

February 18, 2009

## **COBRA Provisions in American Recovery and Reinvestment Act**

The House of Representatives and the Senate have passed the American Recovery and Reinvestment Act (the "Act"), which is intended to provide stimulus to lead to an overall economic recovery. The President signed the Act on Tuesday, February 17, 2009. The Act, which is budgeted at \$789 billion, provides funding for a variety of programs and an overall tax cut to American workers. This memorandum will briefly focus on the changes that the Act makes to the coverage continuation provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), which are effective for the first period of coverage beginning on or after February 17, 2009. **In the case of a group health plan that provides and charges for COBRA continuation coverage on a calendar month basis, the effective date is March 1, 2009.** Not all the provisions regarding COBRA that were in the previous House and Senate bills were included in the final version of the Act (such as the extension of the COBRA continuation coverage period for older or long-service employees) but those legislative concepts may be raised again when Congress addresses health care reform.

### **Background**

Under current law, an employee of an employer with 20 or more employees who loses coverage under the employer's group health plan due to a termination of employment may elect to continue that coverage under COBRA for a period of time (generally 18 months from the date coverage is lost) by paying premiums to continue such coverage. Members of the employee's family who have lost medical coverage due to the employee's termination of employment are also eligible to elect to pay premiums and continue coverage. The Act provides federal assistance for payment of COBRA premiums to employees and covered family members with adjusted gross incomes below a maximum threshold who lost or will lose coverage due to *involuntary* termination of employment from September 1, 2008 through 2009. As described below, these federal assistance provisions impose new obligations upon sponsors of single-employer group health plans, multiemployer plans and group health insurers, with penalties for failure to comply.

### **COBRA Premium Subsidy for Eligible Individuals**

**Generally.** The Act provides a subsidy of 65 percent of the COBRA continuation coverage premiums for eligible individuals for a maximum of 9 months, so that an eligible individual will only have to pay 35 percent of the COBRA premium in order to get coverage. For example, if the required COBRA premium is \$1,000 per month, an eligible individual would only need to pay \$350 per month to receive COBRA coverage. The premium assistance period will be shorter than 9 months in certain circumstances, including if an individual becomes eligible for coverage under a major medical group health plan (a person is not considered eligible if he or she is subject to a waiting period under the other group health plan). Such individual is required to notify the employer of eligibility for such other coverage, and will be subject to a penalty of 110 percent of the subsidy amount for failing to do so. Persons other than the employer can pay the eligible individual's premium (such as a state agency or the individual's

parents) and the subsidy will still be available. The legislation is unclear concerning how much of the premium subsidy is available if the employer already requires the employee to pay 35 percent or less of the premium. For example, if an employer, as part of a reduction in force, pays 80 percent of the total COBRA premium and requires the employee to pay only 20 percent of the total premium, it is not clear from the legislation whether the employer can recover 65 percent of the total COBRA premium from the federal government, or some lesser amount. Informal statements from Treasury/IRS indicate that they are interpreting the legislation to mean that the subsidy should be calculated based on the premium that the employee is *actually charged* by the employer, rather than the maximum COBRA premium that the employer would be legally permitted to charge, putting employers who subsidize COBRA at an economic disadvantage.

**Eligibility Requirements.** An individual is eligible for this COBRA premium subsidy if he or she is involuntarily terminated from employment during the period beginning September 1, 2008 and ending December 31, 2009 and is eligible to elect COBRA during that time (as described below, the COBRA election need not have actually been made prior to the date of enactment). Members of the individual's family are also eligible for this premium subsidy if the reason that they become eligible for COBRA is due to the employee's involuntary termination of employment during the applicable time period. Individuals who *elected* COBRA due to an involuntary termination on or after September 1, 2008 but prior to the date of enactment are eligible to receive the subsidy on a prospective basis, beginning on the date of enactment. Individuals who were eligible to elect COBRA during that time period due to an involuntary termination but *did not elect* COBRA will need to be given the opportunity to elect COBRA on a prospective basis, with the maximum coverage period measured from the earliest date that COBRA coverage could have been elected. Employers or plans will have to provide notice to these groups of individuals, as described below. Further, a group health plan must refund or credit any COBRA premiums that subsidy-eligible individuals pay on or after the date of enactment in excess of 35 percent of the premium.

Individuals with modified adjusted gross income that exceeds \$250,000 (for joint return filers) or \$125,000 (for all other filers) will not be eligible for the full premium subsidy. The premium subsidy will be fully phased out for those individuals with adjusted gross income of \$145,000/\$290,000. Any portion of a subsidy that an individual receives but is not eligible for will need to be reported on the individual's annual income tax return, and the amount of tax that such individual would otherwise pay will be increased by the amount of such subsidy. Consequently, employers and insurers will not need to determine whether an individual's income makes him or her ineligible for the subsidy. Rather, employers and insurers can treat all COBRA beneficiaries who have coverage due to involuntary termination during the applicable time period as eligible for the subsidy and receive reimbursement for 65 percent of the premiums for coverage provided. However, if an individual does not want to report the subsidy on his or her annual income tax return, the Act also provides that an individual can notify the employer, insurer or multiemployer plan that he or she will not be eligible for the subsidy and pay the full COBRA premium required.

**Appeal Procedure.** The Act provides that if an individual requests that the group health plan treat the individual as eligible for the subsidy and such request is denied, the individual may appeal the decision to the Department of Labor ("DOL"), or to the Department of Health and

Human Services ("HHS") in the case of COBRA continuation coverage provided pursuant to the Public Health Service Act. DOL or HHS must, in turn, rule on the appeal within 15 business days. If the appeal is denied, the individual could then sue under ERISA § 502(a)(3) for treatment as a subsidy-eligible individual, but the Act provides that the reviewing court is required grant deference to DOL's or HHS's determination.

**Income Treatment.** As long as an individual is eligible for the premium subsidy, it will not be considered additional taxable income. In addition, the premium subsidy cannot be considered as additional income or resources in determining eligibility for any federal or state public benefit program.

### **Mechanics of Receiving the Premium Subsidy**

Although this is a federal premium subsidy that could have been paid directly to the covered individual, the mechanics of the subsidy program instead require the entity who provides the coverage and collects 35 percent of the premium to receive reimbursement for the remaining 65 percent of the premium from the federal government. For a group health plan that is a multiemployer plan, the *plan* will be entitled to the reimbursement. For a group health plan that is not a multiemployer plan and is not insured, the *employer* will be entitled to the reimbursement. In addition, although the legislative language is not clear, it appears that for a group health plan that is not a multiemployer plan and where the coverage is provided by insurance, the *employer* will be entitled to the reimbursement, if such group health plan is subject to the COBRA provisions in ERISA, the Code, the Public Health Service Act or United States Code title 5 (*i.e.*, federal government organization and employees). In any remaining cases (*e.g.*, where the continuation coverage is provided to comply with a state law that applies to employers with fewer than 20 employees) where the coverage is provided by insurance, it appears that the *insurance company* providing the insurance will be entitled to the reimbursement.

The method of providing the reimbursement is for the reimbursement to be taken from the payroll taxes that the entity receiving the reimbursement owes. If the amount of the premium subsidy is greater than the payroll tax liability for that period, the additional amount due will be treated as a refund or a credit of payroll taxes as if it was an overpayment of payroll taxes. The IRS will have to provide details on how the payroll tax returns will need to be filed to reflect this reimbursement of the premium subsidy, and what additional information is required to verify that the reimbursements are correct. In this regard, the Act provides that entities who receive the subsidy will be required to file a report with the Secretary of Treasury that contains information about the amount of the subsidy, and the taxpayer identification numbers of the individuals who received the subsidy. The Act requires Treasury to issue regulations or other guidance describing this report requirement in detail, and to explain how the reporting will work for multiemployer plans.

### **Electing a Different Coverage Option**

The Act provides that an employer may, but is not required, to allow an individual who is eligible for COBRA premium assistance to change his or her health insurance coverage option when making a COBRA election under the employer's plan. The new option must have the same or lower premiums and must be available to non-COBRA active employees under the plan. In

addition, the election to change must be made within 90 days of receipt of the COBRA election notice. If these requirements are satisfied, the new coverage option will be treated as COBRA coverage. This ability to change coverage options will not allow an individual to elect into a flexible spending arrangement or coverage that provides only dental, vision, counseling or other referral services (or a combination of such services). Under current law, COBRA beneficiaries are only eligible to elect to continue the coverage that they had immediately before the COBRA qualifying event, although they must generally be given the ability to change options during the employer's open enrollment.

### **Notice Requirements**

The Act requires employers to modify COBRA election notices or provide separate, supplemental notices to all individuals who become entitled to elect COBRA continuation coverage during the period beginning on September 1, 2008 and ending on December 31, 2009. Such notices must describe the new premium subsidy and, if applicable, the right to change coverage options, as well as certain other information. The Act requires DOL, Treasury, and HHS to work together to develop a model notice within 30 days of the date of enactment. With respect to individuals who became entitled to elect COBRA before the date of enactment, the employer must provide the additional notification within 60 days after the date of enactment.

The Act provides that failure to provide such notice shall be treated as a failure to meet the notice requirements under COBRA. This means that a failure to send a timely COBRA election notice that complies with the new requirements could subject the employer or plan to a penalty of up to \$110 per day under ERISA § 502(c)(1). This penalty is one that is imposed at the discretion of the court, and is seldom enforced to the fullest extent, unless the plan administrator acted intentionally. In addition, failure to comply with the new election notice requirements could also result in adverse tax consequences under section 4980B(b) of the Internal Revenue Code (*i.e.*, excise taxes of \$100 per day per notice for each day that the plan administrator fails to comply with COBRA (\$200 if more than one qualified beneficiary in a same family is affected)), up to specified maximums.

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We will provide updates on further developments. In the meantime, if you have any questions, please contact your regular Groom attorney or any of the Health and Welfare Practice Group attorneys listed below:

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