

Changes to COBRA under the American Recovery and Reinvestment Act

On February 17, President Barack Obama signed the American Recovery and Reinvestment Act of 2009 ("ARRA") into law. This stimulus package provides significant health care continuation coverage relief for lower- and moderate-income employees who are **involuntarily terminated between September 1, 2008 and December 31, 2009**

The COBRA changes affect both the federal COBRA provisions and the Public Health Service Act program that provides similar extension benefits for public programs. In addition, the subsidy provisions apply to state continuation coverage that is comparable to federal COBRA. ***That would include so-called "mini-COBRA" state laws that cover groups below the 20 employee threshold for COBRA.*** Reference to "COBRA" throughout this memo will also refer to the state programs that meet those requirements.*

Additional clarifying guidance and regulatory explanations regarding the COBRA subsidy provisions of ARRA are still forthcoming, as is a model notice from the Department of Labor that explains the availability of COBRA premium assistance to affected employees. The information contained in this summary may be modified as further guidance becomes available. In the meantime, the general highlights of ARRA's COBRA provisions are as follows.

Cobra Premium Subsidy.

ARRA provides a subsidy of 65% of the COBRA continuation coverage premiums for eligible individuals for a maximum of 9 months, so that an eligible individual will only have to pay 35% of the COBRA premium to obtain coverage.

The period expires on the earlier of:

1. 9 months,
2. The date the individual becomes eligible for group health coverage or Medicare or
3. The end of the maximum required period of continuation under COBRA. A person is not considered eligible if he or she is subject to a waiting period under another group health plan.

Further, the beneficiary must notify the employer in writing if they become eligible for coverage under a group health plan or Medicare and is subject to significant penalties (110% of the subsidy amount) for failing to do so.

Eligibility Requirements.

An individual is eligible for the COBRA premium subsidy if he or she is: involuntarily terminated from employment during the period beginning September 1, 2008 through December 31, 2009 and is eligible to elect COBRA during that time. Members of the individual's family are also eligible for this premium subsidy if the reason that they become eligible for COBRA is due to the employee's involuntary termination of employment during the applicable time period.

Individuals who elected COBRA due to an involuntary termination on or after September 1, 2008 but prior to the date of enactment are eligible to receive the subsidy on a prospective basis, beginning for the first period of coverage after February 17, 2009. (Example: March 1, 2009 for Calendar coverage)

Individuals who were eligible to elect COBRA during that time period due to an involuntary termination but did not elect COBRA will need to be given the opportunity to elect COBRA on a prospective basis, with the maximum coverage period measured from the earliest date that COBRA coverage could have been elected.

Employers or plans will have to provide notice to these groups of individuals. Further, an employer or insurer must refund or credit any COBRA premiums that subsidy-eligible individuals pay on or after the date of enactment in excess of 35% of the premium. This may be in the form of a reimbursement payment or credit against future premium payments due.

Eligibility - Income Test

Individuals with modified adjusted gross income that exceeds \$250,000 (for joint return filers) or \$125,000 (for all other filers) will not be eligible for the full premium subsidy. The premium subsidy will be fully phased out for those individuals with adjusted gross income of \$290,000/145,000.

Any portion of a subsidy that an individual receives but is not eligible for will need to be reported on the individual's annual income tax return, and the amount of tax that such individual would otherwise pay will be increased by the amount of such subsidy. Consequently, employers and insurers will not need to determine whether an individual's income makes him or her ineligible for the subsidy. Rather, employers and insurers can treat all COBRA beneficiaries who have coverage due to involuntary termination during the applicable time period as eligible for the subsidy and receive reimbursement for 65% of the premiums for coverage provided.

However, if an individual does not want to report the subsidy on his or her annual income tax return, the Act permits that an individual can notify the employer, insurer or multiemployer plan that he or she will not be eligible for the subsidy and pay the full COBRA premium required.

Income Treatment.

As long as an individual is eligible for the premium subsidy, it will not be considered additional taxable income. In addition, the premium subsidy cannot be considered as additional income or resources in determining eligibility for any federal or state public benefit program.

Appeal Procedure.

The Act provides that if an individual requests that the group health plan treat the individual as eligible for the subsidy and such request is denied, the individual may appeal the decision to the Department of Labor ("DOL"), or to the Department of Health and Human Services ("HHS") in the case of COBRA continuation coverage provided pursuant to the Public Health Service Act. DOL or HHS must rule on the appeal within 15 business days. If the appeal is denied,

the individual may then sue under ERISA Section 502(a)(3) for treatment as a subsidy-eligible individual, but the Act provides that the reviewing court is required to grant deference to DOL or HHS's determination.

Method to Receive the Premium Subsidy

The subsidy program requires the entity who provides health coverage and collects 35% of the premium to receive reimbursement for the remaining 65% of the premium from the federal government.

- For a group health plan that is self-insured, the employer will be entitled to the reimbursement.
- For an insured group health plan subject to COBRA, the employer will also be entitled to reimbursement.

The subsidy is to be taken as a reduction of an employer's payroll taxes. If the amount of the premium subsidy is greater than the payroll tax liability for that period, the additional amount due will be treated as a refund or a credit of payroll taxes as if it was an overpayment of payroll taxes.

The IRS will provide details regarding how payroll tax returns will be filed to reflect this credit for the premium subsidy, and what additional information is required to verify that reimbursements are correct. ARRA provides that entities who receive the subsidy will be required to file a report with the Secretary of Treasury that contains information about the amount of the subsidy, and the taxpayer identification numbers of the individuals who received the subsidy. ARRA also requires Treasury to issue regulations or other guidance describing this report requirement in detail, and to explain how the reporting will work for multiemployer plans.

State Mini-COBRA Coverage.

Not all employers are subject to COBRA. Small employers with less than 20 employees may only provide state continuation benefits. If state benefits are "comparable" to COBRA, the federal subsidy will exist. In this instance the insurance carrier and not the employer, will be entitled to the payroll tax credit (even though the credit does not cover its employees). A list of states that are determined to provide comparable coverage is not yet available.

Electing a Different Coverage Option

ARRA provides that an employer may, but is not required to, allow an individual who is eligible for COBRA premium assistance to change his or her health insurance coverage option when making a COBRA election under the employer's plan. The new option must have the same or lower premiums and must be available to non-COBRA active employees under the plan. In addition, the election to change must be made within 90 days of receipt of the COBRA election notice.

If these requirements are satisfied, the new coverage option will then be treated as COBRA coverage. This ability to change coverage options will not allow an individual to elect into a flexible spending arrangement or coverage that provides only dental, vision, counseling or other referral services (or a combination of such services). Under current law, COBRA beneficiaries are only

eligible to elect to continue the coverage that they had immediately before the COBRA qualifying event, although they must generally be given the ability to change options during the employer's open enrollment.

Notice Requirements

ARRA requires employers to modify COBRA election notices or provide separate, supplemental notices to all individuals who become entitled to elect COBRA continuation coverage during the period beginning on September 1, 2008 and ending on December 31, 2009.

Such notices must describe the new premium subsidy and, if applicable, the right to change coverage options, as well as certain other information. The Act requires the DOL, Treasury and HHS to work together to develop a Model Notice within 30 days of the date of enactment.

Notices are required to be sent to subsidy-eligible persons who became qualified beneficiaries before the date of enactment within 60 days of enactment. (The Act does not affect the timing of notices sent to individuals who become qualified beneficiaries on or after the date of enactment.) The election period for those beneficiaries who became eligible before the date of enactment will begin on the date of enactment and end 60 days after the date the plan administrator provides the required notice.

ARRA provides that failure to provide such notice shall be treated as a failure to meet the notice requirements under COBRA. This means that a failure to send a timely COBRA election notice that complies with the new requirements could subject the employer or plan to a penalty of up to \$110 per day under ERISA Section 502(c)(1). This penalty is one that is imposed at the discretion of the court, and is seldom enforced to the fullest extent, unless the plan administrator acted intentionally. In addition, failure to comply with the new election notice requirements could also result in adverse tax consequences under Section 4980B(b) of the Internal Revenue Code (i.e., excise taxes of \$100 per day per notice for each day that the plan administrator fails to comply with COBRA (\$200 if more than one qualified beneficiary in a same family is affected), up to specified maximums.

The COBRA changes take effect on the first coverage month following the date ARRA was enacted (i.e., March 1, 2009, for most plans). The Department of Labor (DOL) has 30 days in which to issue model notices. The Treasury Department is responsible for issuing other guidance and regulations.

As information becomes available we will provide additional clarifying guidance and regulatory explanations regarding the COBRA subsidy provisions