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NEW COBRA REGULATIONS UNDER THE AMERICAN RECOVERY & REINVESTMENT ACT OF 2009

Client Alert

The recently enacted American Recovery and Reinvestment Act of 2009 (the "Act") changes the way employers handle continuation of group health benefits and subsidies for coverage of certain terminated employees. The Act requires that a special COBRA notice be given to employees whose employment is terminated involuntarily between September 1, 2008 and December 31, 2009. These former employees and their eligible dependents have special election rights and are eligible for subsidies to pay their COBRA premiums for health coverage. No later than April 18, 2009, employers must notify employees who terminated prior to February 17, 2009 (the date the Act became law) of the changes, although the subsidies and election rights are generally effective March 1, 2009.

Eligible Individuals

The following individuals are eligible for the COBRA subsidy:

- Employees who are involuntarily terminated between September 1, 2008 and December 31, 2009;
- Are eligible to elect COBRA coverage during that period; and
- Elect COBRA coverage (either upon termination or during a special election period during 2009).

Special COBRA Election Period and Notice Requirements

Employers are required to notify former employees (and their dependents) who may be eligible for the subsidy. The notices vary depending on whether the individual's "qualifying event" occurred before or after February 17, 2009, the date of enactment.

Qualifying Events On or After February 17, 2009

Employers must provide qualified beneficiaries who have a qualifying event on or after February 17, 2009, and before January 1, 2010, a notice that includes the following information:

- Forms necessary to establish eligibility for the COBRA subsidy;
- The name, address and phone number of the plan administrator;
- A description of the extended election period;
- A description of the beneficiary's obligation to notify the plan if the individual becomes eligible for subsequent coverage under another group health plan or under Medicare, and a description of the penalty for failing to notify the plan;
- A description of the beneficiary's right to a reduced premium and any conditions on entitlement to the reduced premium; and
- If the Employer has chosen to allow qualified beneficiaries to elect a less expensive option than the one the beneficiary was enrolled in on the date of the qualifying event. *The Employer is not required to allow qualified beneficiaries to elect a less expensive option.*

Employers can provide this information in a separate notice or incorporate it into the standard COBRA notice provided to employees with a qualifying event. The notice must generally be distributed within 45 days after the qualifying event.

Qualifying Events Before February 17, 2009

Employers must provide former employees (and their dependents) who had a qualifying event on or after September 1, 2008, and before February 17, 2009, but who failed to elect COBRA coverage, a special 60-day election period to elect COBRA coverage. The 60-day election period begins on the date that the notice is provided to the qualified beneficiary. The notice should include the items mentioned above. The notice should also make clear that if the qualified beneficiary elects COBRA coverage, the coverage will be effective as of the first period of coverage beginning after February 17, 2009 (March 1, 2009, in most instances), not the date of the original qualifying event. However, the maximum 18 months of COBRA coverage is measured from the date of the original qualifying event.

The notices for these qualified beneficiaries must be provided by April 18, 2009 (60 days after the date of enactment).

Although only employees who lost coverage due to "involuntary termination" are eligible for the subsidy, to be safe employers should send this notice to any employee or dependent who had a qualifying event on or after September 1, 2008, even if they lost coverage for another reason, e.g., voluntary separation or reduction in hours. (Until further guidance is issued, it is not clear whether the notice must be sent to all qualified beneficiaries or just those who were involuntarily terminated.) The notice should be sent regardless of whether the individual elected COBRA, or if the individual elected COBRA, whether the individual is no longer covered (for example, if he or she failed to pay the required premiums).

Creditable Coverage

The law gives qualified beneficiaries some assistance in not triggering a 63-day break in coverage for HIPAA creditable coverage purposes. The time period beginning on the date of the qualifying event and ending with the day before the date of enactment of the Act will be disregarded for purposes of determining the 63 day break in coverage.

Subsidy for Payment of COBRA Premiums

The government-provided COBRA subsidy is 65 percent of the COBRA premium charged to the former employee or dependent. The COBRA subsidy will not be paid in cash; rather the eligible individual will be deemed to have paid the full COBRA premium if he pays 35 percent of the required premium. Essentially, the process works as follows: the individual pays the portion not covered by the subsidy to the employer or plan (as applicable) and the employer or plan "advances" the subsidy until it is reimbursed for its share of the COBRA subsidy. It will recover the subsidy by reducing its income tax withholdings and FICA taxes by the amount of the subsidy. The subsidy is shown on line 12a of the newly revised Form 941. A copy of the form can be found at http://www.irs.gov/pub/irs-pdf/f941.pdf. To the extent that the applicable entity cannot fully recover the subsidy via a Form 941, the government will pay the reimbursement directly.

In order to qualify for the subsidy, the individual must pay 35 percent of the "applicable premium." The statute allows someone else to pay the 35 percent (e.g., a parent or other relative, a guardian, a State agency, or a charity), but not the employer. This will affect the design of severance arrangements in which the employer subsidizes a former employee's COBRA cost for a specified period of time. Instead, employers may want to eliminate the subsidy and increase the cash severance. If the employer pays more than 65 percent of the full cost of coverage, the subsidy is either eliminated or greatly reduced.

The subsidy is phased out for individuals earning more than $125,000 individually or $250,000 jointly, and is eliminated for those earning $145,000 or $290,000 jointly. To the extent that these individuals are not eligible for the subsidy, their individual tax liability will be increased by the amount of subsidy that they receive. Employers must allow highly compensated individuals subject to this restriction to waive the subsidy and pay the full COBRA premium. An individual who waives his or her right to the subsidy cannot claim it in a subsequent year (e.g., 2010) if their income level qualifies. As a result, individuals who will not qualify in 2009 may choose to pay the additional income taxes associated with the subsidy rather than waive it.

Duration of Subsidy Payments

The COBRA subsidy applies for up to nine months of coverage, or, if earlier, until the individual becomes eligible for other group health plan coverage or becomes eligible for Medicare.

COBRA Administrator Duties

- Identify employees who have been involuntarily terminated since September 1, 2008;
- Establish a procedure to identify any employee whose employment is involuntarily terminated through December 31, 2009;
- Prepare a notice to affected former employees and their covered dependents informing them about the subsidy and distribute the notice to affected individuals within 60 days after the date of the enactment;
- Supplement ongoing COBRA notices to include a description of the new COBRA subsidy provisions;
- Confirm if the employer will permit identified employees and their covered dependents to elect a less expensive option than previously elected; and
- Provide a monthly report summarizing premiums eligible for the subsidy.

Client/Plan Administrator Duties

- Apply for the subsidy, using revised form 941, utilizing the monthly report summarizing premiums eligible for the subsidy. A revised copy of form 941 is available by selecting the following link http://www.irs.gov/pub/irs-pdf/f941.pdf.

Potential Plan Document Language Revisions

BAS is evaluating the new legislation as is pertains to changes in Plan Document language, and will notify our clients accordingly.

BAS will continue to analyze the legislation, on behalf of our clients, and advise additional clarifications as they become available.