

New COBRA Subsidy Requirements

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Earlier this year, President Barack Obama signed into law sweeping economic stimulus legislation known as the American Recovery and Reinvestment Act of 2009 (ARRA). ARRA includes a number of provisions designed to assist unemployed workers and their families, including federally subsidized COBRA¹ premiums.

COBRA Generally

Under COBRA, employees and their spouses and dependent children who participate in certain group health plans and who lose coverage due to certain qualifying events (such as termination of employment, death, or divorce) must be permitted to elect to continue group health plan coverage at favorable group rates. Individuals who lose group health plan coverage are known as “qualified beneficiaries.” Under COBRA, continued coverage must generally be made available for up to 18 months². Group health plans may charge covered employees and their spouses and dependent children the full cost of the COBRA coverage, plus a two percent administrative fee.

New COBRA Subsidy Requirements

Under ARRA, the federal government will subsidize up to 65 percent of the COBRA premiums for certain “assistance eligible individuals” or “AEIs” for up to nine months.

ARRA’s COBRA subsidy provisions impose new requirements on companies sponsoring group health plans and their insurers and administrators, including the obligations to: Temporarily subsidize COBRA premiums for AEIs; Offer “second chance”

COBRA elections to certain AEIs; Notify COBRA qualified beneficiaries of their new COBRA rights; Maintain records related to COBRA subsidies and file reports with the government; and Update HIPAA³ coverage crediting procedures.

The new COBRA requirements became effective immediately upon enactment under. The new requirements apply to group health plans under covered federal COBRA law, the Federal Employees Health Benefits Program (FEHBP) and, in certain respects, under any similar state laws (often referred to as “mini-COBRA” laws).

The new COBRA subsidy requirements are highlighted in the attached Exhibit A: “COBRA Subsidy Basics” chart and are summarized in more detail in this article.

COBRA Subsidy Guidance

The new COBRA subsidy requirements are generally set forth in Section 3001 of ARRA. The Internal Revenue Service (IRS) has issued comprehensive guidance on the new COBRA subsidy requirements in IRS Notice 2009-27 and has published additional guidance on its Web site⁴. The Department of Labor (DOL) has issued model COBRA forms and instructions⁵, and other guidance available on its Web site⁶. The DOL, in conjunction with the Treasury Department and IRS, has also sponsored several Web casts describing the new COBRA subsidy requirements⁷. Additional guidance is also expected to be issued.

Subsidy Eligibility

Assistance Eligible Individuals

The federal COBRA subsidy is available to all assistance eligible individuals. AEIs include employees and their covered spouses and dependent children who:

- Are COBRA qualified beneficiaries as a result of an involuntary termination that occurs between September 1, 2008 and December 31, 2009;

- Lose group health plan coverage resulting in eligibility for COBRA coverage between September 1, 2008 and December 31, 2009; *and*
- Elect COBRA coverage.

IRS Notice 2009-27 makes clear that *both* the involuntary termination *and* the loss of group health plan coverage resulting in eligibility for COBRA coverage must occur during the period from September 1, 2008 through December 31, 2009. This means that:

- If the employee is involuntarily terminated before September 1, 2008 but loses coverage during the period from September 1, 2008 through December 31, 2009, he or she and his or her covered spouse and dependent children are not eligible for the subsidy.
- Similarly, if the employee is involuntarily terminated during the period from September 1, 2008 through December 31, 2009 but loses coverage after December 31, 2009, he or she and his or her covered spouse and dependent children are not eligible for the subsidy.
 - For example, if an employer provides continued health benefits during a severance period that ends after December 31, 2009 and chooses to have COBRA start at the end of the severance period (rather than choosing to have COBRA coverage run concurrently with the severance period), the subsidy requirements do not apply to the employee and his or her covered spouse and dependent children.

Higher Income AEs

The COBRA subsidy must be made available to all AEs. However, higher income AEs are subject to a recapture tax that effectively reduces or eliminates the subsidy. The subsidy is recaptured through an increase in the higher income individual's income tax liability for the year. The subsidy is recaptured completely for AEs who earn more than \$145,000 (single filers) or \$290,000 (joint filers) in the year in which the subsidy is received. The subsidy is phased-out through the recapture tax for AEs with income starting in excess of \$125,000 (single filers) or \$250,000 (joint filers) in the year in which the subsidy is received.

To avoid the recapture tax, higher income AEs may elect to permanently waive their rights to the subsidy. The waiver must be in writing and should be provided to the person providing the COBRA premium reimbursement. Once made, the subsidy waiver is irrevocable and cannot be reversed even if the AE later earns less than the income limits.

Involuntary Terminations

To be eligible for the COBRA subsidy, the COBRA qualified beneficiary must lose group health plan coverage as a result of an "involuntary termination" that occurs between September 1, 2008 and December 31, 2009.

IRS Notice 2009-27 provides guidance on what is considered an involuntary termination for COBRA subsidy purposes. IRS Notice 2009-27 provides that 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."

Examples of what does and does not constitute an involuntary termination for purposes of the COBRA subsidy are set out in Exhibit B: "COBRA Subsidy Involuntary Termination Checklist."

IRS Notice 2009-27 makes clear that an involuntary termination is an involuntary termination of *employment*, not an involuntary termination of *health coverage*. This means that the COBRA subsidy is not available if the loss of coverage is due to other COBRA qualifying events such as a divorce or loss of dependent child status.

Subsidy Amount

The federal government will subsidize up to 65 percent of the COBRA premium paid by or on behalf of the AE. AEs are only required to pay up to 35 percent of the COBRA premium during the COBRA subsidy period.

IRS Notice 2009-27 provides guidance on how to calculate the amount of the COBRA subsidy.

- For purposes of the subsidy, the COBRA premium is the cost that would be charged to the AE for COBRA coverage if the individual were not an AE. If a company charges an individual for the full cost of COBRA plus a two

percent administrative fee, the COBRA subsidy will be based on such cost plus the two percent fee.

- The COBRA subsidy applies only to the amount paid by or on behalf of the AEI. For example, assume the monthly COBRA premium plus two percent administrative fee is \$1,000.
 - If the company requires the AEI to pay the full cost of the \$1,000 premium, the AEI is eligible for a subsidy of \$350 (35 percent of \$1,000) and the employer is eligible for a tax credit of \$650 (65 percent of \$1,000).
 - If the company only requires the AEI to pay \$500 of the \$1,000, the AEI is eligible for a subsidy of \$175 (35% of \$500) and the company will be eligible for a tax credit of \$325 (65% of \$500).
- If a plan that previously charged less than the maximum premium allowed by COBRA increases the premium to the maximum allowed by COBRA, the subsidy applies to the increased premium.

IRS Notice 2009-27 also clarifies how the COBRA subsidy requirements apply when coverage is provided to both AEIs and individuals who are not AEIs (such as domestic partners). If there is no additional cost to providing COBRA coverage to an individual who is not an AEI, the subsidy applies to the entire COBRA premium. If there is an additional cost to providing COBRA coverage to the individual who is not an AEI, the COBRA subsidy applies only to that portion of the premium required to cover the AEIs.

COBRA Subsidy Reimbursement

Group health plan sponsors and insurers must advance the cost of the COBRA subsidy and file a claim for reimbursement from the federal government through a payroll tax credit, generally on IRS Form 941, Employer's Quarterly Tax Return. The 2009 Form 941 has been updated reflect the COBRA subsidy requirement. The credit is claimed on line 12a and the number of individuals receiving COBRA subsidy assistance is reported on line 12b. The company sponsoring the group health plan is generally required to advance the COBRA premium and claim the payroll tax credit. However, in the case of an insured plan subject to state law

or multiemployer plan, the insurer or multiemployer plan is required to advance the COBRA premium and claim the payroll tax credit.

Coverage Eligible for COBRA Subsidy

The COBRA subsidy applies to most group health plans. IRS Notice 2009-27 provides that the COBRA subsidy applies to vision-only and dental-only plans, but does not apply to flexible spending arrangements (FSAs) offered under cafeteria plans. The subsidy is also available for health reimbursement arrangements (HRAs). The subsidy also applies to retiree health plans that provide the same coverage to similarly situated active employees (even if a higher premium is charged to retirees).

COBRA Subsidy Period

The subsidy coverage period begins on the first day of the first COBRA premium period beginning after February 17, 2009 (March 1st for most plans).

The COBRA subsidy period ends on the earliest of (a) the first date the AEI is eligible for coverage under another group health plan or Medicare coverage, (b) the date that is nine months after the first day of the first month in which the COBRA subsidy applies to the AEI, and (c) the date the AEI is no longer eligible for COBRA coverage. Coverage may end sooner if the AEI fails to pay the COBRA premium on time.

Individuals who become eligible for coverage under another group health plan or Medicare are obligated to notify the current group health plan in writing of such eligibility. An individual who fails to provide this required notice and improperly receives the COBRA subsidy will be subject to a tax penalty of 110 percent of the amount of subsidies improperly received (unless the failure to notify is due to reasonable cause).

The maximum COBRA subsidy period is nine months.

IRS Notice 2009-27 makes clear that:

- If an AEI is eligible for other group health plan coverage but chooses not to enroll in such other group health plan coverage, the subsidy does not apply.

- The COBRA subsidy is available after December 31, 2009 for individuals who qualify as AEIs before December 31, 2009. For example, an employee who is involuntarily terminated and loses group health plan coverage on September 1, 2009 could receive a COBRA subsidy until May 31, 2010.
- An AEI is eligible for up to nine months of COBRA subsidy for *each* involuntary termination.

“Second Chance” Elections

The new COBRA provisions require companies to offer “second chance” COBRA elections to AEIs who lost coverage due to an involuntary termination during the period from September 1, 2008 through February 17, 2009. Notice of the second chance election rights was due by April 18, 2009. An AEI has 60 days from the date he or she receives notice of the second chance election to elect second chance COBRA coverage. If elected, second chance COBRA coverage begins with the first period of COBRA continuation beginning on or after February 17, 2009 (March 1, 2009 for most plans).

Under COBRA, plans must give COBRA qualified beneficiaries 45 days to make the first COBRA premium payment. The same 45-day grace period applies to COBRA premiums made under second chance elections.

The right to make a second chance election is generally available only to group health plans that are subject to COBRA or the temporary continuation coverage requirements of FEHBP. It does not apply to plans subject only to state “mini-COBRA” laws, unless the state law provides for such second chance elections.

Lower Cost Coverage Options

Under COBRA, companies are generally required to offer employees only the right to continue the same coverage the employee had in effect immediately before the COBRA qualifying event. ARRA permits companies to offer AEIs the choice to enroll in or change their coverage to lower cost options. If a company does offer lower cost options, AEIs must choose whether to elect such lower cost options within 90 days of receiving notice of the new options. In deciding whether to offer lower cost options to AEIs, companies should weigh the savings

achieved by offering the options against the added administrative requirements in offering the options.

COBRA Notice Requirements

Notice of the new COBRA rights must be provided to COBRA qualified beneficiaries. In March 2009, the DOL issued four model COBRA notices and instructions for providing such notices. The notices were required to be provided as soon as possible and, in the case of second election notices, *no later than* April 18, 2009. A company is not required to use the model COBRA notices and may instead develop its own COBRA notices or revise the model notices to reflect the specific provisions of the company’s group health plan. These notices are on the DOL Web site⁸ and are summarized in Exhibit C: “COBRA Notices.”

COBRA Reporting Requirements

To claim the credit, the company, insurer or multiemployer plan must maintain supporting documentation including: The dates and amounts of each AEI’s COBRA premium and subsidy payments; Proof of each AEI’s eligibility for the subsidy; Each AEI’s taxpayer identification number; and Whether the premium was for individual or family coverage.

HIPAA Requirements

Generally, under HIPAA, a plan is not required to take into account creditable coverage prior to a break in coverage of 63 days or more for purposes of determining pre-existing condition exclusions. However, for AEIs making second chance elections under ARRA, the break in coverage between the date of the AEI’s initial COBRA qualifying event and the first date of coverage is not considered to be a break in coverage under HIPAA’s creditable coverage and pre-existing condition rules.

Expedited Review of COBRA Subsidy Denials

Individuals who apply for and are denied the COBRA subsidy may request an expedited review of the denial. The Department of Labor will decide appeals from participants in group health plans subject to COBRA. The Department of Health and Human Services will decide appeals for federal, state and local government employees and from group health insurance coverage provided pursuant to applicable state laws. Both Departments are

required to issue a determination on appeal within 15 business days from receiving the completed application for review. The DOL has stated informally that plan sponsors will be given notice of and the opportunity to respond to a request for a review within the 15-day period.

An online application for review of a subsidy denial is available on the DOL Web site, with accompanying guidance on the appeals process (available in both English and Spanish).

CONCLUSION

ARRA’s new COBRA subsidy requirements impose new obligations on companies sponsoring group health plans and their insurers and administrators. These new requirements are effective immediately and require coordination among internal human resources, benefits, IT, payroll, accounting and legal departments as well as insurers, third-party administrators, and other outside consultants. A sample COBRA Subsidy Action Plan is attached as Exhibit D. Companies should, if they have not already, develop an action plan to comply with the new COBRA subsidy requirements.

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¹ The Consolidated Omnibus Budget Reconciliation Act of 1985, as amended.
² COBRA coverage is generally available for up to 29 months in the case of qualifying disabilities and for up to 36 months in the case of death, divorce and certain other qualifying events.
³ The Health Insurance Portability and Accountability Act of 1996, as amended.
⁴ See <http://www.irs.gov/newsroom/article/0,,id=204505,00.html>.
⁵ See <http://www.dol.gov/ebsa/COBRA/modelnotice.html>.
⁶ See www.dol.gov/cobra.
⁷ Available at www.dol.gov/cobra
⁸ See <http://www.dd.gov/ebsa/COBRA/modelnotice.html>.

EXHIBIT A: COBRA SUBSIDY BASICS	
Assistance Eligible Individuals (AEIs)	<p>Covered employees and their spouses or dependent children who:</p> <ul style="list-style-type: none"> • Are COBRA qualified beneficiaries as a result of an involuntary termination that occurs between September 1, 2008 and December 31, 2009; • Lose group health plan coverage resulting in COBRA eligibility between September 1, 2008 and December 31, 2009; and • Elect COBRA coverage.
Subsidy Amount	<ul style="list-style-type: none"> • AEIs are only required to pay up to 35 percent of the COBRA premium during the subsidy period. • The federal government will subsidize 65 percent of the COBRA premium not paid by or on behalf of the AEI. • No subsidy is provided if the company pays the full cost of the AEI’s COBRA premium. • If the company pays part of the cost of the AEI’s COBRA premium, the subsidy is reduced proportionately.
Subsidy Reimbursement	Companies must advance the cost of the subsidy and seek reimbursement in the form of a payroll tax credit on IRS Form 941.
Subsidy Recapture	<ul style="list-style-type: none"> • The subsidy is recaptured through a tax increase for individuals who earn more than \$145,000 (single filers) or \$290,000 (joint filers) in the year in which the subsidy is received.

	<ul style="list-style-type: none"> The recapture tax is phased-in for incomes starting at \$125,000 (single filers) and \$250,000 (joint filers).
Subsidy Waivers	AEIs subject to the recapture tax may permanently elect to waive their rights to the subsidy.
Grace Period	For the first two COBRA premium periods beginning after February 17, 2009 (March and April 2009 for most plans), companies may require AEIs to pay the full COBRA premium as long as the AEIs are reimbursed or receive credit toward future COBRA premium payments.
Subsidy Begins	With the first COBRA premium period after February 17, 2009 (March 1, 2009 for most plans).
Subsidy Ends	On the earlier of: <ul style="list-style-type: none"> Nine months from the date it begins; The end of the maximum COBRA period (generally 18 months); for AEIs who elect “second chance” COBRA coverage, the maximum COBRA period runs from the date of the original qualifying event; The date the AEI fails to pay the required portion of his or her COBRA premium; or The first date the AEI becomes eligible for coverage under another group health plan or Medicare.
Penalty for Failure to Provide Notice of Eligibility for Other Coverage	<ul style="list-style-type: none"> An AEI who fails to provide notice of eligibility under another group health plan or Medicare and improperly receives the premium subsidy may be subject to a tax penalty of 110 percent of the subsidy amount.
Maximum Subsidy Period	Nine Months
Second Chance Elections	<ul style="list-style-type: none"> AEIs who lost coverage between September 1, 2008 and February 17, 2009 and who either (a) declined or (b) elected and then terminated COBRA coverage must be given a “second chance” to elect COBRA at the new subsidized rates. AEIs have 60 days from the date of such notice to elect second chance coverage. If elected, second chance coverage is retroactive to the first COBRA period beginning on or after February 17, 2009 (March 1, 2009 for most plans).
Lower Cost Enrollment Options	Companies and insurers may permit AEIs to change their COBRA elections to lower cost enrollment options; this provision is optional.
COBRA Notices	Companies and insurers must notify COBRA qualified beneficiaries of the new COBRA subsidy requirements (see “COBRA Notices” Chart).
COBRA Reporting	Companies and insurers will be required to maintain and possibly file with the Treasury Department documentation supporting the COBRA subsidy, including: <ul style="list-style-type: none"> The dates and amounts of premium payment and subsidy reimbursement for each AEI; An attestation of involuntary termination of employment for each AEI who receives a subsidy; A taxpayer identification number for each AEI; and Whether the subsidy is for individual or family coverage.
Expedited Review of Denials	<ul style="list-style-type: none"> Individuals who apply for and are denied the COBRA subsidy may appeal to the DOL (or other appropriate government agency). The DOL (or other appropriate government agency) will review and decide the appeal within 15 business days. Companies and insurers will be given notice of and the opportunity to respond to the appeal within the 15-day period.

EXHIBIT B: COBRA SUBSIDY INVOLUNTARY TERMINATIONS CHECKLIST

Includes Termination of Employment Due To	Does <i>Not</i> Include Termination of Employment Due To
<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Failure to renew a contract, if the employee is willing to execute a contract on similar terms and continue to work <input checked="" type="checkbox"/> “Good reason” due to employer action that causes a material negative change in the employment relationship <input checked="" type="checkbox"/> Reduction to zero hours, such as a layoff, furlough or other suspension of employment resulting in loss of health coverage <input checked="" type="checkbox"/> Reduction in hours other than to zero if the employee quits due to such reduction and the reduction is a material negative change in the employment relationship <input checked="" type="checkbox"/> Retirement, if the employer would have terminated the employee’s employment and the employee knew of the pending termination <input checked="" type="checkbox"/> Cause (note that if the employee is terminated for “gross misconduct” the employee and his or her spouse and dependent children are not eligible for COBRA) <input checked="" type="checkbox"/> Illness or disability (a mere <i>absence</i> from work due to illness or disability is not an involuntary termination) <input checked="" type="checkbox"/> Resignation due to a material change in the employee’s geographic work location <input checked="" type="checkbox"/> Employer-initiated lock-out <input checked="" type="checkbox"/> Employer-initiated “buy-out” where the employer indicates that after the buy-out offer period, a certain number of employees may be terminated <input checked="" type="checkbox"/> Call to active military duty (informally noted in DOL’s April 6, 2009 Second COBRA Compliance Assistance Web cast) 	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Death of the employee <input checked="" type="checkbox"/> Reduction in hours other than to zero (except as noted) <input checked="" type="checkbox"/> Retirement (except as noted) <input checked="" type="checkbox"/> Employee or employee-representative initiated work stoppage

EXHIBIT C: COBRA NOTICES

Notice	Send To	Comments
General Notice (Full Version)	<i>All qualified beneficiaries (not just AEs) who experience a qualifying event at any time from September 1, 2008 through December 31, 2009, regardless of the qualifying event</i>	This full version includes information on the premium subsidy as well as information required in the COBRA election notice
General Notice (Abbreviated Version)	AEs who experienced a qualifying event on or after September 1, 2008 and who have elected and still have COBRA coverage	This is a shortened version of the General Notice -- it contains the same information as the full version regarding availability of the COBRA premium and new COBRA rights, but does not include COBRA election coverage information
Alternative Notice	Insured group health plan participants who become eligible for continuation of coverage under state law	This notice is for insurance companies who provide group insurance coverage under applicable state law
Extended Election Period Notice	<p>AEs (or any individual who would be an AE if a COBRA continuation election were in effect) who:</p> <ul style="list-style-type: none"> Had a qualifying event at any time from September 1, 2008 through February 16, 2009, <i>and</i> Either did not elect COBRA continuation coverage or who elected COBRA continuation coverage but subsequently discontinued COBRA coverage 	<p>This notice provides information on the additional election opportunities under ARRA, as well as premium subsidy information</p> <p>This notice is due by April 18, 2008</p>

EXHIBIT D: COBRA ACTION CHECKLIST

Action	Deadline*
1. Develop company-specific COBRA action plan <ul style="list-style-type: none"> • Work with internal HR, benefits, IT, payroll, tax, accounting and legal departments as well as insurers, third-party administrators and other outside consultants 	As soon as possible
2. Identify current AEIs <ul style="list-style-type: none"> • See “COBRA Subsidy Basics” chart 	As soon as possible
3. Decide whether to offer lower cost enrollment options for AEIs	As soon as possible
4. Decide how to structure COBRA premium payments and subsidy advances and whether to use two month grace period	As soon as possible
5. Prepare COBRA notices and election forms <ul style="list-style-type: none"> • Consider using model COBRA notices and tailoring them specifically to the company’s group health plan requirements 	As soon as possible
6. Prepare subsidy waiver form for employees who wish to waive the subsidy	As soon as possible
7. Notify participants of new COBRA rights including subsidy, second chance enrollments and any lower cost enrollment options	April 18, 2009 for notices of “second chance” elections; as soon as possible for all other notices
8. Update procedures for crediting coverage for purposes of HIPAA	As soon as possible
9. Develop internal procedures to maintain records and file documents with the Treasury Department	As soon as possible
10. Develop procedures to address any COBRA subsidy appeals submitted by individuals	As soon as possible
* The COBRA subsidy requirements became effective on February 17, 2009. Compliance with the new subsidy obligations is required immediately.	