

EMPLOYEE BENEFITS UPDATE

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New Legislation Implementing COBRA Premium Subsidy Requires Group Health Plan Sponsors to Take Immediate Action

On February 17, President Obama signed into law the American Recovery and Reinvestment Act (the "Act") of 2009, which includes significant changes to the Consolidated Omnibus Reconciliation Act of 1985 ("COBRA"). The Act provides for a 65% federal subsidy of COBRA premiums for involuntarily terminated employees (and their families) for up to nine months and is effective for periods of coverage beginning on or after February 17, 2009.

Employers that maintain group health plans that are subject to federal COBRA laws, insurers providing coverage to small insured plans subject to state mini-COBRA statutes, and multi-employer group health plans must act now to comply with the new law. Significant provisions from the Act, as they apply to employers who sponsor group health plans subject to COBRA, are highlighted below. A list of suggested action items can be found at the end of this summary.

What Group Health Plans Are Affected?

The COBRA premium subsidy applies to all group health plans, other than health flexible spending arrangements. The requirements

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apply not only to group health plans subject to COBRA, but to group health plans that are subject to comparable state continuation coverage laws (e.g., small employer plans). Not all state continuation coverage laws are necessarily considered comparable. According to the Act's legislative history, to be comparable the continuation right generally must be for coverage that is substantially similar to the coverage that is lost at a monthly cost, which is based on a specific percentage of plan's cost of providing such coverage.

Who is Eligible for the COBRA Subsidy?

"Assistance eligible individuals" are eligible for the COBRA subsidy. An "assistance eligible individual" is defined as any COBRA qualified beneficiary who loses group health plan coverage as the result of the employee's involuntary termination of employment on or after September 1, 2008 and before January 1, 2010. It is important to keep in mind that the COBRA subsidy is available not only to covered employees, but their covered spouses and dependent children as well.

Unfortunately, the Act does not define "involuntary termination," which leaves employers with some unanswered questions. The COBRA subsidy was intended to provide assistance to employees (and their families) who lose their jobs as a result of layoffs or downsizing. However, it is not clear whether the COBRA subsidy is also available to employees who participate in an early retirement program and whether it matters if the early retirement program is followed by mandatory layoffs. While the spirit of the Act would suggest that such individuals should be eligible for the COBRA subsidy, the Act, itself, does not appear

to extend the COBRA subsidy under such circumstances because the employees would have voluntarily terminated their employment by participating in the early retirement program.

The COBRA subsidy is not available if an employee is terminated for gross misconduct which does not generally qualify for COBRA continuation coverage. However, the COBRA subsidy would be available if the employee was terminated for poor performance, as long as it does not rise to the level of gross misconduct. It is not clear how to treat an employee who is given the opportunity to resign rather than be fired for cause, or an employee who fails to return from a leave of absence.

Unfortunately, it is not clear what is the most conservative approach to take in determining whether an employee has been involuntarily terminated. The Departments of Labor, Health and Human Services, and Treasury are aware of the issue and have informally suggested that employers look to state unemployment insurance laws for guidance. Some benefits practitioners have suggested that if the circumstances surrounding a termination are ambiguous, plan sponsors should deny the COBRA subsidy on grounds that the termination was voluntary and let the affected individual appeal the decision to the Department of Labor (or the Department of Health and Human Services for plans subject to state mini-COBRA statutes) which has been given authority to review denials of COBRA premium assistance. Presumably, if the Department determines that the termination was involuntary, plan sponsors will be given an opportunity to comply with the decision and a violation of COBRA will not be asserted, however, additional guidance on this issue

would be appreciated. Others have suggested that when a plan sponsor has made a good faith determination that an employee's termination is involuntary (and retains its attestation of such determination, which is required for the employment tax credit further described below), it would appear to be unlikely that the IRS would reach a contrary finding and challenge the payroll tax credit taken by the plan sponsor.

Those who are eligible for Medicare or for other group health plan coverage (such as a group health plan sponsored by a spouse's employer) are also ineligible for the COBRA premium reduction. See "Duration of the COBRA Premium Subsidy" for further information concerning what is considered "other group health plan coverage."

Are Plan Sponsors Responsible for Applying the Subsidy Phase Out that Applies to High Income Individuals?

In general, the COBRA subsidy is not included in individual income. However, the COBRA subsidy is phased out if a taxpayer's modified adjusted gross income exceeds \$125,000 (\$250,000 for joint filers) and is completely unavailable if a taxpayer's modified adjusted gross income exceeds \$145,000 (\$290,000 if filing jointly). The taxpayer, not the plan sponsor, is responsible for repaying all or a portion of the subsidy depending on the taxpayer's adjusted gross income. The amount that must be repaid, if any, is determined when the taxpayer calculates his or her income tax liability for the year.

High-income individuals may make an election to waive the right to the COBRA subsidy provided under the Act. The election is irrevocable and applies even if the COBRA

subsidy spans both the 2009 and 2010 tax years. While plan sponsors may not be responsible for determining if an assistance eligible individual's adjusted gross income exceeds the threshold amount, they should provide assistance eligible employees with an opportunity to waive the COBRA subsidy.

When is the COBRA Subsidy Available?

The changes to COBRA are effective the date the Act was enacted (i.e., February 17, 2009) and the subsidy is available for "periods of coverage" beginning on or after February 17, 2009. A "period of coverage" is the monthly (or shorter) period for which COBRA premiums are charged. If a plan sponsor uses calendar months as the period of coverage, the subsidy applies beginning March 1, 2009. However, certain transition rules apply as described in greater detail below (see "Providing the COBRA Subsidy to Newly Eligible Individuals," "Providing the COBRA Subsidy to Assistance Eligible Individuals Who Previously Elected COBRA Coverage," and "Special COBRA Election Period for Involuntary Terminations on or After September 1, 2008 and Before February 17, 2009").

Providing the COBRA Subsidy to Newly Eligible Individuals

Individuals who elect COBRA coverage because coverage is lost as a result of an employee's involuntary termination of employment that occurs on or after February 17, 2009 are entitled to the COBRA premium reduction. It is not clear if plan sponsors should automatically reduce COBRA premiums for these individuals or provide them with an opportunity to apply for the reduced premium at the time of their

COBRA election. Because assistance eligible individuals who are eligible for Medicare or other group health plan coverage are not eligible for the COBRA premium reduction, requiring an individual to apply for the reduced COBRA premium and certify that he or she is not otherwise eligible for Medicare or other group health plan coverage seems appropriate. The Department of Labor is required to issue model notices on or before March 19, 2009 that will hopefully address this issue.

Plan sponsors who are able to implement the changes required by the Act can do so immediately. However, because of the short time frame, it may take some time for plan sponsors to incorporate the changes in their COBRA administration and revise their COBRA election notices. Therefore, the Act allows plan sponsors to continue their current COBRA practices, including charging assistance eligible individuals the unreduced COBRA premium, for the first two periods of coverage to which the COBRA subsidy applies (*e.g.*, March and April if the plan uses calendar months as the period of coverage) as long as the plan sponsor reimburses assistance eligible individuals the amount of the overpayment within 60 days of such payment or provides a future credit against COBRA premiums if it is reasonable to believe that the credit will be used within 180 days of the overpayment.

It is not clear if assistance eligible individuals who have not been notified of the availability of the reduced COBRA premium (*i.e.*, because the plan sponsor has not yet updated its COBRA election notice) and fail to elect COBRA coverage during this interim period are entitled to the special election described below.

Providing the COBRA Subsidy to Assistance Eligible Individuals Who Previously Elected COBRA Coverage

Individuals who were eligible for COBRA coverage because of an employee's involuntary termination of employment that occurred on or after September 1, 2008 and before February 17, 2009 and who *elected COBRA coverage* are entitled to the reduced COBRA premium effective for periods of coverage beginning on or after February 17, 2009. For most plans, the reduced premium will be available March 1, 2009. The Act does not allow for the retroactive reduction in COBRA premiums. As explained in "Providing the COBRA Subsidy to Newly Eligible Individuals," plan sponsors can continue to charge the full premium for the first two periods of coverage following the enactment of the Act (*e.g.*, March and April) as long as the plan sponsor subsequently reimburses assistance eligible individuals within 60 days of such payment or provides a future credit against COBRA premiums if it is reasonable to believe that the credit will be used within 180 days of the overpayment.

As mentioned above, it is not clear if plan sponsors should automatically reduce COBRA premiums for these individuals or provide them with an opportunity to apply for the reduced premium and confirm that they are not eligible for Medicare or other group health plan coverage. The Department of Labor is required to issue model notices on or before March 19, 2009 that will hopefully address this issue.

Special COBRA Election Period for Involuntary Terminations on or After September 1, 2008 and Before February 17, 2009

Individuals who were eligible for COBRA coverage because of an employee's involuntary termination of employment that occurred on or after September 1, 2008 and before February 17, 2009 and who *failed to elect COBRA (or who elected COBRA coverage, but whose coverage has since lapsed)* must be provided a second opportunity to elect COBRA coverage. Plan sponsors must provide notice of this special election period within 60 days of February 17, 2009 (*i.e., April 1, 2009*). Assistance eligible individuals will have 60 days from the date the notice is provided to elect COBRA. If an assistance eligible individual elects coverage during this special election period, COBRA coverage will commence with the first period of coverage beginning after February 17, 2009 (generally March 1, 2009) and will not extend beyond the period of COBRA coverage that would have been required if COBRA had been initially elected. In other words, COBRA coverage will not be retroactive and the maximum COBRA coverage period will still be measured from the employee's termination date.

Optional Enrollment Rights

COBRA requires that qualified beneficiaries be provided with the opportunity to continue the coverage they had prior to the loss of coverage. Qualified beneficiaries must also be provided with the same rights as similarly situated individuals, including the right to change coverage options during annual enrollment.

The Act permits, but does not require, group health plans to provide a special enrollment right to assistance eligible individuals allowing them to change coverage options under the group health plan in conjunction with electing COBRA continuation coverage. Individuals may only elect different coverage if:

- The plan sponsor has decided to allow for coverage changes under such circumstances;
- The premium for the different coverage does not exceed the premium for coverage in which the assistance eligible individual was enrolled at the time the involuntary termination occurred;
- The different coverage is not coverage that provides only dental, vision, counseling or referral services, a flexible spending arrangement, or an on-site medical facility maintained by an employer that consists primarily of first-aid services, prevention and wellness care, or similar care.

If optional enrollment rights are provided, assistance eligible individuals must be provided with a 90-day election period to elect COBRA and change coverage options (rather than a 60-day election period to elect COBRA for the existing coverage option).

How to Calculate the COBRA Premium Subsidy

An assistance eligible individual must be treated as if he or she has paid the full premium required for COBRA continuation coverage if the individual has paid 35% of the premium.

The amount the assistance eligible individuals pays (and the 65% subsidy reimbursed by

the federal government) is calculated based on the amount the assistance eligible individual would otherwise be required to pay for COBRA continuation coverage, which includes the 2% surcharge. For example, if the monthly premium for single employee medical coverage is \$350 and a plan sponsor charges \$357 (i.e., 102% of the applicable premium), the assistance eligible individual would pay \$124.95 (i.e., 35% of \$357) and the plan sponsor would receive a payroll offset of \$232.05 (i.e., 65% of \$357).

If a plan sponsor does not charge the full premium, the calculations are based on the amount actually charged to the assistance eligible individual. For example, if as part of a severance agreement, a plan sponsor has agreed to pay \$200 toward the cost of single employee COBRA coverage, the assistance eligible individual would only have to pay \$54.95 (i.e., 35% of \$157) and the plan sponsor would receive a payroll offset of \$102.05 (i.e., 65% of \$157). Employers structuring severance programs should consider the impact any continued employer contributions toward the cost of COBRA coverage will have on the COBRA subsidy.

How are Employers Reimbursed for the COBRA Subsidy?

Reimbursement of 65% of the COBRA premium is provided in the form of a payroll tax credit and is payable to:

- The employer maintaining the group health plan that is subject to federal COBRA laws or that is self-insured;
- The insurer providing coverage to small insured plans subject to state mini-COBRA statutes; or
- A multi-employer group health plan (for multi-employer plans).

Employers may recover the 65% subsidy by taking the subsidy amount as a credit on its quarterly employment tax return (i.e., Form 941). The employer can take the credit only after it has received the 35% premium from the assistance eligible individual, regardless as to whether the employer prepays the amount due to the insurance carrier.

No additional information has to be submitted with Form 941, however, employers must maintain documentation supporting the credit claimed. The IRS recently issued guidance at <http://www.irs.gov/newsroom/article/0,,id=204505,00.html> that identifies some of the documentation that must be maintained.

If the payroll tax credits do not cover the subsidy repayment owed, the Secretary of Treasury will credit or refund the difference.

Duration of the COBRA Premium Subsidy

The COBRA subsidy is available for nine months, but will terminate early under any one the following conditions:

- The end of the maximum coverage period required under COBRA or applicable state law; or
- The assistance eligible individual becomes eligible for Medicare or coverage under another group health plan (other than coverage consisting of only dental, vision, counseling or referral services (or a combination thereof), health flexible spending arrangement, health reimbursement arrangement, or treatment provided by on-site

medical facilities that consist primarily of first-aid services, prevention and wellness care, or similar care).

It is important to note that an assistance eligible individual will lose the COBRA premium subsidy when he or she becomes eligible for Medicare or other group health plan coverage, regardless as to whether the individual actually enrolls in such other coverage. Individuals that fail to notify the group health plan when they are no longer eligible for the reduced COBRA premium face monetary penalties.

Notice Requirements

Revised COBRA Election Notice - Employers will need to revise their COBRA election notice (or draft an addendum to their existing COBRA election notice) to include additional information concerning the availability of the premium reduction to assistance eligible individuals. The revised COBRA election notice must be provided to all individuals who have a COBRA qualifying event during the period from September 1, 2008 through December 31, 2009, and not just those who become eligible for COBRA coverage because of an employee's involuntary termination of employment, so that all qualified beneficiaries are apprised of their potential rights under the Act.

If a qualified beneficiary requests the reduced COBRA premium and the plan sponsor determines that a qualified beneficiary is not entitled to the COBRA subsidy (*e.g.*, because the employee's termination was voluntary) the qualified beneficiary can appeal the decision to the Department of Labor (or the Department of Health and Human Services with respect to state mini-COBRA coverage). The Department of

Labor (or the Department of Health and Human Services) must make a determination within 15 business days after receipt of the application.

Special Election Notice - Within 60 days following the Act's enactment (April 18, 2009), employers must provide a new COBRA special election notice to individuals who were eligible for COBRA coverage because of an employee's involuntary termination of employment that occurred on or after September 1, 2008 and before February 17, 2009 and who either failed to elect COBRA coverage or whose COBRA coverage lapsed. Assistance eligible individuals must be given 60 days from the date the new COBRA special election notice is provided to elect COBRA coverage.

Plan sponsors may also want to consider sending the special election notice to individuals who became eligible for COBRA coverage as a result of an employee's voluntary termination of employment that occurred on or after September 1, 2008 and before February 17, 2009 and who either failed to elect COBRA coverage or whose COBRA coverage lapsed, so that all potential assistance eligible individuals are apprised of their rights. Plan sponsors that decide to send the special election notice to such individuals should include a statement in the notice or a separate letter indicating that while the plan sponsor believes that the individuals are not eligible for special election because the termination was voluntary, the qualified beneficiaries may appeal this determination either by contacting the plan administrator or appealing directly to the Department of Labor (or the Department of Health and Human Services with respect to state mini-COBRA coverage).

The Department of Labor is required to issue model notices on or before March 19, 2009.

Where Can Employers Find Additional Information Concerning the COBRA Subsidy?

The Secretary of Treasury has issued some guidance at <http://www.irs.gov/newsroom/article/0,,id=204505,00.html> which includes Q&As on the subsidy and corresponding credit on an employer's quarterly employment tax return.

The Department of Labor has issued some guidance at <http://www.dol.gov/ebsa/cobra.html> which includes a fact sheet, FAQs for employers and employees, and a job loss poster. We are still waiting for the Department of Labor to issue model notices. Those must be issued by March 19, 2009.

Employer Action Items

- Consider whether to allow assistance eligible individuals to elect less expensive coverage. This is optional. If a plan sponsor decides to allow assistance eligible individuals to change their coverage options when they elect COBRA coverage, such individuals have a 90-day election period (rather than a 60-day election period).
- Identify qualified beneficiaries who became eligible for COBRA coverage because of an employee's voluntary or involuntary termination of employment on or after September 1, 2008 and before February 17, 2009 who do not currently have COBRA coverage because they either failed to elect COBRA coverage or coverage has since lapsed and prepare an up-to-date mailing list.
- Prepare a *Special Election Notice* explaining that qualified beneficiaries who did not elect COBRA or whose COBRA coverage has lapsed have a second opportunity to elect COBRA coverage and pay a reduced COBRA premium if they qualify as an "assistance eligible individual." Employers may want to wait to prepare this notice until the Department of Labor has issued the model notice.
- Send the *Special Election Notice* on or before April 18, 2009 to qualified beneficiaries who became eligible for COBRA coverage because of an employee's involuntary termination of employment and allow assistance eligible individuals to elect COBRA coverage at a reduced COBRA premium for coverage periods beginning on or after February 17, 2009. Employers may also want to consider sending the *Special Election Notice* to qualified beneficiaries who became eligible for COBRA coverage because of an employee's voluntary termination of employment to apprise them of their potential rights if they believe that the termination was involuntary.
- Revise existing COBRA election notices or draft an addendum to existing COBRA election notices describing the availability of the premium reduction to assistance eligible individuals. Employers may want to wait to prepare this notice until the Department of Labor has issued the model notice.

EMPLOYEE BENEFITS UPDATE

- Identify all qualified beneficiaries who became eligible for COBRA coverage on or after September 1, 2008.
- Send a *Revised COBRA Election Notice* describing the premium assistance to all qualified beneficiaries who became eligible for COBRA coverage on or after September 1, 2008.
- If there is a delay in implementing the new COBRA subsidy requirements (*e.g.*, for March and April), implement procedures to refund excess COBRA premiums paid or to offset future COBRA premiums if it is reasonable to believe that the credit will be used within 180 days of the overpayment.
- Adopt a method for permitting high income individuals to permanently waive premium assistance.
- Implement procedures for complying with the new subsidy provisions, including how to be reimbursed for 65% of the COBRA premium by claiming a credit on Form 941.
- Amend plan documents and update summary plan descriptions.

If you have any questions regarding these new requirements, please call Denise Atwood at 602.382.6297 or Nancy Campbell at 602.382.6374.

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