K&L GATES

Compensation and Benefits Alert

February 2009

www.klgates.com


**Author:**

**Stacy H. Barrow**
stacy.barrow@klgates.com
+1.617.951.9178

**Other Contacts:**

**Amy W. Limeres**
amy.limeres@klgates.com
+1.907.777.7603

**Mary Turk-Meena**
mary.turk-meena@klgates.com
+1.704.331.7590

**Emily D. Zimmer**
emily.zimmer@klgates.com
+1.704.331.7405



K&L Gates comprises approximately 1,700 lawyers in 29 offices located in North America, Europe and Asia, and represents capital markets participants, entrepreneurs, growth and middle market companies, leading FORTUNE 100 and FTSE 100 global corporations and public sector entities. For more information, please visit www.klgates.com.


# President's Economic Stimulus Plan Provides Subsidized COBRA Coverage

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (Act), which is also known as the "economic stimulus plan." The Act contains a broad package of federal spending and tax cuts designed to create jobs and reinvigorate the economy. From an employee benefits perspective, one of the more notable provisions of the Act is the availability of a federal subsidy, for up to nine months, of 65% of the cost of COBRA continuation coverage for employees (and their spouses and/or dependents) who lose group health insurance coverage between September 1, 2008 and December 31, 2009 due to the employee's involuntary termination of employment. These provisions are immediately effective and require prompt employer action to comply.

Although the subsidy seems straightforward, compliance will require attention to many details often handled by multiple parties. To comply, employers will need to coordinate with COBRA and payroll vendors, provide an additional notice and respond to new government reporting requirements. It is expected that compliance with the Act's COBRA provisions will be closely scrutinized by the Department of Labor (DOL), as the DOL has established an expedited time frame for reviewing any subsidy-related complaints.

## Premium Subsidy

The premium subsidy applies to continuation coverage provided under federal COBRA law as well as state insurance law (which is sometimes referred to as "mini-COBRA" and generally pertains to small, fully insured groups that are not otherwise subject to federal COBRA). The subsidy applies to all group health plans subject to COBRA (e.g., medical, dental and vision), other than a health care flexible spending arrangement (health FSA). To be eligible for the subsidy, which applies to COBRA premiums for employees as well as their spouses and/or dependents, group health plan coverage must be lost between September 1, 2008 and December 31, 2009 due to the employee's involuntary termination of employment, which does not include termination by reason of "gross misconduct" (these individuals are referred to as "assistance eligible individuals," or AEIs). Note that while individuals eligible for the subsidy must have lost coverage between September 1, 2008 and December 31, 2009 due to involuntary termination of employment, the subsidy is only available for periods of coverage starting March 1, 2009.

The premium subsidy covers 65% of the cost of COBRA coverage elected by the AEI, which includes family tier coverage, if applicable, as well as the 2% COBRA administration fee.

The AEI is responsible for the remaining 35% of the COBRA premium. If the employer does not charge the full 102% cost to COBRA-eligible individuals, the premium subsidy applies to the premium actually charged to, and paid by, the individual (or an entity other than the employer).

The premium subsidy, and COBRA in general, does not apply to domestic partners, same-sex spouses and/or their dependents unless they meet the IRS definition of dependent.

Because of the availability of the subsidy, employers should expect increased elections of COBRA coverage. This is likely to lead to additional costs for affected group health plans because claims of COBRA participants often exceed the COBRA premium charged.

## Recovering The Premium Subsidy

Employers maintaining fully insured or self-insured group health plans subject to federal COBRA will initially bear the cost of the subsidy. These employers may recoup the amount of their subsidy payments from the federal government by reducing their payroll tax liability. The Treasury Department will provide further guidance on the methodology for recouping subsidy payments through reduction of payroll taxes.

In the case of a group health plan that is a "multiemployer plan," the plan will be entitled to reimbursement for the cost of the premium subsidy. Because these plans pay little or no payroll taxes, the subsidy reimbursement will be in the form of a credit or refund check from the government. For plans not subject to federal COBRA, the insurer providing the coverage will be entitled to the reimbursement for the cost of the premium subsidy.

## Duration Of The Premium Subsidy

The subsidy is available for a maximum of nine months, but may terminate earlier if the AEI reaches his or her maximum COBRA duration (which includes possible early termination of COBRA) or becomes eligible for coverage under another group health plan or Medicare. For the purpose of determining the subsidy duration, an individual will not be considered eligible for other group health plan coverage until any waiting period for the coverage is met. It is important to note that the subsidy may end prior to the expiration of COBRA because, for example, the subsidy generally ends upon eligibility for other coverage, but COBRA coverage ends upon actual enrollment in other coverage. For these purposes, other group health plan coverage does not include coverage consisting only of dental, vision, counseling or referral services such as an employee assistance plan, or coverage under a health FSA or health care reimbursement arrangement (HRA).

AEIs are obligated to notify their former employer, in writing, upon becoming eligible for another group health plan or Medicare. Simply ceasing to pay COBRA premiums is not sufficient notice under the Act, though it should be noted that the only penalty the employee would be subject to for failure to notify his or her former employer is 110% of any improperly paid subsidy amount. Presumably, an employee ceasing to pay COBRA premiums would not receive a subsidy for that period of coverage and there would be no improperly paid amount.

## Premium Subsidy Unavailable For Certain High Earners

The amount of the subsidy is reduced for an individual with a modified adjusted gross income (MAGI) in excess of $125,000 ($250,000 for joint returns) for the taxable year in which he or she receives the subsidy, and phases out entirely for an individual whose MAGI exceeds $145,000 ($290,000 for joint returns) in that taxable year. In the event an individual is ultimately ineligible for the subsidy due to the income limitation, his or her federal income tax liability will be increased by the amount of any ineligible COBRA subsidy payments made during that taxable year. Consequently, employers will not be responsible for determining whether an individual's income will cause him or her to be ineligible for the subsidy. Alternatively, high-earning AEIs may avoid this potential tax liability altogether by making an election to permanently waive subsidy eligibility (further guidance on the rules regarding the waiver will be forthcoming).

## New Notice And Reporting Requirements

The Act requires administrators of group health plans to provide additional information to AEIs via the plan's COBRA election notice within 60 days of enactment. Administrators may choose to revise their current notices or include the new information as a separate notice. All AEIs must receive the notice (i.e., those individuals who lose group health plan coverage between September 1, 2008 and December 31, 2009), which must include, for example, a description of the premium assistance available as well as the special 60-day election period described below. The Act provides that model notices will be made available by the DOL by March 19, 2009.

Employers may be required to file certain reports with the IRS relating to the subsidy, which may include the employer's attestation that each employee receiving the subsidy was involuntarily terminated, whether the subsidy relates to one, or more, individuals and an accounting of payroll tax credits taken (including an estimate of credits to be taken in the following reporting period). Further guidance on this aspect may be forthcoming from the Treasury Department.

## Special 60-Day Election Period

The Act provides a special 60-day election period for those individuals whose loss of coverage due to involuntary termination of employment occurred on or after September 1, 2008 and who are otherwise eligible for a subsidy. This special election period must be offered to AEIs who originally declined COBRA continuation coverage as well as those who elected and subsequently terminated COBRA coverage. The 60-day period for an AEI to elect COBRA coverage commences on the date the individual receives the notice described in the section above. COBRA continuation coverage elected during this period will be effective as of March 1, 2009, so employers should not delay in sending the notice. However, the maximum COBRA duration for individuals electing COBRA coverage during this special election period will still be measured from the date of the original loss of coverage due to involuntary termination of employment.

The Act also provides that in the event an AEI elects COBRA coverage during the special 60-day election period, the period of time beginning with the loss of coverage due to involuntary termination of employment and ending on March 1, 2009 will not be counted as a break in coverage for purposes of the 63-day creditable coverage rule under the Health Insurance Portability and Accountability Act of 1996 (HIPAA). This federal law prohibits group health plans from imposing a pre-existing condition limitation unless the individual has had a greater than 63-day gap in "creditable coverage."

## Action Items For Employers

- Identify individuals who are eligible for premium subsidy assistance and whether any are currently enrolled in COBRA continuation coverage
- Consider permitting high-earning employees to permanently waive the subsidy, should it become available to them
- Review severance policies and individual severance agreements providing for COBRA coverage to determine if any special provisions apply (such as a subsidy not generally provided to other group health plan participants)
- Develop processes to implement the premium subsidy by May 1, 2009 as required by the Act and determine how to apply any excess COBRA premiums paid since March 1, 2009
- Closely track the maximum COBRA duration as well as the maximum premium subsidy period, as the two will likely not match
- Coordinate with payroll and/or COBRA vendors to determine their level of preparedness and the extent to which they can assist with tracking and notice requirements
- Review any stop-loss policy associated with a self-insured group health plan to confirm that AEIs will be covered
- Develop and send required notices as soon as possible to avoid delaying elections

We expect further guidance to follow in the coming weeks and months and will keep our friends and clients informed. In the meantime, if there are any questions, please contact the individuals listed at the top of this article, or the K&L Gates lawyer with whom you work.

K&L Gates comprises multiple affiliated partnerships: a limited liability partnership with the full name K&L Gates LLP qualified in Delaware and maintaining offices throughout the U.S., in Berlin and Frankfurt, Germany, in Beijing (K&L Gates LLP Beijing Representative Office), and in Shanghai (K&L Gates LLP Shanghai Representative Office); a limited liability partnership (also named K&L Gates LLP) incorporated in England and maintaining our London and Paris offices; a Taiwan general partnership (K&L Gates) which practices from our Taipei office; and a Hong Kong general partnership (K&L Gates, Solicitors) which practices from our Hong Kong office. K&L Gates maintains appropriate registrations in the jurisdictions in which its offices are located. A list of the partners in each entity is available for inspection at any K&L Gates office.

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2009 K&L Gates LLP. All Rights Reserved.