

# EMPLOYEE BENEFITS ALERT

## 2009 ECONOMIC STIMULUS ACT INTRODUCES COBRA PREMIUM SUBSIDY FOR INVOLUNTARILY TERMINATED EMPLOYEES

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*The American Recovery and Reinvestment Act of 2009 (often referred to as the “Economic Stimulus Act”) introduces a major change to the health plan continuation coverage rules prescribed under the Consolidated Omnibus Budget Reconciliation Act (“COBRA”). Finding that few unemployed workers elect to continue coverage through COBRA due to the high cost of premium payments, and fearing a jump in the number of uninsured individuals during the current economic crisis, Congress has introduced a government subsidy to allow employees who have been involuntarily terminated from employment to continue their coverage in group health plans for a limited period at a lower cost. By reason of this new law, employees who are involuntarily terminated from employment during a stated period, and who elect COBRA continuation coverage, are allowed to pay only 35% of their COBRA premiums for up to nine months. The remaining 65% is then initially paid by the employer or the insurance carrier (depending on the type of health plan). The employer or insurance carrier is then eligible for a credit against its federal employment taxes for its share of the premiums. An analysis of the new COBRA premium assistance subsidy rules and their effect on employers, presented in the form of questions and answers, is set forth below.*

### A. FRAMEWORK OF THE COBRA PREMIUM ASSISTANCE RULES

#### 1. When do the new rules become effective?

The new rules officially became effective as of February 17, 2009, the date the legislation was signed into law. However, the COBRA premium subsidy is available for employees who were involuntarily terminated from employment on or after September 1, 2008. The COBRA premium subsidy will be made available to eligible individuals for monthly (or shorter) COBRA coverage billing periods that begin on or after the law’s effective date. For most group health plans, March 1, 2009 is the applicable premium assistance commencement date. Special notices regarding the new COBRA premium subsidy are required to be provided to individuals who become eligible for COBRA continuation coverage, including employees involuntarily terminated from employment on or after September 1, 2008.

## **2. Which group health plans are governed by the new rules?**

The new COBRA premium subsidy rules essentially apply to all employer-sponsored group health plans, including:

- Health plans maintained by private and tax-exempt employers that are governed by ERISA;
- Health plans maintained by state and local governments that are governed by the Public Health Service Act (“PHSA”); and
- Health plans maintained by the U.S. government and its agencies.

Group health plans that are exempt from the federal COBRA statute because the sponsoring employer has fewer than 20 employees, but which are governed by a state health continuation law, are also governed by the new rules. Small employers in Oregon are subject to such a state law. For purposes of this Alert, the term “COBRA” includes the state law continuation coverage.

The new COBRA premium subsidy rules do not apply to Section 125 health care flexible spending account (“FSA”) arrangements.

## **3. Who is entitled to the COBRA premium subsidy?**

The COBRA premium subsidy is available to an employee who:

- Is involuntarily terminated from employment during the period beginning on September 1, 2008 and ending on December 31, 2009;
- By reason of such involuntary termination of employment, becomes eligible for COBRA continuation coverage; and
- Actually elects the COBRA coverage.

A covered spouse or dependent of the terminated employee who otherwise is a “qualified beneficiary” with respect to the employee is also separately eligible for the COBRA premium subsidy.

As to be discussed more fully below, the subsidy is available to employees who were terminated from employment prior to the effective date of the new law, even if they did not elect COBRA continuation coverage. These employees are eligible to make a “second chance” COBRA election.

In summary, the COBRA premium subsidy is available to the following individuals:

- Individuals who are currently receiving COBRA benefits by reason of an involuntary termination that occurred on or after September 1, 2008;

- Individuals who were previously eligible for COBRA coverage by reason of an involuntary termination that occurred on or after September 1, 2008, who did not elect COBRA, and who now otherwise remain eligible for COBRA;
- Individuals who were previously eligible for COBRA coverage by reason of an involuntary termination that occurred on or after September 1, 2008, who elected COBRA but are no longer covered because they did not pay the required premium, and who now otherwise remain eligible for COBRA; and
- Individuals who will hereafter become eligible for COBRA coverage by reason of an involuntary termination occurring on or before December 31, 2009.

Employees who are eligible for the COBRA premium subsidy are referred to under the rules as “assistance eligible individuals.”

#### **4. What is meant by an “involuntary termination of employment”?**

The law does not define the term “involuntary termination of employment.” The legislative history of the new law also does not provide or otherwise suggest a definition. Thus, for the time being, employers must adopt and apply a good-faith standard.

In this connection, the occurrence of an “involuntary separation of service” is also relevant for purposes of Code Section 409A (which provides special tax rules for non-qualified deferred compensation plans). Regulations recently issued by the IRS under Code Section 409A define the term “involuntary separation from service” as follows:

‘An involuntary separation from service means a separation from service due to the independent exercise of the unilateral authority of the employer to terminate the employee’s services, other than due to the employee’s implicit or explicit request, where the employee was willing and able to continue performing services. An involuntary separation from service may include the employer’s failure to renew a contract at the time such contract expires, provided that the employee was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and to continue providing such services.

The determination of whether a separation from service is involuntary is based on all the facts and circumstances. Any characterization of the separation from service as voluntary or involuntary by the employee and the employer in the documentation of the separation from service is presumed to properly characterize the nature of the separation from service. However, the presumption may be rebutted where the facts and circumstances indicate otherwise. For example, if a separation from service is designated as a voluntary separation from service or resignation, but the facts and circumstances indicate that absent such voluntary separation from service the employer would have terminated the employee’s

services, and that the employee had knowledge that the employee would be so terminated, the separation from service is involuntary.’

The key to this definition is that the terminated employee must have been willing and able to continue in employment. Thus, for example, if an employee fails to return to work after the expiration of FMLA leave and is discharged for that reason, the employee is not considered to have been “involuntarily terminated” because he or she was not “willing and able” to continue to perform services.

**Alert Point: An involuntary termination includes more than just a layoff. Discharges for poor performance occurring during the subsidy period will also entitle the employee to the COBRA premium subsidy. “Mutual separations” should be reviewed carefully to establish whether the severance qualifies as being “involuntary.”**

**5. How do the COBRA premium subsidy rules apply to employees who were involuntarily terminated prior to the effective date of the rules?**

The premium subsidy is available to any individual who qualifies for COBRA as a result of an involuntary termination of employment occurring between September 1, 2008 and December 31, 2009. Consequently, individuals who are currently receiving COBRA coverage due to an involuntary termination during this period are eligible for the subsidy, effective as of the COBRA billing period commencing on March 1, 2009 (or possibly earlier, as explained in B.2. below).

Individuals who were involuntarily terminated from employment on or after September 1, 2008, and before February 17, 2009, but who declined COBRA continuation coverage, or whose COBRA coverage was dropped for nonpayment, are also eligible for the COBRA premium subsidy under a “second chance” provision in the new rules. These individuals must be provided a notice of the second chance election right. Upon receipt of the notice, the individual will then have 60 days to elect COBRA.

The COBRA coverage for individuals who elect coverage under the “second chance” provision of the new rules will commence on the first day of the first COBRA period beginning after February 17, 2009 (typically, March 1, 2009). In other words, COBRA continuation coverage is not retroactive to the date of that individual’s qualifying event. However, the maximum coverage period for these individuals (i.e., the 18-month period) will be measured from the date of the COBRA qualifying event (i.e., the termination of employment date), and not from March 1, 2009.

**Example:** An employee was involuntarily terminated from employment on September 30, 2008, became entitled to COBRA continuation coverage beginning on October 1, 2008, but declined such coverage because of the expense. The employee later elected coverage under the “second chance” provision. In this situation, the employee’s COBRA coverage would begin on March 1, 2009. However, the period of COBRA coverage for that individual would end 18 months from October 1, 2008, meaning the employee’s coverage would cease no later than March 31, 2010 (barring a second qualifying event).

**Alert Point:** In regard to an employee who makes the second chance election, the period between the initial COBRA qualifying event and (typically) March 1 will not count towards the 63-day break-in-service period calculation applicable to the Health Insurance Portability and Accountability Act (HIPAA) creditable coverage and preexisting condition restrictions.

**6. Is the COBRA premium subsidy available to higher paid employees?**

Yes and no. The COBRA premium subsidy is available for eligible employees of any income level. However, the subsidy actually provided to an employee, or to the spouse or dependent of the employee, will be included, in whole or in part, in the employee’s taxable income (i.e., will be recaptured) if the employee’s adjusted gross income (“AGI”) for the year exceeds \$125,000 (\$250,000 for married couples filing jointly). The full amount of the subsidy will be included in income if the employee’s AGI exceeds \$145,000 (\$290,000 for a married couple filing jointly). If the employee’s AGI for the year is between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for married couples filing jointly), a portion of the subsidy will be recaptured.

Higher paid employees who wish to avoid the awkwardness of the recapture can decline the subsidy by making a permanent election to waive the allowance (the manner of which will be determined later by the IRS), and by notifying the plan of such election.

**Alert Point:** Employers should now prepare a form allowing a higher paid employee to waive the premium subsidy.

**B. TERMS OF SUBSIDY**

**1. How much is the COBRA premium subsidy?**

Under the general COBRA rules, an individual can be required to pay 100% of the premium for the coverage, plus a 2% administrative fee. The combined amount (102%) is referred to under COBRA as the “premium.”

Under the new rules, assistance eligible individuals receiving COBRA continuation coverage during the subsidy period are required to pay only 35% of the premium. Although not expressly stated in the new rules, an analysis of the current and new COBRA rules leads to the conclusion that the 35% factor applies to the total amount otherwise payable by the individual (i.e., 35% of the 102% amount).

**2. When will the COBRA premium subsidy first become available?**

The COBRA premium subsidy is available to assistance eligible individuals for premiums due for the first COBRA premium period beginning on or after February 17, 2009 (the date of enactment of the Economic Stimulus Act). In almost all cases, COBRA is provided and billed on a calendar month basis. As such, the subsidy will typically first become available under an employer's group health plan for the monthly coverage period beginning on March 1, 2009.

**3. What is the maximum duration of the COBRA premium subsidy period?**

Except in the case of small group health plans governed by a state continuation coverage law, the COBRA premium subsidy is available until the end of a 9-month subsidy period. The 9-month period begins on the first day of the calendar month during which the individual becomes eligible for the subsidy. If the COBRA coverage period under the group health plan is maintained on a calendar month basis, then the assistance eligible individual receives nine full months of the subsidy. For example, if the subsidy becomes available to an employee on March 1, 2009, the subsidy period runs through November 30, 2009.

However, if the coverage period is based other than on a calendar month period, the subsidy period will be less than nine full months. For example, if the COBRA coverage billing period applicable to an individual under a plan begins on March 15, 2009, the 9-month subsidy period is measured from March 1, 2009 (the first day of the first subsidy coverage month), and thus will end on October 31, 2009 (8½ months after the COBRA commencement date).

This 9-month subsidy period does not change the standard maximum coverage periods under COBRA. Therefore, individuals will still be allowed to continue COBRA coverage beyond the subsidy period on a fully self-pay basis in accordance with the general COBRA rules.

**Alert Point: The Oregon health plan continuation coverage rules (applicable to small employer plans) require only six months of continuation coverage to be made available to eligible individuals (rather than the 18 [or 36] months available under the federal COBRA rules). Therefore, the COBRA premium subsidy period for a small, Oregon-governed plan will be limited to the six months (i.e., for the actual continuation coverage period), and not nine months.**

#### **4. Can the COBRA premium subsidy be prematurely terminated?**

The COBRA premium subsidy period pertaining to an assistance eligible individual will terminate prior to the end of the maximum 9-month period if the individual:

- (a) Becomes eligible for coverage under another group health plan, other than:
  - A plan providing only dental, vision, counseling or referral services;
  - A healthcare FSA plan; or
  - An on-site medical clinic that consists primarily of first-aid services, prevention or wellness care;
- (b) Becomes eligible for Medicare benefits; or
- (c) Otherwise ceases to be eligible for COBRA coverage (for example, if the employer discontinues the plan).

**Alert Point: Under the general COBRA rules, COBRA coverage can be terminated due to other coverage under another group health plan or Medicare only if an individual actually enrolls in the plan or Medicare. In contrast, the COBRA premium subsidy can be terminated merely upon the individual becoming eligible for the other coverage. Consequently, an individual who becomes eligible for coverage under another plan, but declines that other coverage, will lose the subsidy without losing the COBRA coverage.**

#### **5. How will a plan receive notice of an individual's new eligibility for other coverage?**

An individual who is receiving the COBRA premium subsidy, and who, during the subsidy period, becomes eligible for coverage under another health plan or Medicare, is required to notify the plan in writing of the new eligibility for coverage. An individual who fails to provide the notice can be assessed for a penalty equal to 110% of the subsidy provided after the eligibility date of the newly available coverage.

#### **6. What if an individual is denied the COBRA premium subsidy?**

If an individual requests that the group health plan treat the individual as being eligible for the COBRA premium subsidy, but such request is denied, the individual may appeal the decision to the Department of Labor (or to the Department of Health and Human Services ["HHS"], in the case of PHSA-governed governmental plans). The Department of Labor (or HHS) is required to rule on the appeal within 15 business days.

## C. NOTICE REQUIREMENTS

### 1. What notice requirements are imposed under the new rules?

Under the new rules, assistance eligible individuals must be provided with a notice of the following:

- Any forms to be submitted to establish eligibility for the COBRA premium subsidy (such as proof of an involuntary termination);
- The name, address and telephone number of the plan administrator, and any other person maintaining relevant information regarding the COBRA premium subsidy;
- A description, **displayed in a prominent manner**, describing the individual's right to the COBRA premium subsidy, as well as the conditions for the subsidy;
- A description of the special election period for individuals terminated prior to the effective date of the new rules (see below);
- A description of the individual's obligation to notify the plan should they become eligible for coverage under a different group health plan or Medicare, as well as an explanation of the penalty should they fail to provide the plan with such notice;
- If applicable, a description of the individual's option to enroll in different health coverage through their employer, if the employer elects this option (see C.5. below).

The rules direct the Department of Labor to provide model language for federally-governed health plans by March 19, 2009. In addition, the Department of Labor is directed to issue (without a deadline) special notice rules for state-governed continuation coverage plans.

**Alert Point: The law provides that an employer will not be in compliance with the general COBRA election rights obligation rules unless and until the COBRA premium subsidy rights notice is provided. Consequently, an employer that provides the "regular" COBRA notice, but fails to timely provide the COBRA premium rights notice, can be liable for the notice penalties (up to \$110 per day). In addition, the COBRA election period will not commence until the special notice is provided.**

**Accordingly, an employer may choose not to wait for the Department of Labor to actually release a model notice in a timely manner, but instead prepare its own notice to avoid non-compliance penalties.**

## 2. Who must provide the notice?

In regard to federally-governed health plans, the legal “plan administrator” is required to provide the general COBRA premium subsidy rights notice. Under COBRA, the employer is considered the legal plan administrator. Accordingly, the employer has the ultimate responsibility for providing the notice.

**Alert Point: The Oregon health care continuation coverage law applicable generally to small employer health plans does not require a continuation coverage notice to be provided to terminated employees. In this regard, for Oregon (and other similar states), the U. S. Department of Labor will issue rules regarding the premium assistance notice obligations. A pronouncement from the Oregon Insurance Division can be found at [http://www.cbs.state.or.us/external/ins/news\\_releases/2009/022009-federalstimulus.pdf](http://www.cbs.state.or.us/external/ins/news_releases/2009/022009-federalstimulus.pdf).**

## 3. To whom and when must the notice be provided?

The provisions of the law regarding the recipients and timing of furnishing the COBRA premium subsidy notice are somewhat disconnected. Technically, the notice requirements are as prescribed below.

- (a) The notice must be provided to each individual who becomes eligible for COBRA continuation coverage due to a qualifying event of any sort that occurs on or after September 1, 2008, and on or before December 31, 2009.

**Alert Point: The law requires that all individuals who become eligible for COBRA by reason of a qualifying event occurring on or after September 1, 2008 be provided the new notice. This means that, subject to further guidance and relief from the Department of Labor, the notice must be provided to all individuals who become eligible for COBRA by reason of a voluntary termination of employment, divorce or any other qualifying event, including for individuals who incurred a qualifying event prior to February 17, 2009.**

- (b) Peculiarly, the rules have a specific deadline for the notice to be provided to individuals who were involuntarily terminated from employment on or after September 1, 2008, and before February 17, 2009. The deadline is April 18, 2009 (60 days after the enactment of the rules).

The law does not prescribe a specific deadline for providing the notice to other individuals who incurred a qualifying event during this period (i.e., those individuals who are not eligible for the subsidy but who still receive a notice).

- (c) The timing of the special notice to be furnished to individuals who incur a normal COBRA qualifying event on or after February 17, 2009 will be governed by the general COBRA election rights rules. This will require that the COBRA premium subsidy rights notice be provided (along with the general COBRA election rights notice) within 44 days of the qualifying event.

**4. What happens if a former employee pays the full amount of the premium before being notified of the COBRA premium subsidy right?**

Congress understood that employers are likely unable to provide the COBRA premium subsidy notice, or to implement new procedures, before the effective date of the new law. In this regard, the law provides a special transition provision for an assistance eligible individual who pays the full COBRA premium with respect to the first or second consecutive subsidy period that commences on or after the effective date of the law (e.g., March and April), whereby the employer (or the insurance company, in the case of a small employer state-governed plan) must either:

- Reimburse the individual for the amount of premium that exceeds 35% of the total premium; or
- Provide the individual with a credit against his or her subsequent premium payments.

If the premium credit method is used, such credit must be fully applied within 180 days. If, at any time during the 180-day period, it is reasonable to believe that such credit will not be fully applied within that period, payment equal to the remaining credit must be made to the individual within 60 days.

**5. Can an assistance eligible individual change to another plan mid-year?**

If an employer offers two group health plans to active employees (i.e., a “high” and “low” plan, with more expensive premiums charged under the high plan), and if an assistance eligible individual is covered under the high plan, then the employer may, at its option, allow COBRA participants to switch to the less costly plan outside of the normal open enrollment period, without regard to the Section 125 cafeteria plan restrictions. In order to allow the mid-year election change, the following conditions must be satisfied:

- The COBRA premium for the low plan cannot exceed the premium for the coverage the individual had under the high plan when the COBRA-qualifying event occurred;
- The low plan must be currently offered to active employees (i.e., an individual cannot switch to a retiree plan);
- The coverage under the low plan cannot:
  - Provide only dental, vision, counseling or referral services;
  - Be a flexible spending account; or
  - Be an on-site medical clinic that consists primarily of first-aid services, prevention or wellness care.

## **D. EMPLOYER PAYROLL CREDITS AND REPORTS**

### **1. How does the payroll tax offset work?**

The new rules prescribe a unique method for the federal government's funding of the COBRA premium subsidy. Under the new system, once the plan receives the reduced premium payment from the assistance eligible individual, the employer can claim the subsidy amount as a credit against its federal income tax withholding and FICA obligations. In the case of a small employer state continuation coverage plan, the insurance company will claim the payroll credit, rather than the employer.

The IRS has not yet issued guidance as to the mechanics of the payroll credit.

### **2. What reports will need to be filed?**

Employers will eventually be required to file reports with the IRS, related to the COBRA premium subsidy, that include the following:

- (a) A statement that each former employee receiving the COBRA premium subsidy was involuntarily terminated;
- (b) An accounting of the payroll tax credits taken during the reporting period, and an estimate of the credits to be taken during the following reporting period; and
- (c) A report of all eligible assistance former employees, the amount of the subsidy treated as a payroll tax credit for each employee, and a designation as to whether the subsidy is for coverage of an single individual or multiple individuals.

The IRS is currently developing the specifics of these reports, as well as deadlines for employers to file the reports.

## **E. ACTION ITEMS**

The new COBRA premium subsidy rules are already in effect. Therefore, employers should undertake the following actions as soon as possible.

- (a) Identify employees who were involuntarily terminated from employment on or after September 1, 2008, and who did not elect COBRA, or who have since lost that coverage.
- (b) Meet with your outside COBRA administrator to establish the special notice arrangements.
- (c) Decide whether you feel it is prudent to wait for the Department of Labor model notice, or if you wish to move ahead with a good-faith notice to avoid delays and elongated election periods.

- (d) Discuss with your COBRA administrator how to handle COBRA premium overpayments received during the March and April election transition period.
- (e) Prepare a premium subsidy waiver form for higher paid employees.
- (f) Work with your COBRA administrator regarding a procedure to notify individuals when their premium subsidy period will end.
- (g) Work with your payroll administrator regarding the required information to be captured and reported to the IRS.
- (h) Decide whether you will allow employees to switch to a lower-cost plan mid-year (if applicable).

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Should you have any questions regarding the new COBRA premium subsidy rules, please feel free to contact Wally Miller or Kirk Reynolds of the firm's Employee Benefits Practice Group via email, or by phone at (541) 686-8833.

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