

The COBRA Subsidy in the Economic Stimulus Law

COBRA (The **Consolidated Omnibus Budget Reconciliation Act**), which became law in 1986, allows certain former employees, retirees, spouses, former spouses, and dependent children the right to temporarily continue group health coverage at group rates. The law generally covers health plans maintained by employers (private and public sector, as well as employee organizations) with 20 or more employees.

Under COBRA, qualified COBRA beneficiaries who lose eligibility for employer-sponsored health coverage due to a *qualifying event*¹ can continue that coverage for up to 18 months, and, in the case of divorce or separation, for up to 36 months. As written, however, COBRA required the beneficiary to pay the entire premium, plus up to a 2% administrative fee.

To provide short-term assistance to those who are *involuntarily terminated* during the current recession, the economic stimulus package signed by President Obama on February 17th (**The American Recovery and Reinvestment Act, or ARRA**) contained a COBRA subsidy provision. The new COBRA rules impose new administrative requirements on plan sponsors, as well as on third parties involved with the COBRA administration.

The following FAQ summarizes the key provisions of ARRA:

When is the subsidy effective?

The subsidy applies to "...any premium for a period of coverage beginning on or after date of enactment." So, for the vast majority of eligible COBRA participants (i.e., for COBRA billed on a monthly basis), the subsidy will be effective on March 1st.

Who is eligible for the subsidy?

The subsidy is available to all COBRA beneficiaries who are "*Assistance Eligible Individuals*" or *AEIs*. *AEIs* are defined as those employees who:

1. lose their group health plan coverage due to *involuntary termination of employment* between *September 1, 2008 and December 31, 2009, inclusive*; and,
2. are not eligible for other group health coverage (such as a spouse's plan) or Medicare; and,
3. elect COBRA coverage

¹ *Under the 1986 law, COBRA qualifying events were defined as (1) the death of a covered employee; (2) the termination of a covered employee's employment -- other than by reason of the employee's gross misconduct; (3) a reduction of hours of a covered employee's employment; (4) the divorce or legal separation of a covered employee from the employee's spouse; (5) a covered employee becoming entitled to Medicare benefits; or (6) a dependent child ceasing to be a dependent child of the covered employee under plan's dependent eligibility definition.*



The COBRA Subsidy in the Economic Stimulus Law

For the purposes of the subsidy, what is the definition of “involuntary termination of employment?”

This question has generally received far more attention than any other related to ARRA and the subsidy program. In response, the IRS released Notice 2009-27² on March 31st. The following is the full excerpt from that Notice relating to this issue.

NOTE: we have added comments/examples, which are indented and in italics, and were not part of Notice 2009-27.

IRS Notice 2009-27

INVOLUNTARY TERMINATION (Q&A-1 through Q&A-9 apply solely for purposes of determining whether there is an involuntary termination under section 3001 of ARRA (including new Code sections added by section 3001 of ARRA), but not for any other purposes under the Code or any other law.)

Q-1. What circumstances constitute an involuntary termination for purposes of the definition of an assistance eligible individual?

A-1. An involuntary termination means a severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employment, other than due to the employee’s implicit or explicit request, where the employee was willing and able to continue performing services.

An involuntary termination may include the employer’s failure to renew a contract at the time the contract expires, if the employee was willing and able to execute a new contract providing terms and conditions similar to those in the expiring contract and to continue providing the services.

In addition, an employee-initiated termination from employment constitutes an involuntary termination from employment for purposes of the premium reduction if the termination from employment constitutes a termination for good reason due to employer action that causes a material negative change in the employment relationship for the employee.

For example:

- *there is a plant closing and the employee declines the opportunity to take a job with the same company in another state (See Q&A-7 below); or,*
- *the employee was working 40 hours per week, but the employer*

² A full copy of the Notice can be obtained at <http://www.irs.gov/pub/irs-drop/n-09-27.pdf>.

The COBRA Subsidy in the Economic Stimulus Law

reduces the employee's work schedule to 25 hours per week. The reduction -- in and of itself -- does constitute a COBRA qualifying event. But it does not constitute an "involuntary termination" for subsidy purposes. However, if the employee -- because of the reduction in hours -- resigns to accept another job with more hours, this may be considered an involuntary termination since it is in response to a material negative change in employment conditions.

Involuntary termination is the involuntary termination of employment, not the involuntary termination of health coverage.

For example:

- *an employee is involuntarily terminated on August 19, 2008 and remains enrolled in the group health plan until September 1, 2008. The employee is eligible for COBRA, but is not eligible for the subsidy, since the qualifying event (the involuntary termination of employment) occurred prior to September 1, 2008.*
- *an employee is involuntarily terminated on December 15, 2009 and remains enrolled in the group health plan until January 1, 2010. The employee is eligible for COBRA, and is eligible for the subsidy, since the qualifying event (the involuntary termination of employment) occurred prior to December 31, 2009.*

Thus, qualifying events other than an involuntary termination, such as divorce or a dependent child ceasing to be a dependent child under the generally applicable requirements of the plan (such as the loss of dependent status due to aging out of eligibility), are not involuntary terminations qualifying an individual for the premium reduction.

In addition, involuntary termination does not include the death of an employee or absence from work due to illness or disability.

The determination of whether a termination is involuntary is based on all the facts and circumstances. For example, if a termination is designated as voluntary or as a resignation, but the facts and circumstances indicate that, absent such voluntary termination, the employer would have terminated the employee's services, and that the employee had knowledge that the employee would be terminated, the termination is involuntary.

Q-2. Does an involuntary termination include a lay-off period with a right of recall or a temporary furlough period?

A-2. Yes. An involuntary reduction to zero hours, such as a lay-off, furlough, or other suspension of employment, resulting in a loss of health coverage is an involuntary



The COBRA Subsidy in the Economic Stimulus Law

termination for purposes of the premium reduction.

Q-3. Does an involuntary termination include a reduction in hours?

A-3. Generally no. If the reduction in hours is not a reduction to zero, the mere reduction in hours is not an involuntary termination. However, an employee's voluntary termination in response to an employer-imposed reduction in hours may be an involuntary termination if the reduction in hours is a material negative change in the employment relationship for the employee.

Q-4. Does involuntary termination include an employer's action to end an individual's employment while the individual is absent from work due to illness or disability?

A-4. Yes. Involuntary termination occurs when the employer takes action to end the individual's employment status (but mere absence from work due to illness or disability before the employer has taken action to end the individual's employment status is not an involuntary termination).

Q-5. Does an involuntary termination include retirement?

A-5. If the facts and circumstances indicate that, absent retirement, the employer would have terminated the employee's services, and the employee had knowledge that the employee would be terminated, the retirement is an involuntary termination.

Q-6. Does involuntary termination include involuntary termination for cause?

A-6. Yes. However, for purposes of Federal COBRA, if the termination of employment is due to gross misconduct of the employee, the termination is not a qualifying event and the employee and other family members losing health coverage by reason of the employee's termination of employment are not eligible for COBRA continuation coverage.

Q-7. Does an involuntary termination include a resignation as the result of a material change in the geographic location of employment for the employee?

A-7. Yes.

Q-8. Does an involuntary termination include a work stoppage as the result of a strike initiated by employees or their representatives?

A-8. No. However, a lockout initiated by the employer is an involuntary termination.



The COBRA Subsidy in the Economic Stimulus Law

Q-9. Does an involuntary termination include a termination elected by the employee in return for a severance package (a "buy-out") where the employer indicates that after the offer period for the severance package, a certain number of remaining employees in the employee's group will be terminated?

A-9. Yes.

End of IRS Notice 2009-27 Q&A

What if an employee was terminated for poor work performance or violation of the employer's attendance policy?

ARRA's COBRA rights apply to involuntary terminations as defined in IRS Notice 2009-27. If the involuntary termination was for a reason other than gross misconduct and occurred between September 1, 2008 and December 31, 2009, it triggers ARRA's COBRA subsidy rights.

An employer terminated an employee in October of 2008 for poor work performance. The employee did not elect COBRA within the normal 60-day election period. Must the employer now offer the employee another chance to elect COBRA?

Yes. Because this employee was involuntarily terminated after September 1, 2008, and did not enroll in COBRA (and poor work performance doesn't constitute gross misconduct), you will need to offer the terminated employee (and any dependents who became qualified beneficiaries due to the employee's termination) the opportunity to elect COBRA during the special election period. Further, COBRA coverage elected during the special election period will be effective as of the first coverage period on or after February 17, 2009 (March 1 for plans with monthly coverage periods).

Does an individual qualify for the subsidy if he or she is eligible for other group health coverage?

No. An individual who is eligible for coverage under another group health plan (except plans consisting of only dental, vision, counseling, and/or referral services) or under Medicare -- **regardless of whether he or she is enrolled in that coverage** -- does not qualify.

How much is the subsidy?

The subsidy is 65% of the applicable COBRA premium. For the purposes of the subsidy, "premium" includes the administrative fee of up to 2%.



The COBRA Subsidy in the Economic Stimulus Law

How long does the subsidy last?

For each AEI who elects COBRA, the subsidy period will be the lesser of:

1. nine months; or,
2. the date the AEI becomes eligible for coverage under either another group health plan or Medicare

How will it work?

The AEI will pay 35% of the applicable COBRA premium and the employer will pay the remaining 65%. The employer then claims that expense as a credit against future wage withholdings and payroll taxes.

How will the employer claim the tax credit?

The employer will claim a tax credit against periodic deposits for wage withholdings and FICA payroll taxes equal to the COBRA premiums paid on behalf of AEIs (i.e., the 65% not paid by the individual).

If the employer's eligible COBRA payments exceed the amount of wage withholdings or FICA payroll taxes reported, the US Treasury will reimburse the employer directly for the difference.

The IRS has released:

1. a revised **Employer's QUARTERLY Federal Tax Return (Form 941)**, which now includes a section (lines 12 a. and 12 b.) for reporting the subsidy payments made on behalf of AEIs. It can be found at <http://www.irs.gov/pub/irs-pdf/f941.pdf>
2. detailed instructions on how to complete the revised form. They can be found at <http://www.irs.gov/pub/irs-pdf/i941.pdf>

Please note: the tax credit for the 65% payments made on behalf of an AEI can only be taken by the employer if the AEI has actually paid their 35% share. Depending on the timing of the AEI's payment and the filing of the Form 941, this may delay the employer's recoupment by one calendar quarter.

Does the employer have any other special reporting requirements?

Yes. The US Treasury will be defining the reports that employers claiming the tax credit must provide. These will include:

- an attestation of the involuntary employment termination of each employee for whom reimbursement of the subsidy is claimed.
- a report of the amount of payroll taxes offset for a reporting period, and the estimated offsets of such taxes for the next reporting period.

The COBRA Subsidy in the Economic Stimulus Law

- a report containing tax identification numbers of all employees who received the subsidy, the amount of the subsidy for each such employee and any other qualified beneficiary, and a designation with respect to each such employee as to whether the subsidy is for coverage of one person or more than one person.

What happens if a current COBRA beneficiary (i.e., previously elected COBRA) who is an AEI has already paid their March and April COBRA premium in full?

ARRA provides a transition rule...the employer can either reimburse the person 65% of the premiums that were paid, or provide a credit of that amount to offset future premiums, if it is a reasonable assumption that the credit will be used up within 180 days. If the employer chooses to refund the overpayment to the AEI, the reimbursement must be sent to the AEI within 60 days of receipt of the original (i.e., 100%) payment.

What other features, requirements and limitations/restrictions are included in ARRA?

The COBRA subsidy provisions of ARRA also include the following:

A. SPECIAL ELECTION PERIOD

Employers must provide a 60-day special election period for AEIs who did not previously elect COBRA. This special election period also applies to AEIs who initially elected COBRA but are no longer enrolled on the date of ARRA enactment (February 17th).

In other words, AEIs who did not elect COBRA previously -- or did but have since terminated the COBRA coverage -- may elect COBRA coverage and enjoy the benefits of subsidy, but only for nine months, or the date the AEI becomes eligible for coverage under either another group health plan or Medicare -- *whichever comes first*. Coverage can be elected back to March 1st, but the maximum duration of COBRA coverage is still measured from the date of the original qualifying event.

B. NOTICE AND RESPONSE REQUIREMENTS

The regulations impose new notice and response requirements on the federal government, the employer and the former employee.

The Government

The Department of Labor was responsible under ARRA for developing model Notices within 30 days of ARRA's passage. Per ARRA, the Notices must include the following:

- the availability of the subsidy, and a description of conditions effecting entitlement to the subsidy, if any

The COBRA Subsidy in the Economic Stimulus Law

- the availability of the “Plan Enrollment Option” -- *if offered by the employer* -- and a description of the other options (see **Employer** section on pages 8 and 9 for more details on the Plan Enrollment Option)
- forms necessary to confirm subsidy eligibility
- plan administrator contact information (i.e., employer) and, if applicable, the COBRA administrator
- a description of the Special Election Period
- a description of the AEI’s responsibilities regarding the required written notification to the plan of eligibility for other group health plan coverage or eligibility for Medicare
- a description of the penalty for failing to provide such written notice

The DOL published the model Notices on March 19th. There are four versions:

- **General Notice/Full** -- must be sent to qualified beneficiaries, not just employees, who experienced a qualifying event at any time from 9/1/2008 through 12/31/2009, regardless of the type of qualifying event, and who either have not yet been provided a COBRA notice or who were provided an election notice on or after 2/17/2009 that did not include the additional information required by the law. This full version includes information on the premium reduction as well as information required in a COBRA election notice.
- **General Notice/Abbreviated** -- includes the same information as the full one regarding the availability of the premium reduction and other rights under ARRA, but does not include the COBRA coverage election information. This may be sent to persons who had a qualifying event on or after 9/1/2008, have already elected COBRA, and still have it.
- **Alternative Notice** -- version that insurance issuers (e.g., carriers and HMOs) must send to persons who became eligible for continuation coverage under NY State’s “Mini COBRA” legislation. Issuers must modify the Notice to reflect the specific requirements of the NY law.
- **Notice in Connection with Extended Election Periods** (see (a) **Special Election Period** on page 7 for additional details) -- employers subject to the Federal COBRA provisions (i.e., with 20 or more employees) must send this Notice to any AEI (or any individual who would be an AEI if a COBRA continuation election were in effect) who:

The COBRA Subsidy in the Economic Stimulus Law

1. had a qualifying event at any time from September 1, 2008 through February 16, 2009; and,
2. either did not elect COBRA during the normal 60-day election period, or who elected COBRA but subsequently discontinued it

All four notices can be accessed at <http://www.dol.gov/ebsa/COBRAmodeInotice.html>.

The Employer

At the employer's discretion, a "Plan Enrollment Option"³ may be offered. Under this option, AEIs are allowed to enroll in any health plan option that is still offered by their former employer to active employees – *even if that is different than the coverage the AEI held at the time of their qualifying event*. In order for an AEI to take advantage:

- o the employer must make the option available; and,
- o the premium for the alternative coverage must be equal to or less than the premium for the coverage the AEI was enrolled in at the time of the qualifying event; and,
- o the alternative coverage is still offered to active employees in the same population that the AEI was in at the time of separation (e.g., bargaining unit, employee class, etc.)

Therefore, in order to determine which Notice to send, the Employer must first decide whether or not to offer the Plan Enrollment Option.

Employers must provide the appropriate Notice to affected individuals by April 18th (within 60 days of ARRA enactment). Failure to do so is a violation of standard COBRA notice requirements, and could result in penalties ranging from **\$100 to \$200 per day per individual**.

Employers must offer COBRA coverage from the first period of coverage on or after the date of ARRA enactment. For most plans, this will be March 1st.

The Former Employee (the AEI)

The AEI must elect COBRA (return the required forms) within 60 days of receiving the special election notice, or 90 days if the Plan Enrollment Option is offered.

³ *the Plan Enrollment Option does not apply to standalone vision or dental plans, a health FSA or HRA plan, an onsite medical facility, or other referral programs. Also, if the Plan Enrollment Option is offered, AEIs will have 90 days to elect (v. 60 days if the Plan Enrollment Option is not offered)*

The COBRA Subsidy in the Economic Stimulus Law

The AEI must notify the employer in writing if he or she becomes eligible for other group health plan coverage or Medicare. Failure to do so may result in a penalty imposed on the individual of **110% of the premium reduction** unless the failure was due to reasonable cause.

The Government, the Employer and the AEI

ARRA includes a provision that allows an AEI to appeal a denial of either the subsidy or any of the other special enrollment rights provided under ARRA. The US DOL will handle appeals related to private sector employer plans subject to COBRA provisions, and HHS will handle appeals for Federal, State, and local governmental employees, as well as appeals related to group health insurance coverage provided pursuant to state continuation coverage laws.

The DOL is currently developing the process and an official appeal form. The process will include obtaining information from the employer, plan or insurer where appropriate. For the AEI (initial written appeal) and the Employer (response to DOL/HHS request for information), there will be specific deadlines each must meet. Per ARRA, the DOL or HHS must respond within 15 business days of their receipt of the appeal.

C. IMPACT ON NEW YORK "MINI COBRA" PROGRAM

ARRA extends the premium subsidy to New York's "Mini COBRA" program, which mandates that continuation of coverage provisions comparable to Federal COBRA must be offered by small groups (i.e., 2 to 19 employees).⁴

If the employer is paying the carrier for the Mini COBRA coverage, then the same approach as outlined above (AEI remits 35% of applicable premium plus administrative fee; employer pays the 65% balance and claims the tax credit) would apply.

However, if there is no employer involvement (i.e., AEI pays carrier directly), the insurer would be responsible for compliance, and would receive the subsidy reimbursement.

D. EMPLOYER FUNDING OF COBRA

The subsidy is triggered by the COBRA premiums that an AEI would pay in the absence of these new rules. Therefore:

⁴ See http://www.ins.state.ny.us/faqs/faqs_cobra.htm for additional details on the NYS "Mini COBRA" law

The COBRA Subsidy in the Economic Stimulus Law

- o employers paying some of the AEI's portion of the COBRA premium -- for example, as part of a severance package -- will receive the subsidy based only on the AEI's net premium, not the employer's contribution
- o employers paying the full AEI share of the COBRA premium will not be eligible for any reimbursement

E. OTHER RESTRICTIONS AND LIMITATIONS

- o taxpayers with an adjusted gross income (AGI) exceeding \$145,000 (\$290,000 for joint filers) are not eligible for the subsidy
- o the subsidy is reduced proportionately for taxpayers with an AGI between \$125,000 and \$145,000 (\$250,000 and \$290,000 for joint filers)
- o an AEI who does not satisfy the income threshold in 2009 may still be eligible in 2010 if AGI falls below the stated levels. However, an AEI may waive his/her subsidy rights. If an AEI wishes to waive their rights, it must be confirmed in writing to the employer.

NOTE: the waiver is permanent. An AEI who waives in 2009 cannot claim the subsidy in 2010 even if AGI falls below the threshold

- o AEIs who did not elect COBRA during their initial 60-day election period cannot enroll for COBRA, or benefit from the subsidy, retroactively (i.e., earlier than March 1st)
- o AEIs who did elect COBRA when originally eligible and have been paying the full premium are not eligible for the subsidy on those prior premium payments -- but their payments will drop in March
- o AEIs who are still within their 60-day COBRA election period can enroll retroactively (i.e., same as in the past under "standard" COBRA) but the subsidy will apply only to premium payments due March 1st and later
- o ARRA does not extend COBRA coverage, subsidized or not, beyond the COBRA end date as determined by the "standard" COBRA regulations

NEXT STEPS

In light of the IRS's expanded guidance on "involuntary termination," employers should first determine if they have had any AEIs since September 1, 2008 or expect they might have any between now and December 31st

If the answer to both is "no," then the subsidy program contained in ARRA does not apply.



The COBRA Subsidy in the Economic Stimulus Law

Employers who answer “yes” to either should begin preparing to implement the new rules. Among the necessary steps are:

- collect information on current AEIs and their dependents -- both those that already elected COBRA and those who did not
- establish data collection procedures for (potential) future AEIs
- if multiple plans are offered to active individuals in the same employee population as the AEIs, decide on offering the Plan Enrollment Option (see *The Employer* section on page 9)
- if COBRA payments have been part of past severance packages, review employment practices that might result in your subsidizing COBRA premiums in the future (see **D. Employer Funding of COBRA** section on page 10)
- if applicable, contact your COBRA administrator to ensure they have adapted their forms and processes to help keep you compliant
- prepare the appropriate Notice that will be sent to current AEIs by April 19th:
 - current COBRA participants who are now eligible for a subsidy; and,
 - AEIs not currently enrolled in COBRA
- update current Notices to include the required DOL information for use with future AEIs
- determine what changes, if any, need to be made to payroll systems and reporting,
- establish procedures for tracking AEIs who are receiving the subsidy, and for complying with the IRS reporting requirements for tax credits
- establish procedures for collecting waivers from individuals affected by the income limitations

