



COUNCIL OF SMALLER ENTERPRISES

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MEMBER ALERT

THE NEW COBRA PREMIUM SUBSIDY: QUESTIONS - AND ANSWERS

The stimulus package signed into law by President Obama on February 17, 2009 (the American Recovery and Reinvestment Act of 2009 or the “Recovery Act”), provides a 65% COBRA premium subsidy for up to 9 months for workers involuntarily terminated on or after September 1, 2008 and prior to January 1, 2010. This new provision immediately imposes significant administrative responsibilities on group health plan sponsors and administrators. The purpose of this Client Alert is to address the most pressing questions associated with this new provision.

What is COBRA?

COBRA is the acronym for the Consolidated Omnibus Budget Reconciliation Act of 1985 which imposed a requirement on many group health plans to offer employees and their covered dependents (the latter referred to as “qualified beneficiaries” in the COBRA statute) the opportunity to continue to participate in a group health plan for a specified period of time after the occurrence of certain “qualifying events” that otherwise would have terminated their plan participation.

Under pre-Recovery Act rules, employees and qualified beneficiaries who elected COBRA continuation coverage were required to pay up to 102% of the premium cost of similarly situated plan participants (with the additional 2% intended to cover the plan sponsor’s administrative costs). The COBRA coverage can continue for the employee and qualified beneficiaries for at least 18 months after the date that their health plan coverage would otherwise have been lost due to certain qualifying events, such as an employee’s voluntary or involuntary termination of employment (for other than gross misconduct).

How Has the Recovery Act Changed the COBRA Premium Rules?

The 2009 Recovery Act provides a 65% “subsidy” for COBRA premiums for a period of up to nine months for eligible employees and their qualified beneficiaries. The “subsidy” consists of a commensurate reduction in required premiums during the period. An employee and his or her qualified beneficiaries are eligible for the COBRA premium subsidy if the employee is, or was, involuntarily terminated at any time from September 1, 2008 through December 31, 2009 (for reasons other than gross misconduct), and the employee and/or qualified beneficiaries elect COBRA coverage. (Employees do not have to have been “laid off” to qualify for the new subsidy; they could have been fired for misconduct – so long as it was not gross misconduct). The amount of the premium subsidy is generally not subject to federal income tax for the employee or qualified beneficiaries.

However, the new law does provide a “recapture” provision for the premium subsidy provided to higher-income individuals. Under this provision, if a COBRA premium subsidy is provided to an eligible individual, or his or her spouse or dependents during any portion of the tax year, and the individual’s adjusted gross income (calculated with minor modifications) for the tax year exceeds \$125,000 (\$250,000 in the case of a joint return), the subsidy is subject to a graduated “phase out” – and “phased out” entirely for individuals with adjusted gross income of \$145,000 (\$290,000 in

the case of a joint return). This “phase out” is actually accomplished by an increase in the individual’s income tax liability for the tax year.

Such higher-income individuals can avoid the circular effect of the COBRA premium subsidy – and then income tax recapture - by making a permanent election (in a manner to be set out by the IRS) to waive the right to premium assistance, and notifying the employer or insurer maintaining the group health plan. Such individuals do not have to elect to waive the premium assistance, however, and they may not be in a position to know with confidence early in 2009 whether they will be subject to the recapture.

What Plans are Subject to COBRA and to the New Premium Subsidy Rule?

COBRA generally applies to all group health plans, except for church plans, governmental plans (which are nevertheless generally subject to COBRA-like requirements under the Public Health Service Act), and “small employer plans”. Small employer plans are plans maintained by employers that normally employ fewer than 20 employees.

While “small employer plans” have not historically been subject to COBRA requirements, the new premium subsidy rule extends to health care continuation coverage that is required by “comparable” state laws. It would appear, for example, that Ohio’s six month health care continuation coverage law, which has no “small employer” exception, would be considered “comparable” to COBRA for this purpose. **Therefore, even Ohio employers with fewer than 20 employees that maintain a group health plan will apparently have to comply with the new premium subsidy rules.**

Do Plan Sponsors Have to Absorb the Cost of Reduced Employee COBRA Premiums?

No. The Recovery Act provides a mechanism for an employer to recoup the premium dollars lost due to the premium subsidy. To receive the reimbursement, the employer will have to file a claim for reimbursement in accordance with rules to be prescribed by the IRS. The employer will be treated as having paid to IRS, on the date that the eligible individual’s premium payment is received, payroll taxes in an amount equal to the amount of the premium reduction. To the extent that the amount treated as paid exceeds the amount of the employer's liability for payroll taxes, IRS will credit or refund the excess as if it were an overpayment of payroll taxes.

The employer claiming the reimbursement will also be required to submit reports to IRS that include (1) an attestation of the involuntary termination of covered employees, (2) the amount of payroll taxes offset, and (3) the amount of subsidy reimbursed with respect to each covered employee and qualified beneficiary.

Do Employees Have to Be Notified of the New COBRA Premium Subsidy?

Yes. The Recovery Act requires a plan administrator to provide a notice, by April 18, 2009, to: (i) individuals who first become eligible for COBRA during the subsidy period; (ii) to any eligible individual who had elected COBRA coverage as of February 17, 2009; and (iii) to any individual eligible to take advantage of the extended election period (see “What is the Special Election Period for the New Premium Subsidy?”, below).

This new notification must include information about the availability of the COBRA premium subsidy; and, if the employer so permits under the group health plan, a description of the option to enroll in different coverage (see “Can Premium Subsidy Eligible Individuals Change their COBRA Coverage?”, below).

This new COBRA notification requirement may be met either by amending existing COBRA notice forms, or by preparing a separate document with the new required information.

The new notification must also include:

(1) the forms required for the individual to establish eligibility for the premium subsidy;

(2) the contact information for the plan administrator and any other person maintaining relevant information in connection with the subsidy;

(3) a description of the special, extended election period, discussed below;

(4) a description of the obligation of the eligible individual to notify the plan of eligibility for subsequent coverage under another group health plan or Medicare, and the penalty for failure to do so;

(5) 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; and

(6) a description of the option of the eligible individual to enroll in different coverage offered, if that is permitted by the employer, discussed below.

The Department of Labor is charged with developing models for the new required notices, by March 19, 2009. DOL is also supposed to provide rules about similar notices regarding the premium subsidy for plans not covered by the general COBRA notice rules (church plans, governmental plans and small employer plans).

Are There Potential Penalties for Plan Sponsors that Fail to Provide the New COBRA Premium Subsidy Notice?

Failure to provide this new additional notification is treated as a violation of the general COBRA notice requirements. An excise tax of \$100 per qualified beneficiary, per day of noncompliance can be imposed on an employer or plan administrator for failing to meet this - and other - COBRA requirements. If there is more than one qualified beneficiary involved in the same qualifying event (for example, an employee and dependents), then the daily maximum excise tax on all failures on any day during the noncompliance period concerning all of those qualified beneficiaries is \$200. However, the IRS may also waive part or all of the COBRA excise tax, if the failure to satisfy the COBRA rules is due to reasonable cause and not willful neglect.

Additionally, an eligible individual's time period for electing COBRA coverage under this new provision does not begin to run until the individual receives the notice described above. (See "What is the Special Election Period for the New Premium Subsidy?", below). Thus, the longer an employer or plan administrator delays in sending out the required notice, the longer an eligible individual can "wait and see" whether significant medical expenses are incurred before committing to sign up for COBRA coverage.

What is the Special Election Period for the New Premium Subsidy?

The new law requires a special extended election period for qualified beneficiaries who are eligible for the subsidized COBRA coverage. Specifically, an individual who does not have a COBRA continuation coverage election in effect on February 17, 2009, but who would be an eligible individual if a COBRA election were in effect, is permitted to elect COBRA continuation coverage during the period beginning on February 17, 2009 and ending 60 days after the date on which the notice regarding the extended election period is provided to him or her.

In addition, an eligible individual (due to an involuntary termination on or after September 1, 2008) who elected COBRA coverage before February 17, 2009, but who is no longer enrolled on such date (because, for example, the individual was unable to continue paying the premium), is entitled to elect COBRA coverage during this extended election period.

Any COBRA continuation coverage elected by an eligible individual during this special election period must begin with the first "period of coverage" beginning on or after February 17, 2009. A "period of coverage" is determined by the period over which a plan provides and charges for COBRA coverage. Since most plans provide and charge for COBRA coverage on a monthly basis, March 1, 2009 will be the beginning of the first period of coverage for such plans. Thus, for individuals first electing COBRA coverage pursuant to the new special election period rules, claims incurred prior to March 1, 2009 would not appear eligible for COBRA reimbursement. However, claims incurred on or after March 1, 2009 would be eligible for COBRA reimbursement, even if the eligible individual does not make his or her election under the new rules (or pay the required premium) until after that date.

COBRA continuation coverage elected by an eligible individual during this special election period will also not extend beyond the period that COBRA continuation coverage would otherwise have been required if the coverage had been elected under the standard (i.e., not extended) election period. **Thus, the new COBRA premium subsidy rules (including rules**

providing an extended election period) never extend the period of COBRA continuation coverage beyond the original maximum period required under general COBRA rules (generally, 18 months after a qualifying event). Furthermore, the general COBRA rules which terminate COBRA coverage upon a covered employee or qualified beneficiary becoming eligible for coverage under another group health plan or Medicare continue to apply.

How Does the Special Election Period Affect Preexisting Condition Limitations?

Under current rules limiting exclusions of group health plan coverage for “preexisting conditions”, a period of “creditable coverage” can be disregarded if, after the prior coverage period, and before enrolling in a new plan, there was a 63-day period during which the individual was not covered under any creditable coverage. (Creditable coverage prevents a group health plan from applying a preexisting condition limitation). However, for individuals who elect COBRA continuation coverage under the extended election period, the period that begins on the date of the qualifying event (e.g., involuntary termination of employment), and ends with the beginning of the period of coverage elected during the new extended election period, is disregarded for purposes of determining this 63-day period.

Can Premium Subsidy Eligible Individuals Change their COBRA Coverage?

Under pre-Recovery Act COBRA rules, covered employees and their qualified beneficiaries can only continue the same health care coverage under COBRA that they had immediately before the occurrence of the qualifying event causing the loss of coverage.

Now, however, sponsoring employers can permit individuals eligible for the new COBRA premium subsidy to enroll in different coverage if: (i) the premium for the different coverage is not more than the premium for the coverage the individual was enrolled in at the time of the involuntary termination; (ii) the different coverage is also available to active employees of the employer at the time the election is made; and (iii) the different coverage is not coverage that provides only dental, vision, counseling, or referral services (or a combination of such services), or a health care flexible spending account (FSA).

Thus, where employers allow, individuals eligible for the COBRA premium subsidy are permitted to change coverage options under the plan, within 90 days after the date of notice of the plan enrollment option, in conjunction with electing COBRA coverage. However, once the election of the other coverage is made, it becomes COBRA continuation coverage, and must continue to be made available to the eligible individual for the remainder of the COBRA required period (generally 18 or 36 months) even though the premium subsidy only lasts for nine months.

Are There Any Notice Requirements Imposed on Individuals Receiving the COBRA Subsidy?

Any individual who has been receiving the COBRA premium subsidy must notify the group health plan providing the subsidized COBRA coverage if he or she becomes eligible for coverage under another group health plan or Medicare. This notice must be in writing and be provided in the time and manner that DOL is to specify. If the individual fails to provide the notice in the time and manner required by DOL, he must pay a penalty of 110% of the premium reduction (i.e., the subsidy described above) after termination of eligibility for the subsidized COBRA coverage.

The penalty applies only if the premium subsidy is actually provided to a qualified beneficiary for a month that he is not eligible for the reduction. If, for example, the beneficiary becomes eligible for other coverage and stops paying the reduced COBRA continuation premium, the penalty generally will not apply. If, however, the beneficiary continues to pay the reduced premium and does not notify the group health plan of his or her eligibility, the penalty will generally arise.

Employers should review their COBRA policies and practices immediately to comply with these new requirements.

FEBRUARY ■ 2009

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