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EMPLOYMENT LAW

NEWSLETTER OF THE EMPLOYMENT & LABOR PRACTICE GROUP OF MANATT, PHELPS & PHILLIPS, LLP

Manatt Answers Employers' Questions About the New COBRA Premium Subsidies Under the Economic Stimulus Package

President Obama recently signed into law the economic stimulus package (officially known as the American Recovery and Reinvestment Act of 2009), which included a subsidy of COBRA premiums for employees involuntarily terminated between September 1, 2008 and December 31, 2009, as well as their qualified beneficiaries.

Since the stimulus package was signed on February 17, 2009, the Internet has been buzzing with conflicting information about the effect of the new COBRA premium subsidies on employers. We have received a number of questions from clients about employer obligations with regard to the new COBRA subsidies. Manatt answers those questions, and more, below:

Q: *What exactly is the COBRA premium subsidy?*

A: The COBRA premium subsidy is a program in which "assistance eligible individuals" ("AEIs") pay only 35% of their COBRA premiums for up to a maximum of nine months. The remaining 65% of the COBRA premium is paid up front by a group health plan, the employer or the insurer (depending on the type of plan), which is then able to recapture the 65% premium payment through deductions to quarterly payroll taxes.

Q: *Who is responsible for paying the subsidy?*

A: It depends. The entity responsible for collecting the 35% premiums from the AEIs, contributing the remaining 65% portion of the premium, and then obtaining reimbursement of the subsidy in the form of a payroll tax credit varies, depending on the type of group health plan. In the case of a group health plan that is a multi-employer plan, the plan is

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responsible. For non-multi-employer plans, the employer is responsible, unless all of the coverage is provided by insurance, in which case the insurer is responsible. In the vast majority of situations, it will be the employer that is responsible for the subsidy.

Q: Who is an "assistance eligible individual"?

A: An AEI is any individual who:

- Is a qualified beneficiary who is eligible for COBRA continuation coverage between September 1, 2008 and December 31, 2009; AND
- The qualifying event with respect to the COBRA continuation coverage is the result of the involuntary termination of the covered employee's employment during such time period; AND
- The qualified beneficiary properly elects COBRA continuation coverage.

For example, assume John was involuntarily terminated on September 1, 2008. Joanna is John's spouse and was covered by John's group health insurance at the time he was terminated. Both Joanna and John (individually) would be eligible for the premium subsidy.

Subject to specific limitations, an individual is no longer eligible for the subsidy once that individual becomes eligible for coverage under another group health plan or Medicare.

For example, assume an AEI receiving subsidized COBRA premiums will begin new employment on April 1, 2009, and that under the new employer's policy, the AEI will not be eligible for group health coverage until he or she has been with the company for 90 days. When the AEI becomes eligible for coverage under the new employer's group health plan, the individual will no longer be entitled to the COBRA premium subsidy for any months of coverage beginning on or after that date (in this example, for months of coverage beginning July 1, 2009), regardless of whether the AEI actually enrolls in the new group health plan.

Note that this standard differs from the standard under which COBRA coverage may be terminated. Termination of COBRA coverage is permissible only when the individual actually *obtains* coverage under another group health plan. Under the stimulus package, if the individual is eligible for coverage under another group health plan but declines that coverage, the individual can still remain on *unsubsidized* COBRA coverage.

Q: *What if an employee who was laid off after September 1, 2008 did not elect COBRA continuation coverage? Can that employee now change his mind?*

A: Yes. An AEI who was involuntarily terminated between September 1, 2008 and February 17, 2009, and who did not elect COBRA continuation coverage during the applicable election period, may now elect COBRA continuation coverage at any time between February 17, 2009 and 60 days after the date on which the AEI is provided with the requisite notice of extended election periods.

Q: *An employee who was laid off after September 1, 2008 did elect COBRA continuation coverage and has been paying the full premium until now. Do we now have to reimburse the employee for the amounts she paid that were above 35% of the premiums?*

A: No. The premium subsidies begin on or after March 1, 2009 for everyone who qualifies. Therefore, an AEI who has been paying full COBRA premiums is not eligible for reimbursement for those premiums paid for periods of coverage prior to March 1, 2009.

Reimbursements may apply in some circumstances, however, for COBRA premium payments made *after* March 1, 2009. For example, there may be a period of time after March 1, 2009 within which AEIs will still be paying their full COBRA premiums – either because the AEIs have not yet received new COBRA election notices, or because the AEIs are still within their period to elect COBRA continuation coverage. In that case, those AEIs will be entitled to either a reimbursement payment or a credit against subsequent premium payments.

Q: *Are employees who resigned eligible for the subsidy?*

A: No. The subsidy is only for covered employees who were involuntarily terminated, as well as their qualified beneficiaries. Employees who resigned – as well as their qualified beneficiaries – may remain eligible for *unsubsidized* COBRA continuation coverage, subject to the usual COBRA rules.

Q: *If I am responsible for paying the subsidies, how will I recapture those funds?*

A: The employer will be treated as having paid quarterly federal employee payroll taxes in an amount equal to the

subsidies. After determining the amount of COBRA subsidy payments made during the applicable quarter, the employer will then use that total amount as a direct offset against the amount of quarterly payroll taxes due. (Payroll taxes from which the subsidy payments may offset include the employer and employee portions of FICA, Social Security and Medicare taxes.) The IRS will be issuing a new form for employers to use to document these amounts.

Q: For how long will I be required to subsidize the COBRA premiums?

A: The longest period that an AEI may be eligible to receive subsidized premiums is nine months. An AEI is no longer eligible for the COBRA subsidy for months of coverage beginning on or after the earliest of the following dates: (1) the first date that the AEI becomes eligible for coverage under another group health plan; (2) nine months after the first day of the first month that an AEI pays the subsidized premium; or (3) the month the AEI loses regular COBRA coverage.

For example, assume an employee was eligible for 18 months of COBRA continuation benefits beginning on September 1, 2008 (the date of her involuntary termination). The employee paid full COBRA premiums for the period of September 1, 2008–February 28, 2009. Beginning on March 1, 2009, the employee paid 35% of the premium and the employer paid the remaining 65% portion of the premium. On December 1, 2009 (assuming the employee has not become eligible for coverage under another group health plan or Medicare in the interim), the employer is no longer required to subsidize the employee's COBRA premiums, although the employee would still have three months remaining of unsubsidized COBRA continuation coverage.

Q: What are an employer's obligations? Is there anything employers need to do right now?

A: The more immediate employer obligations include identifying individuals who became eligible for COBRA continuation benefits after September 1, 2008, and revising COBRA notices to contain information about the availability of premium subsidies.

Under the new COBRA requirements, additional information must be provided with COBRA election notices for all AEIs (and potential AEIs) either by revising existing COBRA election notices to include the requisite new information, or by providing the new information in a separate document. The

relevant government agencies will be issuing model notices on or before March 19, 2009, but employers need not wait for the release of the model notices to revise their current notices.

Involuntary Termination After February 17, 2009

The timeline for providing notices to individuals who became AEIs after February 17, 2009 is not impacted by the new guidelines, and notice must be provided within the existing COBRA notice periods.

Involuntary Termination After September 1, 2008 but Before February 17, 2009

AEIs whose qualifying event occurred between September 1, 2008 and February 17, 2009, however, must be provided with a revised notice containing information about the availability of premium subsidies, and other specific information, by **April 18, 2009**. Such AEIs, for whom no COBRA election was in effect on February 17, 2009, must also be provided with a notice of extended election period. (Some of the AEIs who may not have been enrolled in COBRA on February 17, 2009 include individuals who failed to elect COBRA within the 60-day election period; individuals whose COBRA coverage was terminated early; and, individuals who were still within their 60-day COBRA election period on February 17, 2009, but had yet to elect COBRA.)

Eventually, employers will also need to account for the subsidies in the form of reports to either the IRS or the Department of Labor. The Treasury Department will soon establish regulations regarding the specific types of reports that will be required, as well as the format of such reports, and the deadlines and means of submission for such reports.

Q: I heard that there is an income limit of \$125,000 (individual) or \$250,000 (joint return) for an individual to be eligible for the subsidy. Is that true, and if so, how do I know if an individual is above that threshold?

A: If an AEI who receives a subsidy has a modified adjusted gross income for the taxable year that exceeds \$125,000 (or \$250,000 in the case of a joint return), then the subsidies will be recaptured from the individual in the form of a tax imposed by the IRS. For those AEIs whose modified adjusted gross income for the taxable year exceeds \$125,000 (or \$250,000 for joint returns), but does not exceed \$145,000 (or \$290,000 in the case of a joint return), there is a sliding scale for

recapture of the subsidy.

The good news, however, is that AEIs are required to account for the subsidy in their own taxes, and thus an employer is not required to account for the income of the individual or adjust subsidy payments. For employers, whether or not an AEI will exceed the income limit for the subsidy, the process remains the same, unless and until the individual makes a permanent election to waive the right to a premium subsidy and notifies the entity receiving the COBRA premium payments of such election.

Conclusion

The stimulus package is complex and further guidance will be issued by various government agencies in the weeks and months ahead. This newsletter is intended as a general overview of the new COBRA provisions and does not purport to cover the specifics of every provision or apply to all circumstances.

FOR ADDITIONAL INFORMATION ON THIS ISSUE, CONTACT:



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