

PUBLICATION

Employers: Start Making Your Lists New Law Creates COBRA Subsidies and Requires Employer Notices

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Employers must act soon to comply with changes to COBRA continuation coverage requirements. The American Recovery and Reinvestment Act of 2009 (the Act), signed by President Obama on February 17, provides COBRA subsidies and special election rights to individuals who lose group health plan coverage due to an involuntary termination of employment between September 1, 2008 and December 31, 2009. The subsidies and special election rights are available effective March 1, 2009, but employers must notify affected individuals of these changes by April 13, 2009. In effect, the Act requires employers to act as the administrators and short-term funders of a government-mandated health program.

While there are a number of open issues from the Act that will require further guidance and interpretation, a general summary of the major provisions of COBRA subsidy portions of the Act is below.

Who is Affected by the Law?

The Act creates a new class of COBRA-qualified beneficiaries called "assistance eligible individuals" or "AEIs." An individual is an AEI if he or she:

- is an employee or dependent who loses coverage under a group health plan during the period beginning September 1, 2008 through December 31, 2009 as a result of the employee's involuntary termination of employment (other than for gross misconduct); **and**
- elects COBRA continuation coverage either during the original COBRA election period or during the special election period (described below).

COBRA Special Election Period

An AEI who did not elect COBRA during an original election period which expired before March 1, 2009 will have a *second chance to elect COBRA coverage*. The second chance to elect COBRA must be offered both to AEIs who originally declined COBRA coverage and to AEIs who elected but subsequently terminated COBRA coverage. This one-time, special election period will end 60 days after the employer provides the special election notice (described below). Generally, an AEI who elects COBRA coverage during the special election period will have COBRA coverage commence effective March 1, 2009, and the plan cannot apply a pre-existing condition exclusion on account of any break in coverage. However, the special election period will not extend the maximum period of COBRA coverage, and it will not make coverage effective before March 1, 2009. An AEI's maximum period of COBRA coverage is still measured from the date of the AEI's original qualifying event. For example, if an AEI was laid off on September 15, 2008, and his group health coverage ended September 30, 2008, then his 18-month period of COBRA continuation coverage normally would end March 31, 2010. The available subsidized coverage would run from March 1, 2009 through November 30, 2009, unless the coverage ends sooner in accordance with the normal COBRA rules or the subsidy ends earlier under the special rules discussed below. Once the subsidy ends, the AEI will be responsible for payment of the entire COBRA premium for any remaining period of coverage.

COBRA Subsidy

Under the subsidized coverage, an AEI pays no more than 35% of the applicable COBRA premium for up to nine months. The employer must provide the remaining 65% of the premium, but is entitled to an equal credit toward payroll taxes. The credit is applied as though the employer had paid an equal amount of payroll tax on the date the AEI's reduced COBRA premium is received. For March and April of 2009, if an AEI pays more than 35% of the applicable COBRA premium, the employer may either reimburse the AEI within 60 days for the overpayment and treat the reimbursement as a credit toward payroll tax, or credit the overpayment toward the AEI's future COBRA premium payments. Special rules apply if the employer charges less than the full premium permitted under COBRA. It is unclear whether the 2% administrative fee can be added to the AEI's 35% premium share. Regulatory guidance should address these concerns.

The subsidy is phased out for "high income" AEIs with modified adjusted gross income above \$125,000 if filing singly, or above \$250,000 for married persons filing jointly. A subsidy recapture tax may apply when a high income AEI files their federal income tax return. Employers will be required to allow these individuals to waive the subsidy permanently. The IRS is to provide guidance on waivers.

Termination of COBRA Subsidy

The subsidy will end on the earliest of: (1) when COBRA would normally end; (2) after nine months of subsidy; or (3) when the AEI becomes **eligible** for coverage under another group health plan, a flexible spending arrangement, an on-site medical treatment program, or Medicare. An AEI is required to notify the employer of eligibility for other coverage, and is subject to a penalty of 110% of the subsidy for failure to do so.

Notice Requirement

The employer must notify AEIs of these new COBRA rights no later than April 13, 2009, using one of two different notices. One notice must be provided to all AEIs currently on COBRA continuation coverage as of March 1, 2009. The other notice must be provided to all AEIs who either declined COBRA when it was initially offered or who elected but subsequently terminated COBRA coverage before March 1, 2009. This may require employers to locate individuals who involuntarily terminated employment months ago. The Department of Labor is required to provide model notices for these purposes no later than March 19, 2009. For AEIs with qualifying events occurring after February 17, 2009, employers can provide the COBRA subsidy information as part of the COBRA election notice in accordance with the regular COBRA timing rules. Again, however, regular COBRA premium payments will apply until March 1, 2009.

Action Steps

Employers should begin compiling a list of all employees who have been involuntarily terminated other than for gross misconduct since September 1, 2008, and dividing that list between those currently enrolled in COBRA continuation coverage and those who are not. The Act does not change the statutory or regulatory disclosure and fiduciary responsibility rules, which can result in very significant excise taxes, civil penalties and personal liability of responsible plan fiduciaries for noncompliance. In addition, the Act contains more specifications that should be reviewed with legal counsel to assure compliance with the Act.