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Fighting Federal Acronyms
COBRA: What Employers Need to Know about the New Federal Subsidy

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What Every Employer Needs to Know (and Do) About the New COBRA Subsidy Provisions in the Economic Stimulus Act

In the wake of the enactment of the American Recovery and Reinvestment Act of 2009 (the "Act"), companies across the country must turn immediate attention to the task of implementing the Act's expansive new COBRA subsidy provisions. Under these new provisions, the federal government will provide a temporary 65% subsidy towards COBRA premiums for individuals eligible for COBRA continuation coverage as a result of involuntary terminations taking place between September 1, 2008 and December 31, 2009.

These provisions have implications for employers of all sizes (including those small employers who are exempt from Federal COBRA but subject to state health coverage continuation laws)—and even the best COBRA administrator will not be able to implement these rules without significant employer involvement. Although guidance and model notices related to these rules are expected to be issued in the near future, because the subsidy is generally effective March 1, 2009, employers need to start their compliance efforts now. Outlined below are important steps you should be taking to make sure your organization complies with (and makes the most of) the new rules.

Step 1: Identify Your Compliance Team

Complying with the new COBRA subsidy rules will require the cooperation of individuals responsible for human resources, payroll, COBRA administration, and legal compliance. Identifying your team now will allow these individuals to coordinate their efforts to make compliance as practical and efficient as possible.

Step 2: Identify Notice Recipients

Under the Act, employers must provide notice about the subsidy to all individuals who became or become eligible for COBRA continuation coverage for any reason between September 1, 2008 and December 31, 2009, even though many of them are not eligible for the subsidy. In other words, even individuals who are entitled to COBRA continuation coverage because they voluntarily terminated their employment or are entitled to COBRA because they experienced a death or divorce must receive the notice.

Step 3: Prepare the Notice

Although the individuals entitled to receive notice of the subsidy can be divided into three categories under the Act—"assistance eligible individuals" (defined in Step 5), individuals who have a "second chance" to elect COBRA continuation coverage (discussed further in Step 6), and all other individuals who became or become eligible for COBRA continuation coverage between September 1, 2008 and December 31, 2009—the required content of the notice is the same for all three groups.

Among other information, all subsidy notices must include the following:

- Information about the subsidy and how it works.
- A description of the new "second chance" election.
- Information about the obligations of recipients to advise their employers' group health plans when they become *eligible* for other group health plan coverage or Medicare, because that eligibility will cause their subsidy to terminate, even if they do not elect to enroll under that coverage.[1]
- Information and election forms describing any new special enrollment rights that you may decide (but are not required) to offer, which would enable assistance eligible individuals to switch plan coverage options by electing COBRA continuation coverage benefits under a plan coverage option that is different—and less costly—than the coverage option in which they were enrolled at the time of the covered employee's involuntary termination.[2]
- The name, address, and telephone number of the plan administrator (or the person maintaining relevant information in connection with the subsidy).

Additionally, we recommend that, at minimum, all subsidy notices also include the following supplemental information:

- Instructions about how high-income individuals can waive the subsidy up front to avoid future tax liabilities associated with the subsidy.[3]
- Information about how electing COBRA under the new "second chance" election can help prevent the application of certain pre-existing condition exclusions.
- Notification of an individual's right to appeal a group health plan's determination that such individual is not an "assistance eligible individual" to the Secretary of Labor. The Secretary of Labor is required to make a decision as to the individual's eligibility within 15 business days after receipt of the individual's appeal.

[1] An individual who fails to notify his or her employer's group health plan may be subject to a penalty equal to 110% of the subsidy that was actually provided to that individual but should not have been due to his or her eligibility for other group health plan coverage or Medicare. No penalty will be imposed, however, if the failure is due to reasonable cause and not willful neglect.

[2] In considering whether to offer these new special enrollment rights, you will need to take into account a number of technical parameters about the coverage options that may be offered and the duration of the special enrollment period.

[3] Generally, individuals whose modified adjusted gross income exceeds $125,000 (or $250,000 on a joint return) will not be eligible for some or all of the subsidy. The subsidy phases out entirely for individuals with a modified adjusted gross income exceeding $145,000 (or $290,000 on a joint return). However, employers are not responsible for enforcing this rule. If an individual above the applicable income limitations receives the subsidy, the individual's income tax will be increased by the amount of the subsidy so that he or she essentially repays the federal government for the subsidy.

Although different notices could be written for different groups, to simplify the process we suggest sending one comprehensive, well-organized, user-friendly notice for all individuals entitled to notice. Streamlining the notice process in this way may involve substantial revisions to the model notice expected to be issued by the Department of Labor on or before March 19, 2009.

Step 4: Send the Notice

Notices must be sent by April 18, 2009 to: (1) individuals who qualify as "assistance eligible individuals" as of February 17, 2009, and (2) individuals who must be offered a "second chance" to elect COBRA continuation coverage. The Act does not specify a due date for the remaining notices that are currently required. To simplify the process, we suggest sending all currently required notices by April 18, 2009.

Step 5: Identify "Assistance Eligible Individuals"

In order to lower their premiums in a timely fashion, you will need to identify individuals eligible to receive the subsidy, known under the Act as "assistance eligible individuals." "Assistance eligible individuals" include any qualified beneficiary who is eligible for COBRA continuation coverage at any time between September 1, 2008 and December 31, 2009 as a result of the involuntary termination of a covered employee during that period and elects such coverage.[4] This includes the covered employee, as well as any spouse or dependent who was covered under the group health plan at the time of the employee's involuntary termination of employment.[5]

Step 6: Identify Individuals Eligible to Make a "Second Chance" COBRA Election

If an individual attempts to make a "second chance" COBRA election, you will need to determine whether the individual is entitled to such an election. Individuals who, as of February 17, 2009, were previously eligible for COBRA by reason of involuntary terminations occurring on or after September 1, 2008, but are not currently receiving COBRA benefits (either because they failed to elect COBRA, affirmatively declined COBRA, or elected to have COBRA coverage but let it lapse before February 17, 2009), must be offered a "second chance" to elect COBRA. COBRA coverage elected pursuant to this new election right will generally become effective March 1, 2009, but the COBRA duration period—generally 18 months—will still be measured from the date of initial COBRA eligibility. Accordingly, individuals who take advantage of the second chance

[4] Currently, there is no guidance as to the meaning of "involuntary termination" for this purpose. Therefore, in the short term, employers (in consultation with legal counsel) will need to develop their own reasonable standard for what "involuntary termination" means, keeping in mind that these determinations may need to be revisited once guidance is issued.

[5] Because domestic partners are not considered "qualified beneficiaries" for purposes of federal COBRA, it is not clear at this time how the temporary subsidy applies (if at all) to continuation coverage that may be provided by a group health plan to a domestic partner.

will experience a lapse in coverage from the date their coverage otherwise terminated until March 1, 2009.

Step 7: Implement the Subsidy and Document, Document, Document

To implement the subsidy, you need to lower the COBRA payments being collected from assistance eligible individuals to 35% of their COBRA premium, for a period of up to nine months.[6] Then, once 35% of an assistance eligible individual's premium has been collected, you can begin the process of recouping the remaining 65% of that premium from the federal government through credits against your payroll taxes (FICA and income tax withholding). Thus, this process will require coordination between your COBRA recordkeeper and those who handle your payroll tax filings and related deposits. See Step 8 for more details.

The subsidy is only available with respect to COBRA premiums that would otherwise be due from assistance eligible individuals, and not to COBRA premiums that are otherwise subsidized or paid by the employer. In order to maximize the impact of the subsidy on your organization, you may wish to review—and restructure—the terms of your severance plan or policy, as well as the terms of any individualized severance agreements that might provide for the employer's payment of some or all of a former employee's COBRA premiums.

Keep careful records of who is classified as an assistance eligible individual, the notice provided to them, and all subsidy "payments" credited to them, because you will need this information to claim the applicable payroll tax credits from the federal government. You will likely also be required to provide information about the subsidy payments credited to assistance eligible individuals, so that they may report it on their personal income tax returns, if required by the IRS in order to implement the subsidy's income limitation requirements.

Step 8: Seek Reimbursement Through Payroll Tax Credits

In most cases, it is the employer sponsoring the group health plan that recoups the subsidy payment (*i.e.*, the 65% of the premium) from the federal government. Specifically, the employer may decide either to offset its payroll tax deposits or claim the subsidy as an overpayment at the end of the quarter.

The IRS Form 941 has been revised to allow for the credit. On the form itself, the employer must indicate the amount of credit claimed and the number of individuals provided the COBRA subsidy. As noted above in Step 7, the employer must separately maintain the following supporting documentation for the credit claimed:

[6] The Act includes provisions allowing for amounts in excess of 35% of premiums paid by assistance eligible individuals for the first and second COBRA periods of coverage during which the subsidy is in effect (March and April 2009 for most plans) to be refunded or credited against future premium payments. If applicable, these calculations, refunds, and credits will need to be coordinated with your COBRA recordkeeper or insurer.

- Information on the receipt, including the dates and amounts, of the assistance eligible individuals' 35% share of the premium.
- In the case of an insured plan, copy of invoice or other supporting statement from the insurance carrier and proof of timely payment of the full premium to the insurance carrier required under COBRA.
- In the case of a self-insured plan, proof of the premium amount and proof of the coverage provided to the assistance eligible individuals.
- Attestation of involuntary termination, including the dates of the involuntary termination for each covered employee whose involuntary termination is the basis for eligibility for the subsidy.
- Proof of each assistance eligible individual's eligibility for COBRA coverage at any time during the period from September 1, 2008, to December 31, 2009, and election of COBRA coverage.
- A record of the social security numbers of all covered employees, the amount of the subsidy reimbursed with respect to each covered employee, and whether the subsidy was for one individual or two or more individuals.
- Other documents necessary to verify the correct amount of reimbursement.

If an employer is entitled to a payroll tax credit that is larger than its payroll tax liability, it may either apply the excess credit to its next return or request a refund from the federal government.

Step 9: Terminate the Subsidy for Individuals No Longer Eligible to Receive It

The employer is also responsible for terminating the COBRA subsidy when an individual is no longer eligible to receive it. As mentioned above, assistance eligible individuals are eligible to receive the subsidy for up to nine months. However, their eligibility will terminate early if they become eligible (even if not enrolled) for coverage under another group health plan or Medicare, or their otherwise applicable COBRA eligibility period expires. In the event that an assistance eligible individual becomes eligible for coverage under another group health plan or Medicare, he or she has an affirmative duty to notify you, so that the subsidy (but not necessarily his or her COBRA continuation coverage itself) can be terminated.

Step 10: Comply with Additional Guidance as Issued

Both the IRS and the Department of Labor are continuing to issue guidance on the new subsidy. You should continue to monitor the guidance to remain in compliance.