

The COBRA Premium Subsidy Law: Understanding Your Compliance Obligations

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The recently enacted economic stimulus law has provisions that dramatically and immediately affect compliance with the continued group health plan coverage requirements of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). In particular, the American Recovery and Reinvestment Act of 2009 (ARRA) includes a 65 percent subsidy for COBRA premiums paid by qualified beneficiaries who lose group health plan coverage because of a covered employee's involuntary termination of employment at any time from September 1, 2008, through December 31, 2009. The subsidy applies not only to federal COBRA coverage, but also to state-law programs that provide comparable continuation coverage. Therefore, it is important for all group health plan sponsors to learn these new rules and understand their new obligations.

Basic Rules on the Premium Subsidy

For a period of up to nine months, an "assistance-eligible individual" is treated as having paid his or her COBRA coverage in full if the individual actually pays 35 percent of the applicable premium. The remaining 65 percent of the premium is subsidized by the government via a payroll tax credit, described more fully below. Assistance-eligible individuals generally are those qualified beneficiaries who lose coverage as the result of an employee's involuntary termination between September 1, 2008 and December 31, 2009, who elect COBRA coverage and who are not eligible for other group health coverage or Medicare. In addition, individuals who have modified adjusted gross income over \$145,000 (or \$290,000 for joint filers) are not entitled to benefit from the subsidy and would have to repay it via a tax on their individual tax returns.

As is true under COBRA generally, individuals other than a qualified beneficiary (such as a hospital, a charity or Medicaid agency) could pay the applicable premium for that qualified beneficiary and this would still qualify for the subsidy. However, the qualified beneficiary's employer cannot pay for the COBRA coverage and then claim a subsidy for the other 65 percent.

The employment tax credit is referred to as a reimbursement to the plan. Here is how it works:

- Step 1 – The "person to whom premiums are payable" is to be reimbursed by the amount of the premium for COBRA coverage that is not paid by an assistance-eligible individual. In other words, if the qualified beneficiary pays 35 percent of the applicable premium, the person to whom the premium is paid can get reimbursed for the other 65 percent.
- Step 2 – This reimbursement is taken as a credit against that person's liability for payroll tax deposits (including wage withholding and FICA taxes). If the credit would exceed the amount of the payroll tax deposits, then the person would get a direct refund. Importantly, the person is not eligible for the subsidy reimbursement until the person has actually received the reduced premium payment from the assistance-eligible individual. Any person entitled to the reimbursement must report the amounts received on reports to be required by the Internal Revenue Service (IRS). This report is generally due at the same time as the payroll deposits would be due (often within a few days and sometimes within one business day).

The rules governing the timing of tax deposits and when this credit can actually be taken without exposing the person filing to payroll tax penalties are quite technical. Generally, though, the law clarifies that any overstatement of a COBRA premium reimbursement is a payroll tax violation. Further guidance from the IRS is needed to explain how the payroll tax timing rules work when the person is claiming a credit for COBRA subsidy reimbursements, particularly in cases of plans claiming the credit.

Who Is the Person to Whom Premiums Are Payable?

Only the person to whom the COBRA premiums are payable is entitled to the employment tax credit. The person to whom premiums are payable varies depending on the type of plan involved. Importantly, the payroll credit is not always available to the employer of the covered employees.

MULTIEMPLOYER PLANS

If the plan is a multiemployer plan, the plan is the person to whom the premium is payable and is entitled to the credit.

PLANS SUBJECT TO FEDERAL COBRA OR PARTIALLY/FULLY SELF-INSURED

In the case of the following types of plans, the person to whom the premium is payable is the employer maintaining the plan:

- Non-multiemployer plans that are subject to federal COBRA (including the federal health benefit plan), whether or not they are insured
- Plans that are partially or fully self-insured

OTHER GROUP HEALTH PLANS

For all other plans, which generally means plans not subject to federal COBRA and which are fully insured, such as insured small-employer plans or insured church plans subject to state continuation coverage, the person to whom premiums are payable for this purpose is the insurer of the group health plan.

The law does not clearly address who is the person to whom premiums are payable in the context of stand-alone voluntary employees' beneficiary association (VEBA) trusts or multiple employer welfare plans (MEWAs).

Who Is Eligible for the Premium Subsidy?

An assistance-eligible individual includes any qualified beneficiary who elects COBRA coverage and satisfies two additional requirements:

- The qualifying event must be a loss of group health plan coverage on account of a covered employee's involuntary termination from employment.
- The qualifying event triggering the COBRA rights must occur between September 1, 2008, and December 31, 2009, and the individual must be eligible for and elect COBRA coverage. An otherwise eligible individual is not required to elect COBRA coverage by December 31, 2009; however, the qualifying event must occur by that date.

Assistance-eligible individuals include any qualified beneficiary associated with the relevant covered employee (such as a dependent child or a spouse, either of whom is covered immediately before the qualifying event), and these other individuals may independently elect COBRA coverage and benefit from the subsidy. Thus, for example, the subsidy for an assistance-eligible individual could continue even after the covered employee's death.

The law imposes an income threshold as an additional condition on an individual's entitlement to the premium subsidy. An individual is not entitled to benefit from the COBRA subsidy if the individual's income exceeds \$145,000 (or \$290,000 for joint filers). A reduced subsidy is available for individuals between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for joint filers). The mechanism for denying the credit is imposed on the qualified beneficiaries' tax returns via a recapture tax.

What Is an Involuntary Termination?

In considering these rules, it will be important to know what type of termination qualifies as involuntary. A termination of employment for gross misconduct does not qualify; neither does a voluntary resignation. However, the law is not clear as to whether "good reason" quits constitute involuntary terminations. Also not clarified is whether every type of layoff situation (including a temporary layoff with recall rights) constitutes an involuntary termination. The facts of any situation should be reviewed carefully.

What Type of COBRA Coverage Is Eligible for the Subsidy?

The new premium subsidy is available for COBRA coverage that is otherwise available under a group health plan subject to ERISA and the tax Code. However, the subsidy is not limited to federal COBRA coverage. “COBRA continuation coverage” includes coverage under state law that requires continuation coverage comparable to federal COBRA coverage. On the other hand, the subsidy does not apply to health care flexible spending arrangements (FSAs). A health FSA is defined as a health FSA otherwise offered under a cafeteria plan. Coverage under a health reimbursement account (HRA) is not excluded from eligibility for the subsidy.

How Long Does the Subsidy Last?

An assistance-eligible individual’s eligibility for the subsidy terminates with the first month beginning on or after the earlier of the following:

- The date that is nine months after the first day of the first month for which the subsidy applies (*e.g.*, if the subsidy is available beginning March 1, 2009, it would last through November 30, 2009, and expire December 1, 2009)
- The end of the maximum required period of COBRA coverage
- The date that the assistance-eligible individual becomes eligible for Medicare benefits or health coverage under another group health plan

CAVEATS REGARDING OTHER GROUP HEALTH COVERAGE

Eligibility for the following types of coverage will not terminate eligibility for the subsidy:

- Dental, vision, counseling or referral services (or a combination of those services)
- Coverage under a health care flexible spending accounts (FSA), but not a health reimbursement arrangement (HRA)
- Coverage for treatment that is furnished in an on-site medical facility maintained by the employer and consisting primarily of first-aid services, prevention and wellness care, or similar care (or a combination of that type of care)

INDIVIDUALS HAVE NOTICE RESPONSIBILITY

Once an assistance-eligible individual is eligible for other group health plan coverage or Medicare, he or she is required to notify the group health plan, in writing, of that status. The U.S. Department of Labor (DOL) is supposed to issue rules on this requirement. If an assistance-eligible individual fails to provide this notice in a timely manner, the individual is liable for a penalty equal to 110 percent of the subsidy that ends up being provided after eligibility terminates. The penalty is waived if the individual can show that the failure to notify was due to reasonable cause and not to willful neglect.

How and When Is One Required to Elect the Subsidy?

For all future qualifying events after enactment, the premium subsidy applies through the normal COBRA coverage election process. That is, after an assistance-eligible individual has elected COBRA coverage and it comes time for payment, the assistance-eligible individual only pays the 35-percent amount and that is considered sufficient as payment in full for the COBRA coverage.

Since the new law applies to those who were involuntarily terminated as far back as September 1, 2008, there are certain transition situations that also affect who would be eligible for the subsidy.

CATEGORY 1 — INVOLUNTARY TERMINATION BEFORE ENACTMENT WITH NO COBRA ELECTION IN EFFECT

There is an extended election period for a qualified beneficiary who is otherwise an assistance-eligible individual and who does not have a COBRA election in effect on February 17, 2009. The election period begins on February 17 and ends 60 days after notice of this election right is provided by the plan administrator. In this regard, plan administrators must provide these individuals notice of their rights to the subsidy within 60 days of enactment. Failure to do so could subject the plan administrator to COBRA notice penalties. In this regard, government officials have informally indicated that this notice needs to be provided to all qualified beneficiaries who could have elected COBRA coverage back to September 1, 2008, and who were not enrolled in that coverage as of February 17, 2009.

This special election period is available not just for individuals who did not elect before the date of enactment, but is also available to individuals who elected COBRA coverage before enactment of the new law but who are no longer enrolled, for example, because the individual stopped paying the applicable premium (presumably because it was too expensive).

One area that remains somewhat unclear is how to treat individuals who previously elected COBRA coverage after an involuntary termination and then lost that coverage because they became covered by another group health plan. If that other coverage is still in place, it would appear that the new 60-day election period does not apply. However, if that coverage is not in place, it is less clear whether the individual would be eligible for the new election right and COBRA subsidy.

TIMING FOR PAYING THE INITIAL PREMIUM

Under general COBRA premium payment rules in ERISA and the other federal laws, no payment may be required earlier than 45 days after the date of an initial COBRA election. The ARRA special election right does not amend any of these laws. Instead, it creates a separate COBRA election right. Because it does not specifically amend the existing COBRA premium payment provisions, it is not clear that the 45-day premium payment rule for initial COBRA elections applies. This is particularly unclear where the individual taking advantage of the special election right had previously elected and paid for COBRA coverage but stopped paying for that coverage before the date of enactment. If the 45-day premium grace period does not apply, then it is not clear what time period would apply for the payment of the first COBRA premium under the new subsidized rate.

NO IMPACT ON DURATION OF COBRA COVERAGE

Importantly, this new special election period does not extend the period of COBRA coverage beyond the original maximum required period (generally 18 months after the qualifying event), and any COBRA coverage elected based on this special election period begins for periods of coverage after February 17, 2009, and does not include any period before that date.

COORDINATION WITH HIPAA BREAK IN COVERAGE RULES

As for the gap in coverage that arises in this situation, between the qualifying event date and February 17, 2009, nothing in the new law requires that the gap in coverage be filled. Nevertheless, this gap is not treated as a break in coverage for HIPAA purposes if the person elects COBRA coverage.

Under HIPAA, a group health plan can only impose a pre-existing condition exclusion for a period of up to 12 months (18 months for late enrollment) minus a person's period of prior creditable coverage. If the person has a break in coverage of 63 or more days, that prior coverage can be disregarded and the individual is subject to a full pre-existing condition exclusion period. Because the new law provides that the period between the assistance-eligible individual's qualifying event and the enactment date is not a break in coverage, such an individual could elect COBRA coverage and avoid the impact of what would otherwise be a gap of coverage of more than 63 days.

CATEGORY 2 – INVOLUNTARY TERMINATION BEFORE ENACTMENT AND DID PREVIOUSLY ELECT COBRA

If an assistance-eligible individual had already elected COBRA coverage and started to pay for the applicable premiums in full, special rules apply. Under a transition rule, if the individual paid the full premium for the first period of coverage after February 17, 2009, and/or the next period of coverage, then the person to whom the payment is made (that is, the multiemployer plan, employer or insurer) is supposed to reimburse the individual for the amount previously paid in excess of the 35 percent required to be paid under the new law.

Alternatively, the assistance-eligible individual could be provided with a credit that reduces subsequent premiums for his or her coverage. However, if a credit is applied and it is not reasonable to believe that the credit will be used for health coverage within 180 days of the date that the full premium was paid, then the person to whom payment is made must provide a full refund of the excess amount within 60 days. The same rule applies if, during the 180-day period, it becomes no longer reasonable to believe that the credit will be used during that period.

Separately, the individual providing the refund or credit can apply for the payroll tax credit for these amounts under the same procedures for claiming the payroll tax credit.

Given the complexity involved in making the determination of whether it is reasonable to believe how a credit would be used over time, the easiest approach may simply be to provide the refund to the assistance-eligible individual in all cases and apply to the government for the payroll tax credit.

Are There Other Special Enrollment Rights?

Under COBRA coverage generally, a qualified beneficiary may only continue the coverage in effect immediately before the qualifying event, subject to changes from family to single coverage or other generally available open enrollment or HIPAA special enrollment rights.

Under the new law, an assistance-eligible individual could elect, within 90 days of being notified of this right, to change the actual coverage available in order to drop down to a lower-cost option. However, this right is available only if the employer chooses to make it available and only if the alternative coverage is in a plan offered to employed workers that provides the same or lower health insurance premiums than the individual's previous coverage option. A "plan" for these purposes does not include:

- A plan providing only dental, vision, counseling or referral services (or a combination of the foregoing)
- A health FSA
- Coverage for treatment that is furnished in an on-site medical facility maintained by the employer and that consists primarily of first-aid services, prevention and wellness care, or similar care (or a combination of that type of care)

35 Percent of What?

In calculating the amount to be paid by an assistance-eligible individual, questions will arise as to how to calculate the amount owed.

HOW DOES THE COBRA ADMINISTRATIVE FEE FACTOR INTO THE CALCULATION?

Under COBRA, a qualified beneficiary can be required to pay an administrative fee of up to 2 percent of the full cost of coverage (50 percent in certain disability cases). In calculating the amount owed by an assistance-eligible individual, therefore, it will be important to know how that fee could be charged. Under the new law, the 35 percent amount applies to the full cost of coverage plus any administrative fee permissibly charged by the plan. If an employer uses the services of a COBRA administrator and that administrator is accustomed to receiving the full 2-percent COBRA administrative fee, the parties may need to renegotiate their

agreements to reflect the fact that qualified beneficiaries eligible for a premium subsidy under the ARRA will not be funding that full COBRA administrative fee.

WHAT IF THE EMPLOYER ALREADY SUBSIDIZED COVERAGE?

Many employers provide for subsidized coverage in involuntary termination situations. In such situations, the employer generally cannot charge more than 35 percent of the subsidized amount otherwise owed for COBRA coverage. This issue can be complicated if an employer offers subsidized coverage, first, and then COBRA coverage after that subsidized period. The issue involves determining exactly when COBRA coverage starts. Only that period for which a premium subsidy and corresponding payroll credit may be claimed. Employers should consider carefully how to design alternative coverage packages in light of this new law.

Notices: What Are They and When Must They Be Provided?

Under the law, any COBRA notices provided by plan administrators upon the occurrence of future qualifying events must include additional information

SUBSIDY INFORMATION REQUIRED IN COBRA QUALIFYING EVENT NOTICES

COBRA notices provided by plan administrators upon the occurrence of qualifying events must include additional information, including, for example:

- The forms necessary for establishing eligibility for the premium reduction
- The name, address and telephone number necessary to contact the plan administrator and any other person maintaining relevant information in connection with the premium reduction
- A description of the extended 60-day election period provided for electing the subsidy
- A description of the qualified beneficiary's obligation to notify the plan providing COBRA coverage of eligibility for subsequent group health plan or Medicare coverage that would disqualify the person for the subsidy, and the penalty provided for failure to so notify the plan
- A description, displayed in a prominent manner, of the qualified beneficiary's right to a reduced premium and any conditions on entitlement to the reduced premium
- A description of the qualified beneficiary's option to enroll in different coverage if the employer allows for this election

Aside from actual COBRA notices, the government agencies (primarily the DOL) are required to provide outreach consisting of public education and enrollment assistance concerning these new rules. The outreach should focus on those individuals who were involuntarily terminated before enactment and who need to learn about the new law and make their elections within a relatively short time. Also, as part of this outreach effort, the government agencies are to make information available on their websites.

Penalties: How Are the New Provisions Enforced?

The new law indicates that the operative rules are enforceable as if part of ERISA. This means that eligible individuals could sue under ERISA to enforce their rights under the ARRA. It also means that the Department of Labor could investigate and enforce its provisions.

In addition, COBRA notice penalties may apply against a plan administrator that fails to provide any ARRA-required notices on time. For example, the notice of new election rights for individuals involuntarily terminated before February 17, 2009 (and on or after September 1, 2008), must be provided by April 18, 2009. If it is not so provided, the plan administrator could be subject to ERISA notice penalties.

Presumably, for this purpose, notice provided by first-class mail to the last-known address will suffice. It is worth noting, however, that many of the individuals to whom this COBRA notice must be provided may have moved after having lost their jobs. Therefore, the last-known address may not be as helpful as it was at the time of the initial termination of employment. This is why the government outreach efforts could become so important.

One point that is not as clear is whether the COBRA excise tax provisions in the Internal Revenue Code would apply to violations of the ARRA provisions that are not otherwise incorporated into the tax Code's rules. The law merely states that the provisions are to be treated as part of ERISA—it does not treat them as part of the Code for COBRA penalty purposes. Further guidance may speak to this point.

What Does It All Mean?

Employers and plan administrators need to work quickly. Plans, summary plan descriptions and COBRA notices must be amended. New notices must be created to explain these rights to affected individuals. On top of that, employers and administrators must try to locate individuals who were involuntarily terminated back to September 1, 2008, to advise them of their new COBRA rights.

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