the tax identification numbers of the covered employees, the amount of the subsidy reimbursed with respect to each covered employee and qualified beneficiaries, and a description of whether each subsidy reimbursement is for coverage of one individual or two or more individuals.

### **Notification**

Plan administrators are required to provide notices to two groups of eligible qualified beneficiaries within 60 days after the enactment of the Act. The first notice must go to all eligible qualified beneficiaries who currently have COBRA continuation coverage and the second notice must to any qualified beneficiary who does not currently have COBRA continuation coverage but is eligible for the special enrollment period described below. The notices must advise these individuals of the availability of the subsidy and its conditions, the requirement to notify the employer if the individual becomes eligible for Medicare or another group health plan, the penalty for failing to do so as well as other information required by the Act.

Plan administrators will also need to update the qualifying event notice furnished qualified beneficiaries to reflect the COBRA subsidy.

Violation of the Act's notification requirements is a violation of COBRA's notification requirements.

The Act directs the Department of Labor to provide model notices for plan administrators to use within 30 days after the enactment of the Act.

### **Special Election Opportunity**

The Act provides a special 60-day election opportunity for qualified beneficiaries who are eligible for the subsidy but who did not elect COBRA or who are no longer enrolled in COBRA as of the date of enactment of the Act. The 60-day election period ends 60 days after the notice is provided to the qualified beneficiary of the special election opportunity. The special election opportunity does not extend the period of COBRA coverage beyond the original maximum required period, and any COBRA coverage elected pursuant to this special election opportunity begins on the date of enactment and does include any period prior to that date. If a qualified beneficiary eligible for the subsidy elects COBRA during the special election opportunity, the period beginning on the date of the qualifying event and ending with the day before enactment of the Act is disregarded for purposes of determining if the qualified beneficiary had a 63-day significant break in coverage for purposes of applying pre-existing condition exclusions.

### **Optional Opportunity to Elect Different COBRA Coverage**

Generally, COBRA only requires the employer to offer the same type of coverage that the qualified beneficiary had before qualified beneficiary experienced a qualifying event. The Act, however, permits (but does not require) an employer to allow qualifying beneficiaries eligible for the subsidy to elect a different COBRA coverage. If an employer elects to offer this

option, the employer must provide the qualified beneficiary with an election notice and allow an election period of not less than 90 days.

This option is subject to the following restrictions:

- The COBRA premium for the different coverage may not exceed the COBRA premium for the coverage in which the qualified beneficiary was enrolled in prior to the qualifying event.
- The employer must be offering the different coverage to its active employees at the time the qualified beneficiary elects the different coverage.
- The different coverage cannot be limited to dental, vision, counseling or referral services (singly or in any combination) and cannot be a health care flexible

spending account or an on-site medical facility providing primarily first aid, prevention or wellness care.

**Adjudicating Denials of COBRA Subsidy**

The Act provides for expedited review by the Secretary of Labor or Health and Human Services (in consultation with the Secretary of Treasury) of premium subsidy denials. Such reviews must be completed within 15 business days after receipt of the individual’s application for review. The Secretary’s determination upon review is de novo and is the final determination.

**Conclusion**

While the new COBRA subsidy is funded by taxpayers, plan administrators and employers are responsible for administering the subsidy. They will need to take prompt action to comply with the Act.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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1 The subsidy is also available for continuation coverage provided under state law that provides coverage comparable to COBRA, such as California’s Cal-COBRA. The subsidy is not available for COBRA coverage provided under health flexible spending accounts provided under a cafeteria plan.

2 The following types of group health plan are disregarded for this purpose: (i) coverage that consists of only dental, vision, counseling, or referral services (or combination of any of these), (ii) coverage under a health flexible spending account or health reimbursement arrangement, or (iii) coverage consisting of treatment at an on-site medical clinic maintained by the employer and that consists primarily of first-aid services, prevention and wellness care.