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Saul Ewing Labor,
Employment and
Employee Benefits
Practice Group:

Harriet E. Cooperman
Co-Chair

Robert L. Duston
Co-Chair

COBRA premium subsidies under Federal Recovery Act require immediate employer action

By Joan M. Corcoran and Matthew L. Salm

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (“Recovery Act”) into law. The Recovery Act contains significant, temporary changes to the Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA”) regarding the continuation of group health care coverage following termination of employment. These changes also apply to continuation coverage under state insurance laws. Thus, employers with fewer than 20 employees that sponsor group health care plans not covered under COBRA may also be impacted by these new obligations.

As a result of these amendments, the government will subsidize 65% of the COBRA premiums for employees involuntarily terminated during the period September 1, 2008 to December 31, 2009 for up to nine months. These changes will impact nearly every employer that sponsors a group health plan and dramatically alter an employer’s COBRA notice obligations, the payment of COBRA premiums and payroll tax administration.

“ASSISTANCE ELIGIBLE INDIVIDUALS”

The Recovery Act provides that as of the date of enactment, February 17, 2009, “assistance eligible individuals” will be required to pay only 35% of the applicable COBRA premiums if they elect to continue health care coverage. “Assistance eligible individuals” are defined as individuals who are or were eligible for health care continuation coverage due to an involuntary termination of employment occurring during the period September 1, 2008 to December 31, 2009. The term includes the covered employee whose employment is so terminated, as well as the covered employee’s qualifying beneficiaries.

The statute does not define an “involuntary termination” for this purpose. In some cases, employers will need to determine based on the facts and circumstances whether terminations otherwise classified as voluntary should be treated as involuntary for the purpose of determining eligibility for the subsidy.

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DURATION OF THE SUBSIDY

This subsidy takes effect with an employer's next COBRA premium period. In many cases, this will be as soon as March 1, 2009. The subsidy will be available to eligible employees for up to nine months, but can end sooner. The subsidy will end if the eligible individual reaches the maximum COBRA continuation period (18 months), becomes *eligible* for alternative group health care coverage, becomes eligible for Medicare, or the individual fails to pay the 35% share of the premium. Failure to provide notice of alternative coverage eligibility will subject the eligible individual to a penalty equal to 110% of the reduced premiums provided after termination of eligibility. Note that while the Recovery Act subsidy is discontinued if the individual becomes *eligible* for alternative group health care coverage, the individual may continue coverage, albeit at his or her own cost, under the usual COBRA rules.

GRACE PERIOD

The Recovery Act provides a grace period for employers who are unable to implement these changes prior to issuing March or April premium bills to assistance eligible individuals. This grace period allows employers to accept the full COBRA premium from eligible individuals for two billing periods so long as a reimbursement or a credit in subsequent billing periods is provided to reflect the subsidy.

“SECOND CHANCE” ELECTIONS

The Recovery Act requires employers to offer assistance eligible individuals who declined continuation coverage, or who stopped paying required premiums prior to the date of enactment, a “second chance” to elect health care continuation coverage. It is important to note that if an assistance eligible individual takes advantage of this second chance election, health care continuation coverage will not apply retroactively to the employee's termination date.

REVISED REPORTING OBLIGATIONS

Employers are required to revise their COBRA notices and election forms to explain the new subsidy provisions and the “second chance” election. These revised notices must include information

about the availability of the 65% subsidy, forms to establish eligibility for the subsidy, a description of an eligible individual's obligation to notify the plan when he or she becomes eligible for alternative coverage and the penalty associated with noncompliance. Additionally, as discussed below, revised notices should include information about the limitations imposed on high income individuals.

Employers have been given until April 18, 2009 to distribute second chance notices and elections to assistance eligible individuals involuntarily terminated on or after September 1, 2008 and prior to February 17, 2009. For employees involuntarily terminated on or after the enactment date of the Recovery Act, employers are required to provide notices containing the additional information about the subsidy in accordance with usual timing rules for the provision of COBRA notice and elections.

The Recovery Act directs the Secretary of Labor to issue model notices by March 19, 2009. However, the election window for electing COBRA coverage, including “second chance” coverage, runs for 60 days following delivery of notice. Therefore, employers may wish to draft and issue their own notices as soon as possible to begin the running of the 60-day election period.

PAYROLL TAX OFFSETS

Under the changes detailed in the Recovery Act, assistance eligible individuals who elect health care continuation coverage are responsible for only 35% of the premium. In general, employers will be responsible for the remaining 65% of the premium in the first instance, but will be eligible for reimbursement of these amounts through the federal payroll tax deposit system.

Employers will need to keep track of the total amount of the subsidy paid with respect to premiums received during the federal payroll tax period from assistance eligible individuals. This amount is then used to offset the employer's payroll tax liability for the period. If the amount of the offset exceeds the employer's tax liability for the period, the Internal Revenue Service will directly reimburse the employer for the excess. Additionally, employers claiming the subsidy will also have to:

- Attest to the involuntary termination of each assistance eligible individual;

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- Report payroll taxes offset for the current period (and estimated offset for the next payroll period);
- Report the Taxpayer Identification Numbers of assistance eligible individuals;
- Report the amount of subsidy received; and
- Report whether the subsidy covered one or more qualified beneficiaries.

Under circumstances where the employer has agreed to pay an assistance eligible individual's COBRA premiums, such as under a severance agreement, it appears that the employer will not be eligible to claim the 65% subsidy. Rather, under the statute it seems that reimbursement of the subsidy is only available to the employer where the assistance eligible individual pays 35% of his or her COBRA premium. It is not clear how the 65% subsidy will work if the employer is currently paying a part of the premium.

LIMITATIONS FOR HIGH INCOME EMPLOYEES

Provisions in the Recovery Act limit the COBRA subsidy for individuals whose adjusted gross income exceeds \$125,000 or \$250,000, if filing jointly (these limits may be higher for certain employees working outside the U.S.) If a high income individual elects to receive COBRA premium assistance under the Recovery Act, the subsidy will be subject to “recapture” through an additional tax imposed when the individual files his or her annual individual federal tax return.

WHAT TO DO NEXT?

While we anticipate the government will provide additional guidance on these issues, employers are encouraged to address these changes immediately by taking the following steps:

- Identify all assistance eligible individuals involuntarily terminated since September 1, 2008 to ensure that revised notices, and in particular, “Second Chance” notices, are timely provided;
- Determine whether to wait for the model notice developed by the Secretary of Labor or draft a notice for immediate use;

- Work with payroll and health plan administrators to develop a procedure to calculate, track and maintain the new COBRA premium structure; and
- Review policies and procedures that may be impacted by these changes, such as severance policies, in order to take advantage of this government subsidy.

Saul Ewing will continue to track these changes and provide updates of all pertinent developments. If you have any questions about these requirements, please feel free to contact any of the Saul Ewing attorneys listed below.

Dan S. Brandenburg at dbrandenburg@saul.com or 202-295-6644
Joan M. Corcoran at jcorcoran@saul.com or 410-332-8691
Joanne G. Jacobson at jjacobson@saul.com or 202-295-6616
Paul M. Heylman at pheyman@saul.com or 202-342-3422
Matthew L. Salm at msalm@saul.com or 410-332-8603

This Alert was prepared by Joan M. Corcoran, a Partner, and Matthew L. Salm, an Associate, in Saul Ewing's Labor, Employment and Employee Benefits Practice Group in the Firm's Baltimore office. Joan can be reached at 410.332.8691 or jcorcoran@saul.com and Matthew can be reached at 410.332.8603 or msalm@saul.com. This publication has been prepared by the Labor, Employment and Employment Benefits Practice Group for information purposes only.

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