

Employee Benefits Briefing

COBRA Subsidy Requires Immediate Attention

Introduction

The economic stimulus legislation signed into law by President Obama on February 17th (The American Recovery and Reinvestment Act of 2009) contains COBRA subsidies for employees who are involuntarily terminated between September 1, 2008 and December 31, 2009. This COBRA subsidy applies to all employers that maintain a group health plan regardless of whether they are currently subject to the general healthcare continuation rules under COBRA.

This COBRA subsidy provision requires immediate attention by all employers, and, if any employees have been involuntarily terminated since September 1, 2008, requires action within 60 days of enactment.

This Briefing reviews the new COBRA subsidy provision and provides employers with a series of suggested next steps in order to comply with the requirements of this provision.

Who Is Eligible?

Employees and covered dependents who are (or were) covered under a group medical plan and who lose (or lost) coverage because the employee's employment ended due to an involuntary termination between September 1, 2008 and December 31, 2009 will be eligible to receive this COBRA subsidy.

Involuntary Termination: The legislation appears aimed primarily at employees whose jobs are (or were) eliminated as a result of economic-related reductions-in-force. However, the statutory language only refers to the termination as being "involuntary" and does not appear to distinguish

between reductions-in-force and other types of involuntary terminations. Similarly, existing guidance under COBRA does not define the concept of involuntarily termination. Consequently, it appears that any termination of employment that was not voluntary on the part of the employee would be covered by this provision.

Accordingly, it will be necessary to review terminations since September 1, 2008 even if there have been no economic-related reductions-in-force during that time period. Similarly, it will be necessary to identify all employees whose employment is involuntarily terminated on or before December 31, 2009 even if no reductions-in-force occur during that time period.

Gross Misconduct Termination: Despite broad eligibility rules, if an employee was involuntarily terminated due to gross misconduct, and if no COBRA election was provided to that employee (and his/her covered dependents) as a result of that termination, this legislation does not revive that individual's COBRA right or make that individual eligible for the subsidy. The legislative history to this provision makes it clear that such individuals are not eligible for the COBRA subsidy.

Individuals Who Declined COBRA Coverage Are Still Eligible: Employees and their eligible dependents who suffered a loss of coverage due to an involuntary termination on or after September 1, 2008 do not need to have elected COBRA to be eligible for the subsidy. Such individuals are eligible to elect COBRA coverage and receive the subsidy even if they did not previously elect COBRA coverage (see the discussion of the Special COBRA Election Opportunity below).

What Is the COBRA Subsidy?

The subsidy is equal to 65% of the monthly COBRA premium for the employee and his/her eligible dependents for up to 9 months. The subsidy applies to medical, dental and vision benefits. It does not apply to medical flexible reimbursement accounts.

For example, if a covered employee has elected COBRA coverage for medical, dental and vision benefits, with monthly COBRA premiums of \$1,000, \$150 and \$50, respectively, the individual is eligible for a subsidy of \$650, \$97.50 and \$32.50 per month. The individual would be required to pay only \$350, \$52.50 and \$17.50 per month to maintain coverage, and the employer may not deny coverage for nonpayment of premiums if it receives this 35% amount. In addition, the employer may further subsidize the employee's portion of the premium.

For the first 60 days after enactment, the employer may continue to require the COBRA covered individual to pay the full COBRA premium for coverage. However, once this 60-day period expires, the employer must either offset future subsidized premiums by the subsidy that applies to this period or directly refund the additional amounts to the covered individual.

Employees whose adjusted gross income (AGI) is between \$125,000 and \$145,000 (\$250,000 to \$290,000 for married couples filing jointly) will see a declining subsidy. Those employees whose AGIs are above the top end of the declining subsidy range (i.e., above \$145,000 for single filers and married filing separately and \$290,000 for joint filers) will not receive any subsidy. If an individual receives this subsidy, and his/her applicable AGI exceeds the subsidy limit, the individual will be required to return the subsidy to the government (by adding it to his/her tax liability) when he/she files his/her tax return. Importantly, although a high-paid employee may waive the subsidy, the burden of determining income eligibility for the subsidy is on the employee, not the employer.

When Does Eligibility End?

If an individual is eligible for the COBRA subsidy, that eligibility will continue until the first month beginning on or after the earlier of (1) the date which is 9

months after the first day of the first month for which the subsidy applies, or (2) the date that the eligible individual becomes eligible for Medicare benefits or health coverage under another group health plan (including, for example, a group health plan maintained by a new employer of the individual or a plan maintained by the employer of the individual's spouse).^{*} It is important to note that the subsidy ends on mere eligibility, whereas COBRA coverage ends when the individual is actually covered.

However, the individual will remain eligible for the subsidy if the other group health plan provides only dental, vision, counseling or referral services (or a combination of the foregoing), is a health flexible spending account or health reimbursement arrangement, or is coverage for treatment that is furnished in an on-site medical facility maintained by the employer and that consists primarily of first-aid services, prevention and wellness care, or similar care (or a combination of such care).

Reporting by COBRA Participants

Individuals who are eligible for the COBRA subsidy and who become eligible for another group medical plan or Medicare are required to notify their prior employer that they are so eligible and that they are no longer eligible for the COBRA subsidy. If they fail to notify the employer and continue to receive the subsidy, they will be subject to a tax penalty of 110% of the subsidy when they file their tax returns. Again, the reporting burden rests on the individual, not the employer.

Voluntary Offering of Alternative Coverage

Many employers maintain their medical plans as part of a larger cafeteria plan pursuant to which employees may elect different medical coverages. Under this legislation, employers are permitted (but not required) to allow involuntarily terminated employees (and their covered eligible dependents) to elect to receive their COBRA coverage under another

^{*} A third limit is the end of the maximum required period of continuation coverage for the qualified beneficiary under the Code's COBRA rules or the relevant state or federal law (or regulation). However, due to the closeness in time of the date of enactment to the September 1, 2008 opening of the eligibility window, this limitation will generally not apply.

medical plan with a premium cost that is equal to or less than the premium cost for the plan in which they are currently participating. If the employer elects to make this option available, this will permit employees (and their covered dependents) to elect to receive lower-cost coverage.

Notification to Affected Employees and Dependents

Within 60 days after the legislation is enacted, employers are required to notify affected former employees and their eligible dependents that they have a right to elect COBRA and receive this governmental subsidy.

In addition to the regular COBRA notice, a supplemental notice is required to be given to affected employees to provide additional information including, for example, information about the individual's right to the subsidy and the conditions on the subsidy, a description of the obligation of the individual to notify the employer of eligibility under another group health plan or Medicare, and the penalty for failure to provide this notification.

In this regard, the U.S. Department of Labor has been directed to develop a model notice within 30 days of enactment.

Special COBRA Election Opportunity

Eligible individuals who previously lost coverage and who were offered but did not elect COBRA will have a special additional 60-day election period. The 60-day election period begins on the date that notice is provided to the eligible individual about the special election period. This special election period does not extend the period of COBRA continuation coverage beyond the original maximum required period (generally 18 months after coverage was originally lost) and any COBRA continuation coverage elected pursuant to this special election period begins on the first period of coverage following the date of enactment (which for most plans will be March 1, 2009) and does not include any period prior to that period of coverage. However, the period of time following the original loss of coverage does not count as a gap in coverage that would permit the application of any preexisting condition limitation provisions.

For example, if an employee lost coverage on September 1, 2008 and declined COBRA coverage, the individual could elect coverage from the date of enactment forward, but the maximum period of coverage would end on February 28, 2010 (i.e., 18 months from the original loss of coverage). In addition, any medical expenses incurred between September 1, 2008 (the date coverage ceased) and March 1, 2009 (the date COBRA coverage begins under this election) would not be eligible for reimbursement under the employer's medical plan.

Reimbursement Mechanism

The employer will be eligible to receive reimbursement from the federal government for the COBRA premium subsidy through a reduction in its payroll withholding tax obligations. The mechanism for reporting and transmitting these subsidies has not yet been established, and thus will need to await implementation by the Treasury Department.

Next Steps

1. Identify employees (if any) who have been involuntarily terminated since September 1, 2008.
2. Establish a procedure to identify any employee whose employment is involuntarily terminated through December 31, 2009.
3. Prepare a notice to affected former employees and their covered dependents informing them about the subsidy and work with any outside COBRA vendor to distribute to affected individuals within 60 days after the date of enactment. As noted above, the U.S. Department of Labor has been instructed to issue a model notice within 30 days after the date of enactment.
4. Supplement ongoing COBRA notices to include a description of the new COBRA subsidy provisions and work with any outside COBRA vendors to include the supplemental COBRA notice as appropriate. Again, the U.S. Department of Labor has been instructed to issue a model notice within 30 days after the date of enactment.

5. Decide whether the employer will permit affected employees and their covered dependents to elect alternative COBRA coverage. If the employer chooses to permit affected employees and covered dependents to elect alternative coverage, the notice must include description of this alternative coverage.
6. Work with the payroll or tax department (and/or outside vendors) to establish procedures and record keeping requirements for filing for a refund of the 65% subsidy from the government. Unfortunately, the mechanism for this process will require action on the part of the government.

7. Prepare necessary attestation that the affected employee was involuntarily terminated. Again, this process will require action on the part of the government.

On almost all of the items discussed in this Briefing, there are as many questions raised as answered by the legislation. We will update our clients as guidance is released in the near future.

In the meantime, if you have any questions regarding this Bulletin, please contact Phil Mowery, Paul Russell or any Vedder Price attorney with whom you currently work.

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