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Publications

New Health Tax Credit, New COBRA Election Period, Contained in Enacted Trade Bill

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Background

In August, President Bush signed into law the Trade Act of 2002, (H.R. 3009, Public Law No. 107-210) ("Trade Act"). Among its many trade-related provisions, the bill creates a new tax credit for health insurance expenses and makes changes to the COBRA rules with respect to certain workers who lose their jobs because of trade or who are receiving benefits from the Pension Benefit Guarantee Corporation (PBGC). More specifically, the Trade Act contains provisions to:

- Provide a advance payment tax credit for eligible individuals equal to 65% of the premium for certain types of health insurance coverage (including COBRA coverage) for the individuals and their families; and
- Create a second COBRA election period for eligible workers who lose their jobs because of trade.

Although the effective date of the provisions is not entirely clear, it appears that certain eligible individuals will be entitled to claim a tax credit on their tax return and take advantage of the new COBRA election period beginning in December 2002. The Treasury Department is directed to establish an advance payment program by August 1, 2003.

The tax credit and COBRA provisions enacted in the Trade Act are likely to result in increased administrative and other costs for health insurers, administrators, and plan sponsors, and could exacerbate COBRA adverse selection problems as workers who otherwise may not have elected COBRA coverage have a new opportunity to elect such coverage. The Treasury Department and IRS are currently working on forms and publications to implement these new provisions, but it is not yet clear whether any other guidance interpreting these provisions will be issued in the near future. To help mitigate the significant costs and administrative burdens expected as a result of these new requirements, health insurers, administrators, and plan sponsors may want to consider sending comment letters to Treasury and IRS with suggested interpretations of these new requirements.

It is important to remember that, although the classes of individuals eligible to take advantage of this new tax credit are quite narrow, the credit could prove to be a model for future health insurance tax credits. President Bush has included broad health insurance tax credits in his first two budgets, and Congressional leaders on both sides of the political spectrum have endorsed similar proposals. Congressional and Treasury Department staff have stated informally that they believe the advance payment program under the Trade Act will serve as a "demonstration project" for any future health tax credit legislation.

Detailed Summary

A. Tax Credit For Health Insurance Costs of Displaced Workers

1. Eligibility for Tax Credit

The Trade Act for the first time allows eligible persons to receive a tax credit equal to 65 percent of the cost of certain types of health coverage. Generally, to be eligible for the credit for a particular month, an individual must be (1) receiving a trade adjustment allowance (or a supplemental wage allowance) under the Trade Act of 1974 as a result of losing his or her job because of import competition or shifts of production to other countries, or (2) at least 55 years old and receiving pension benefits paid by the Pension Benefit Guarantee Corporation (PBGC).

The 65 percent tax credit is not available to otherwise eligible individuals who have coverage maintained by any employer or former employer of the individual or the individual's spouse where the employer pays at least 50 percent of the cost of the coverage. For these purposes, coverage purchased under a cafeteria plan is treated as paid by the employer. The credit also is generally not available to individuals who are entitled to benefits under Medicare, Medicaid, a State Children's Health Insurance Program (SCHIP), the Federal Employees Health Benefit Program (FEHBP), and the Civilian Health and Medical Program of the United States (CHAMPUS).

The 65 percent tax credit applies to the amount that an individual pays for premiums for certain "qualified health insurance" for the individual and for the individual's spouse and dependents. Qualified health insurance includes:

- COBRA continuation coverage;
- Employer-sponsored coverage available through the employment of the individual's spouse;Individual health coverage held by the employee during the 30-day period prior to his or her loss of employment; and
- Certain types of coverage arranged for or sponsored by a State — most notably, State high risk pool coverage and State continuation coverage — if the State elects for the coverage to be qualifying coverage and certain other requirements are satisfied.

2. Advance Payment of Tax Credit

The Trade Act directs Treasury to establish a program by August 1, 2003 for making advance payment of the tax credit to "providers of qualified health insurance" on behalf of individuals with a "qualified health insurance costs credit eligibility certificate" in effect ("Certificate"). A Certificate is a written statement that an individual is eligible for the credit that is issued by the Department of Labor (or the PBGC with respect to eligible PBGC recipients) or such other person or entity designated by the Secretary of Labor. Once this advance payment program becomes operational, individuals with a Certificate will pay 35 percent of the premium to providers, and the government will pay the remaining 65 percent of the premium directly to the provider.

The Trade Act creates new tax reporting and disclosure requirements for "providers" who receive advance credit payments. Each person who receives advance payments is required to (1) file an information return with the government identifying the individuals receiving the coverage and showing the amount of and timing of the advance payments, and (2) provide each such individual a statement showing the information provided on the return with respect to that individual.

3. Issues Regarding Eligibility and Advance Payment Provisions

The new tax credit and advance payment program raise many new issues for health insurers, administrators, and plan sponsors, including:

- What entities are considered "providers of qualified health insurance" for purposes of accepting the advance payment credit and satisfying the new reporting and disclosure requirements ¯ i.e., are health insurers, administrators, group health plans, and/or plan sponsors considered "providers" for these purposes?
- Whether providers will be required to accept the new advance payment credit.
- To what extent providers will be responsible for determining who is eligible for the tax credit. The Trade Act provides generally that the Secretary of Labor, PBGC, or "any other person or entity designated by the Secretary of Labor" will certify the eligibility of

individuals. It is not clear to what extent the Secretary could designate health insurers, administrators, and employers as designated entities for purposes of determining eligibility. At the very least, it appears that insurers, administrators, and employers will be required to play some role in determining and/or substantiating whether an individual is eligible for an advance payment credit.

- To what extent providers will be forced to extend credit ("float") to Treasury for the amount of the credit. It is likely that there may be substantial delays between the date a provider provides coverage based upon an advance payment credit and the date the provider is reimbursed by Treasury.
- To what extent providers will have to redesign administrative systems to track advance payment amounts, match those amounts with individual payments, and apply to the government for reimbursement.
- To what extent providers will be liable for the receipt of an advance payment amount where an individual fails to pay his or her share of the premium or if it is later determined that the individual was not eligible for the credit.

B. Extended COBRA Election Period

1. New 60-Day Period

Individuals who become eligible for a trade adjustment allowance under the Trade Act of 1974 but who did not elect COBRA coverage during their initial COBRA election period are provided with a second 60-day election period. This new election period begins on the first day of the month in which the individual became eligible for a trade adjustment allowance, but the new election period only applies if the individual elects coverage within six months after the individual lost health coverage because of the separation from employment giving rise to his or her eligibility for a trade adjustment allowance. Coverage elected during the second election period commences as of the beginning of the new election period. For individuals who elect COBRA coverage during the new election period, the period between the date the individual lost health coverage and the beginning of the new election period is disregarded for purposes of determining whether the individual had a 63-day break in coverage for HIPAA purposes.

2. Issues Regarding Second COBRA Election

The new 60-day COBRA election period also creates several issues for health insurers, administrators, and plan sponsors, including:

- How the insurer, administrator, and/or sponsor will know the date on which an individual becomes eligible for a trade adjustment allowance for purposes of determining the commencement date for the new COBRA election period. Will the Secretary and/or the PBGC or their designee be required to notify the insurer or employer? Is the eligible individual required to provide a Certificate and/or other evidence to the insurer or employer?
- The effect the new COBRA election period will have on existing administrative systems. At the very least, it appears that insurers, administrators, and/or employers will have to modify and possibly redesign existing automated systems used to track COBRA election periods and deadlines for payments.
- Whether current COBRA law applies for purposes of the maximum timeframes for coverage (e.g., 18 months from the date of termination of employment) and deadlines for premium payments.
- Whether plan documents and/or summary plan descriptions have to be amended and COBRA notices must be updated to reflect the availability of the new COBRA election period.
- To what extent the new COBRA election period will exacerbate the problem of adverse selection in COBRA coverage.