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COBRA SUBSIDY REQUIREMENTS

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 ("ARRA"), also known as the Federal Stimulus package. One of the provisions in the ARRA amends the Consolidated Omnibus Budget and Reconciliation Act ("COBRA") to provide a partial subsidy of the COBRA premium for individuals whose employment was involuntarily terminated from September 1, 2008 through December 31, 2009. This imposes a multitude of requirements on employers, under a tight time frame, and raises numerous questions, most of which have yet to be addressed by the Department of Labor.

What is the subsidy? How does it work? Normally under COBRA, beneficiaries of employer health plans¹ who cease to be eligible for health coverage may elect to continue their group health coverage with no interruption for a period of eighteen (and in some circumstances thirty-six) months by paying a COBRA premium up to 102% of the group premium expense for the coverage. Under the ARRA, individuals who qualify for the subsidy must pay 35% of the COBRA premium and the employer or health plan is responsible for payment of the remaining 65% of the premium.² However, as is discussed below, the subsidy applies only to individuals who become eligible for COBRA as a result of an involuntary termination of employment. Also, although beneficiaries who become eligible for COBRA due to an involuntary termination are entitled to up to eighteen months of COBRA coverage, the subsidy only applies for nine months. After the nine months of subsidy are exhausted, the beneficiary must pay the full amount of the COBRA premium.

The COBRA subsidy applies only for health, dental and vision coverage. It does not apply to flexible spending arrangements provided through a cafeteria plan or the health savings accounts.

How does the tax credit for employers work? As noted above, the employer must pay 65% of the COBRA premium for qualified individuals during the subsidy period. Obviously, that can cause a financial burden to the employer. However, the employer may then take a direct credit against its next following payroll deposit to the United States Treasury to offset the amount of COBRA subsidy paid by the employer during the preceding period. If the amount

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¹ Generally, COBRA applies to employers who employ twenty or more employees. COBRA does not apply to governmental or religious employers regardless of their number of employees.

² As is discussed below, the employer may take a credit on its payroll tax for the amount of subsidy paid for eligible beneficiaries.



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of the credit to which the employer is entitled exceeds the amount of payroll taxes owed, the employer may apply the overpayment to the next return or obtain a refund from the IRS.

Who is eligible for the COBRA subsidy? To be eligible for the COBRA subsidy, the beneficiary must have become eligible for COBRA due to an involuntary termination of employment which occurred from September 1, 2008 through December 31, 2009. Thus, an employee whose employment has been terminated involuntarily, for any reason other than gross misconduct, is eligible for the subsidy, subject to the limited exceptions discussed below. Also, if that employee's spouse and dependents were covered under the employer health plan, the spouse and dependents qualify for the COBRA subsidy, even if the employer did not contribute to the premium for their coverage.

Terms of COBRA subsidy and notice requirements. There are three scenarios under which a beneficiary may be eligible for the COBRA subsidy for up to nine months. Under all three scenarios, the employer (or plan administrator) must provide notice to the eligible individual of his or her rights. The notice requirements differ slightly depending on which scenario applies:

1. **Former employee or beneficiary not on COBRA as of February 17, 2009.** The employee or beneficiary is eligible for the COBRA subsidy due to an involuntary termination of employment that occurred between September 1, 2008 and February 17, 2009 and either opted out of COBRA or received COBRA coverage for some period, but elected to discontinue COBRA coverage prior to February 17, 2009. The ARRA provides a sixty day window for that employee or beneficiary to elect or resume COBRA coverage. If that individual elects to receive or resume COBRA coverage, he or she is entitled to the subsidy for up to nine months.

The employer or plan administrator must provide notice to all former employees or beneficiaries who fit under this scenario of the new COBRA election period and subsidy by April 18 2009. The Department of Labor ("DOL") has prepared a Model Notice for individuals who fall under this scenario, which is available at www.dol.gov/ebsa/cobra.html. The Model Notice explains that the eligible individual must complete the Application for Treatment as an Assistance Eligible Individual and COBRA Election Form and return it to the employer or plan administrator within sixty days. Coverage will commence retroactively to the first day of the first coverage period beginning on or after February 17, 2009. If the coverage period is one month commencing on the first of the month, coverage will commence retroactive to March 1, 2009. The eligible individual will be responsible to pay 35% of the COBRA premium, with the employer (and ultimately, the federal government) subsidizing the remaining 65%.

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2. Former employee or beneficiary on COBRA as of February 17, 2009.

The beneficiary is eligible due to an involuntary termination of employment that occurred between September 1, 2008 and February 17, 2009, elected to obtain COBRA coverage, and is receiving COBRA coverage as of February 17, 2009. Effective the first day of the next coverage period (again, March 1, 2009 if the coverage period is one month and commences on the first day of the month), the eligible individual needs only to pay 35% of the premium, with the remaining 65% subsidized. If the eligible individual has already paid his or her COBRA premium in full and does not waive the subsidy (as discussed below), the employer or plan administrator must either credit or refund the premium overpayment.

The DOL's Model Notice for eligible individuals currently receiving COBRA benefits to inform them of the availability of the subsidy is available at www.dol.gov/ebsa/cobra.html. This Notice must be provided by April 18 as well.

3. Employment is involuntarily terminated either from September 1, 2008 through February 16, 2009 and the time to elect COBRA coverage has not yet expired or employment is involuntarily terminated from February 17, 2009 through December 31, 2009. The beneficiary is eligible due to an involuntary termination of employment that has occurred before February 17, 2009, but has not yet submitted his or her COBRA election form and the time do to so has not yet expired,³ or the involuntary termination of employment occurs on or after February 17, 2009 through December 31, 2009. Again, Notice of the subsidy must be provided April 18, 2009 to those beneficiaries who are eligible due to the involuntary termination of employment prior to February 17, 2009. For all individuals who become eligible for the subsidy on or after February 17, 2009, notice must be provided within sixty days of the involuntary termination (or loss of health coverage if coverage extends beyond the termination date). The DOL's Model Notice for individuals who fall under this scenario is available at www.dol.gov/ebsa/cobra.html.

Limitations on COBRA subsidy eligibility. As discussed above, the COBRA subsidy only applies to individuals who become eligible for COBRA due to an involuntary termination of employment. The COBRA subsidy does not apply to employees who lose their group health coverage because of a reduction of hours that renders them ineligible for the employer's group health coverage. Thus, if an employer changes an employee's status from full-time to part-time, and that employee loses health coverage as a result, that employee is not eligible

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³ If the COBRA election period has expired, the beneficiary falls under scenario 1 above.



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for the subsidy and must pay the full amount of the COBRA premium. Also, employees who resign from their employment are ineligible for the subsidy. The ARRA does not address the issue of constructive discharge.

Individuals who are otherwise eligible for the subsidy cease to be eligible when they become eligible for health coverage under another group health plan or for Medicare. Also, the ARRA imposes income limitations on eligibility for the subsidy. Individuals whose modified adjusted gross income exceeds \$145,000 and joint filers whose adjusted gross income exceeds \$290,000 for the tax year for which they would otherwise qualify for the subsidy are ineligible for the subsidy. Of course, a taxpayer may not know whether he or she will exceed the income limits. Thus, the notice of COBRA subsidy, discussed above, must be provided to all individuals who are otherwise eligible for the subsidy. If an eligible individual elects COBRA, receives the subsidy, and then discovers that his or her income exceeds the limits, the individual must repay the amount of the subsidy as an increase in his or her income tax liability.

Individuals can make a permanent election to waive their right to the subsidy. The waiver provision permits an individual who knows that his or her modified adjusted gross income will exceed the income limits to opt out of the subsidy and thus avoid being subject to the recapture tax.

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