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COBRA Premium Subsidy Included in American Recovery and Reinvestment Act of 2009

Laid-off employees will be eligible for a temporary reduction in their COBRA premiums under the American Recovery and Reinvestment Act of 2009 (the "Act"). Recognizing that few laid-off employees can afford to continue health coverage under the Consolidated Omnibus Budget Reconciliation Act (COBRA), the Act creates a federal subsidy that will cover 65% of the COBRA premium for a nine month period, with employees paying only 35%, rather than 100%, of the COBRA premium.

Lori A. Basilico, Partner

Employers will be able to recoup the 65% subsidy from the federal government in the form of a credit against federal payroll taxes. The subsidy applies to premiums paid on or after March 1, 2009.

Eligibility for Premium Subsidy

Employees who lose health coverage due to an involuntary termination of employment between September 1, 2008 and December 31, 2009 are eligible for the premium subsidy. The Act does not define "involuntary termination" and it is not clear whether an employee who took early retirement or buyout in anticipation of a layoff would qualify for the subsidy.

Subsidy-eligible individuals who elect COBRA coverage will be responsible for paying 35% of the COBRA premium. Employers are required to pay the remaining 65% of the premium and will be reimbursed for such amount in the form of a credit against wage withholding and FICA payroll taxes. The payroll tax credit only applies to COBRA premiums paid by the employer pursuant to the Act, so employers who voluntarily agree to pay portions of COBRA premiums as a result of other arrangements, such as in connection with a reduction-in-force or pursuant to a separation agreement, would not be entitled to the payroll credit.

Subsidy-eligible individuals with an adjusted gross income exceeding $145,000 ($290,000 for joint filers) are not eligible for the subsidy. The COBRA subsidy is reduced for individuals whose adjusted gross income exceeds $125,000 ($250,000 for joint filers). Individuals who receive the COBRA subsidy during a year in which they exceed these income limits will be required to repay the subsidy in the form of an additional tax on their tax return. As a result of this income limitation, these "high income individuals" may make a permanent election to waive the subsidy.

Duration of Premium Subsidy

The subsidy is available with respect to premiums paid on or after March 1, 2009, and lasts for up to nine months, ending earlier if the subsidy-eligible individual becomes eligible for coverage under another group health plan or Medicare. Thereafter, if the maximum COBRA period has not expired, the individual must pay 100% of the COBRA premium for the remaining COBRA period. The individual is required to notify the group health plan when he or she becomes eligible for other group health coverage or Medicare.

Note that eligibility for the premium subsidy ends (but not COBRA coverage) when the subsidy-eligible individual becomes eligible for other coverage, even if the individual does not enroll in, or become covered by, such other coverage. COBRA coverage ends when the qualified beneficiary actually becomes covered by another health plan.

Because this new legislation becomes effective immediately, individuals who are eligible for the premium subsidy may have already paid the full COBRA premium for March and/or April 2009. The Act entitles any subsidy-eligible individual who pays more than 35% of the COBRA premium amount during the first two coverage periods following enactment of the Act to reimbursement from the employer for the excess over the amount which the individual is required to pay, or a credit of that amount against future COBRA premium payments. For example, if a subsidy-eligible individual paid the entire COBRA premium for March 2009, the individual may receive a refund or credit equal to 65% of the COBRA premium.

Special COBRA Election

Plans must provide a second COBRA election to former employees who were involuntarily terminated on or after September 1, 2008 but who did not elect COBRA during their initial COBRA election period. Such individuals will have 60 days in which to elect COBRA. If elected during this special election period, COBRA coverage will begin on March 1, 2009 (the first period of coverage beginning on or after the enactment of the Act) rather than the date of the employment termination but will not extend beyond the original COBRA period, measured from the date of the employment termination. For example, a subsidy-eligible individual terminated on November 30, 2008 who makes a timely election during this special COBRA election period will be entitled to COBRA coverage beginning March 1, 2009 and ending May 31, 2010 (18 months from November 30, 2008).

Option to Change Coverage

Under COBRA, qualified beneficiaries must be offered the same coverage they had at the time of their qualifying event and cannot change their coverage until the next open enrollment period. The Act permits employers to offer subsidy-eligible individuals the opportunity to elect COBRA coverage under the benefit option in which he or she is enrolled at the time of the qualifying event or to change to a lower-cost health plan option offered to active employees. Subsidy-eligible individuals must make this change within 90 days after receiving notification to elect a different option.

New COBRA Notices

Plans must provide individuals who become eligible for COBRA coverage between September 1, 2008 and December 31, 2009 with notices explaining the availability of the premium subsidy and the option to enroll in different health plan coverage, if permitted by the employer. Plans must also send new notices describing the special COBRA election rights to subsidy-eligible individuals entitled to the election. The Act requires the Department of Labor to develop model notices for plans to use for these purposes within 30 days.

Reporting Requirements for Employers

The Act requires employers to initially pay the 65% premium subsidy and recoup such amount through reduced federal payroll tax payments. These payroll taxes include federal income tax withholding as well as the employer and employee share of FICA. If the amount of the subsidy paid by the employer exceeds the amount of the employer's liability for these federal payroll taxes, the employer will receive a direct payment from the federal government.

Employers will be required to file reports and additional information relating to the subsidy, including attestations that each employee receiving the subsidy was involuntarily terminated, calculation of the offset, the amount of the subsidy provided to each individual and information as to whether the subsidy is for individual or family coverage.

The subsidy applies to governmental plans and small health plans subject to state (or "mini-COBRA") statutes if the state continuation coverage requirements are comparable to those required by COBRA.

Conclusion

These new COBRA requirements require employers to take immediate action, identifying all former employees who must receive notice of the premium subsidy, offering the special COBRA election period to those subsidy-eligible individuals who previously declined COBRA coverage, revising COBRA communications materials and coordinating with COBRA administrators and payroll providers to develop systems and procedures for recouping the federal subsidy.

Plans must provide a second COBRA election to former employees who were involuntarily terminated on or after September 1, 2008 but who did not elect COBRA during their initial COBRA election period.

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John H. Reid III, Partner	860.541.7721	jreid@eapdlaw.com
Lori A. Basilico, Partner	401.276.6475	lbasilico@eapdlaw.com
Benjamin Ferrucci, Partner	617.239.0862	bferrucci@eapdlaw.com

Edwards Angell Palmer & Dodge

111 Huntington Avenue
Boston, MA 02199
Tel 617.239.0100
Fax 617.227.4420
eapdlaw.com