

## **Stimulus Plan Requires Immediate COBRA Action**

**February 17, 2009**

The American Recovery and Reinvestment Act of 2009 (the stimulus plan or the stimulus bill) that President Obama signed into law today contains, among other employee benefit changes, a series of new provisions temporarily modifying Consolidated Omnibus Budget Reconciliation Act (COBRA) group healthcare plan continuation rules. These provisions represent the most wide-ranging changes to COBRA since its inception and will require immediate action by employers and COBRA administrators.

The objective of these provisions is to provide a government subsidy which for nine months will cover 65% of the cost of COBRA coverage for assistance-eligible individuals whose employment is involuntarily terminated on and after September 1, 2008 and before January 1, 2010. This subsidy is generally tax-free to the assistance-eligible individual.

However, this simple objective is surrounded by extremely complicated requirements for employers, COBRA administrators, and even assistance-eligible individuals. The new provisions will result in, among other things:

- “Second chance” COBRA elections
- New election options
- Revised COBRA notices
- Modified COBRA invoices
- Interactions with payroll tax deposit mechanisms to fund the 65% subsidy
- New reporting to the Secretary of Treasury and assistance-eligible individuals
- Adverse individual income tax consequences for assistance-eligible individuals who earn too much income in 2009 or 2010

Worse yet, these provisions are immediately effective and will impact March COBRA invoices in practical terms. Further, in general, the full 65% credit against payroll tax will not be available unless the former employee pays 35% of the full COBRA premium. It will also not be available for former employees who enrolled in retiree medical benefits instead of COBRA (unless the retirees are eligible for the “second chance” COBRA elections). It is unclear how the 65% credit will work in the circumstance of an existing employer COBRA subsidy. In light of these changes, employers that already subsidize COBRA premiums should review their policies and procedures promptly, in order to make any necessary modifications for March and future COBRA billing cycles.

Finally, these provisions will inevitably result in more COBRA-qualified beneficiaries who are covered under their former employer's group healthcare plan. Since claims for COBRA-qualified beneficiaries usually exceed COBRA premiums, these provisions will likely have the net effect of increasing unreimbursed employer expenditures for group healthcare.

In response to these significant immediate changes, Morgan, Lewis & Bockius will hold a one-hour webinar on February 26 on the new COBRA provisions. The webinar will not only address the nuts and bolts of the new requirements but will also discuss the practical implications, risks, and planning opportunities presented by the stimulus bill's COBRA provisions. To register for the webinar, please go to <https://morganlewis.webex.com/mw03051/mywebex/default.do?siteurl=morganlewis&service=6>.

### **Additional Details**

The COBRA provisions in the stimulus bill are wide-ranging and encompass almost any type of continued medical coverage under state and federal law. As a result, the balance of this LawFlash will refer to "COBRA" coverage in the broad sense envisioned under the stimulus plan rather than the narrower Internal Revenue Code (IRC) and Employee Retirement Income Security Act (ERISA) rules for employers with 20 or more employees.

Further, while this LawFlash is fairly detailed, it still represents a high-level discussion of only some of the numerous stimulus bill COBRA provisions. Further, future guidance and model notices may expand or modify the stimulus bill COBRA rules. Employers are encouraged to contact their COBRA administrators and payroll vendors immediately regarding their ability to address the stimulus bill COBRA changes and the additional administrative costs and fees associated with these expanded COBRA obligations.

### **Amount and Duration of Subsidy**

The subsidy under the stimulus plan is 65% of the premium that is actually paid by an assistance-eligible individual. As a result, the 65% subsidy may not apply to any amount paid by the individual's employer. Employers will undoubtedly investigate changing their healthcare subsidy programs for individuals who have not yet suffered an involuntary termination of employment in order to take full advantage of the 65% subsidy.

The 65% subsidy continues for nine months (even if COBRA coverage extends beyond the end of the subsidy) or until the date any of the following occurs, whichever is earlier:

- The assistance-eligible individual *becomes eligible* (regardless of enrollment status) for other employer group healthcare coverage from a new employer or under a spouse's employer's plan (other than certain limited coverage or a flexible spending account)
- The assistance-eligible individual becomes eligible for Medicare
- COBRA runs out
- The assistance-eligible individual fails to pay the required 35% share of the COBRA premium

While the subsidy is generally tax-free, see the discussion below headed "**Income Limitations**" for situations where the subsidy is taxable to the assistance-eligible individual.

## **Assistance-Eligible Individuals**

Employees who suffer an involuntary termination of employment on or after September 1, 2008 and before January 1, 2010 and are eligible for COBRA are entitled to the enhanced rights and 65% subsidy under the stimulus plan. By way of comparison, the COBRA provisions of the stimulus plan do not apply to any qualified beneficiary whose employment was terminated prior to September 1, 2008—even if their termination was involuntary. The COBRA provisions also do not apply to anyone whose employment termination was due to gross misconduct or if COBRA rights initially arose for any reason other than an involuntary termination of employment, such as a reduction in hours, voluntary termination of employment, death, divorce, or attainment of majority.

## **Impacted Coverage**

The 65% COBRA subsidy applies to medical coverage (other than flexible spending accounts) continued under traditional COBRA rules as well as continuation coverage provided by state and federal governments or required under state insurance law. The 65% subsidy also applies to medical coverage offered by a multiemployer plan.

The 65% subsidy also applies to any family members who independently elect COBRA due to an involuntary termination of employment of an assistance-eligible individual or continue COBRA coverage after a subsequent qualifying event such as the death of the assistance-eligible individual. The subsidy apparently does not apply to the cost of any COBRA-like coverage offered to domestic partners, civil union partners, or same-sex spouses unless they are dependents under the modified terms of IRC section 152.

## **Effective Date**

The stimulus bill's COBRA provisions become generally effective February 17, 2009—the date President Obama signed the bill into law. Further, the 65% subsidy is effective for the first “period of coverage” for assistance-eligible individuals beginning on or after February 17—which in practical terms means that, for employers who bill COBRA premiums on a monthly basis, the 65% subsidy applies to COBRA coverage on and after March 1, 2009. Since it is impractical (if not impossible) to reflect the new subsidy on bills for March COBRA coverage, the stimulus plan provides a two-billing-cycle grace period to credit or refund overpaid COBRA premiums (see “**Grace Period**” below).

## **“Second Chance” Elections**

Many assistance-eligible individuals who were involuntarily terminated and became eligible for COBRA coverage on or after September 1, 2008 either did not elect COBRA or may have already dropped out of COBRA coverage due to failure to pay COBRA premiums. These assistance-eligible individuals (and apparently, similar assistance-eligible individuals who moved on to retiree medical coverage) will have a second chance to elect COBRA coverage and receive the 65% subsidy. The election window for this second-chance opportunity runs for 60 days after receipt of a notice regarding the second-chance opportunity.

## **New Enrollment Option to “Opt Down”**

Employers may, at their option, allow assistance-eligible individuals to elect other options available to current employees as long as the cost of the options does not exceed the cost of the COBRA coverage initially available to the assistance-eligible individual. This replacement coverage will run for the full duration of the assistance-eligible individual’s COBRA coverage—even after the end of the nine-month 65% subsidy. The replacement coverage cannot be limited coverage (i.e., coverage limited only to dental, vision, counseling, or referral services), a medical spending account, or use of only onsite treatment facilities.

## **No Reach Back/No Break in HIPAA Creditable Coverage Period**

Assistance-eligible individuals who are able to take advantage of the “second chance” election will not receive retroactive coverage. Instead, their coverage will commence on, typically, March 1, 2009 and will continue until the end of their originally scheduled COBRA end date. Further, the period between their initial COBRA qualifying event and (typically) March 1 will not count towards the 63-day period applicable to the Health Insurance Portability and Accountability Act (HIPAA) creditable coverage and preexisting condition restrictions.

## **Notification Requirements**

The stimulus bill continuation provisions contain a number of new or expanded notification requirements.

Employers, COBRA administrators, or insurers must notify all individuals who lost COBRA coverage on and after September 1, 2008, whether or not such loss of coverage is involuntary, regarding the following:

- The availability of the 65% subsidy
- The “second chance” election
- The “opt down” opportunity (if offered)
- The information necessary to establish eligibility for the 65% subsidy
- How to elect the subsidy
- The obligation to notify the COBRA administrator of eligibility for any subsequent group healthcare coverage and the penalty associated with failure to so notify

This notice can be incorporated into the regular COBRA election-rights package or provided through a separate notice that is sent along with the regular COBRA election-rights package.

Similar enhanced notices must be given on an ongoing basis for all new COBRA-qualified beneficiaries through December 31, 2009.

These enhanced enrollment notices must be distributed by April 18, 2009. Failure to distribute these notices will be treated as a failure to comply with the ordinary COBRA-notification requirements. The Secretary of Labor is directed to issue model notices by March 19. Given that the “second chance” COBRA election right will run for 60 days after notification, employers may decide to issue the notification as soon as possible in order to further reduce the risk of adverse selection.

Assistance-eligible individuals must follow typical COBRA election procedures and also notify their COBRA administrator in the time and manner required by the Secretary of Labor if they become eligible for other group healthcare plan coverage. Failure to notify COBRA administrators regarding the eligibility for other coverage can result in a penalty for the assistance-eligible individual of 110% of the subsidy unless the failure was due to reasonable cause and not willful neglect.

### **Expedited Review by Secretary of Subsidy Denial**

The stimulus plan creates a new appeal procedure for assistance-eligible individuals who are denied the 65% subsidy. This expedited review process operates outside of the ERISA claims and appeals rules and directs the Secretary of Labor (or the Secretary of Health and Human Services if the coverage is not subject to the COBRA rules of ERISA) to engage in a de novo review of the initial denial and make a final determination with regard to subsidy eligibility within 15 days. This determination will be entitled to deference in any subsequent legal proceeding.

### **Payroll Tax Offsets**

The stimulus plan contains a unique process for funding the 65% subsidy. Unlike the Trade Adjustment Assistance subsidy (where a government contractor collects the partial COBRA premium from former employees, adds the subsidy, and sends the full amount of the premium to the COBRA administrator), assistance-eligible individuals will only pay 35% of the ordinary COBRA premium directly to the employer, COBRA administrator, multiemployer plan, insurer, or government employer. After receipt of the subsidized payment, the recipient is directed to reduce its payroll tax deposits by an amount equal to the remaining 65% of the COBRA premium. For this purpose, payroll tax deposits represent federal income tax wage withholdings and the employer and employee share of FICA tax withholding. The employer (or other recipient of the 65% subsidy) will be treated as if it had paid payroll taxes to the Secretary of the Treasury in an amount equal to the subsidy.

For entities that offer COBRA coverage but do not collect payroll taxes, these entities (such as multiemployer plans) will receive a credit or refund check directly from the Secretary of Treasury in an amount equal to the 65% subsidy.

Payment of the subsidy to an employer or another entity is not treated as income but rather as an employee contribution to a group healthcare plan.

It is unclear whether ERISA plan asset requirements will apply to the subsidy.

The stimulus plan anticipates a fairly complicated reporting scheme that will require entities claiming the 65% subsidy to do the following:

- Attest to the involuntary termination of each assistance-eligible individual
- Report payroll taxes offset for the current period (and the estimated offset for the subsequent period)
- Report the taxpayer identification numbers (TINs) of assistance-eligible individuals
- Report the amount of subsidy received
- Report whether the subsidy covered one or more qualified beneficiaries

Special rules apply to the operation of the subsidy for U.S. possessions (American Samoa, Commonwealth of the Northern Mariana Islands, Commonwealth of Puerto Rico, Guam, and the Virgin Islands).

### **Grace Period**

In light of the almost immediate application of these new COBRA rules, the stimulus bill provides a grace period for employers or COBRA administrators who are unable to modify March or April COBRA bills for assistance-eligible individuals in time to reflect the 65% subsidy. The grace period permits charging the full COBRA premium for two billing periods, followed by an appropriate credit in subsequent billing periods equal to the missed 65% subsidy or, alternatively, a reimbursement to the assistance-eligible individual. Special rules apply if it is apparent or becomes apparent that the credit cannot be used by the assistance-eligible individual within 180 days.

### **Income Limitations**

A last minute addition during the Conference Committee limits the tax-free nature of the 65% subsidy to assistance-eligible individuals whose adjusted gross income exceeds \$125,000 (or \$250,000 in the case of a joint return) for 2009 or, if applicable, 2010. It appears that this limit will be monitored through the assistance-eligible individual's federal income tax return and, if exceeded (subject to a small phase out), result in treating the 65% subsidy as an additional tax to the assistance-eligible individual.

Due to this possible taxation, assistance-eligible individuals will be able to elect to permanently opt out from eligibility for the subsidy through a notice to their COBRA administrator in the form and manner prescribed by the Secretary of the Treasury. Once they have so elected, these assistance-eligible individuals cannot opt back in to the subsidy or claim the foregone subsidy as a credit or deduction on their federal income tax return.

### **Annual Reporting Obligations**

The stimulus plan COBRA provisions envision a number of additional reporting obligations. These obligations will require detailed reporting to the Secretary of Treasury regarding the payroll tax offsets and reporting the subsidy amount to assistance-eligible individuals (likely on a Form W-2).

### **Additional Guidance**

Given the scope, complexity, and unique nature of the stimulus plan COBRA subsidy, it is inevitable that additional guidance may modify the stimulus bill's provisions. Further, it is already apparent that the bill's COBRA rules will require technical corrections which may create a platform for further changes to the rules. Finally, the statute imposes model notification requirements on the Secretary of Treasury and Secretary of Labor; these notices should be carefully reviewed when they are issued in order to determine whether they contain enhancements or modifications to the stimulus bill's COBRA rules.

## Conclusion

As outlined above, the stimulus bill's COBRA provisions are extremely complicated for every entity involved in COBRA administration—and even impact payroll tax deposit and reporting processes. While there will be pressure to quickly comply with the bill's requirements, employers should be careful that they do not inadvertently restrict the eligibility for the stimulus plan's COBRA 65% subsidy or, conversely, overstate the number of assistance-eligible individuals (and run the risk of suffering payroll underwithholding and reporting penalties).

For a broader discussion of these and other issues, be certain to attend the webinar “Stimulus Plan COBRA Changes: Rules and Ramifications” on February 26, or contact any of the Morgan Lewis attorneys listed below:

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