

## DEPARTMENT OF LABOR ISSUES PRELIMINARY GUIDANCE ON NEW COBRA SUBSIDY

March 9, 2009

The American Recovery and Reinvestment Act provides a subsidy of 65% of the COBRA or state continuation coverage premiums for certain involuntarily terminated employees. The Department of Labor has now issued preliminary guidance on how the COBRA subsidy is meant to work. While far from comprehensive, this guidance provides a useful framework for helping to ensure compliance with the new COBRA requirements.

### Overview of Subsidy

The subsidy of COBRA and state continuation coverage premiums is available to an employee if the following requirements are met:

- group health coverage is lost to an involuntary termination of employment;
- the termination of employment occurs on or after September 1, 2008 and before January 1, 2010; and
- the income of the employee does not exceed certain limits.

The subsidy is equal to 65% of the applicable premium and is available for a maximum of nine months. In other words, the covered employee only needs to pay 35% of the applicable premium to continue health insurance coverage. The employer recoups the remaining 65% of the applicable premium by claiming a credit on its payroll tax return.

### Eligibility for Subsidy

An individual is entitled to the subsidy only if his or her loss of coverage is due to an involuntary termination of employment, such as a reduction in force. In addition, the involuntary termination must occur on or after September 1, 2008 and before January 1, 2010. However, as under current law, COBRA continuation coverage is not available if the involuntary termination is due to gross misconduct.

### Amount of Subsidy

If the employee is paying or would normally pay the entire COBRA premium, the result is simple – the employer is now obligated to subsidize 65% of the full premium amount. However, many employers have a practice of paying a portion of the COBRA premiums as part of their severance arrangements with terminated employees. If the employer covers the entire premium for a month, the federal subsidy will not apply for that month. If, on the other hand, the employer pays for some but not all of a monthly premium, it appears that the employee's COBRA obligation is reduced to 35% of the amount he or she is actually required to pay, with the balance provided by the new federal subsidy.

For example, assume the normal COBRA premium is \$800 per month. The employer has agreed to pay \$400 and the participant is required to pay \$400. Under the new legislation, the participant's COBRA premium will now be reduced further to \$140 (35% of \$400). The employer is now required to pay \$660 and is entitled to a payroll tax credit of \$260 (65% of \$400).

### **Duration of the Subsidy**

The subsidy ends on the earliest of:

- nine months after it begins;
- at the end of the maximum COBRA coverage period; or
- on the first day the individual becomes eligible for any other group health plan or Medicare.

### **Effective Date**

The COBRA subsidy is available for coverage periods beginning on or after February 17, 2009. For most plans, which charge for COBRA coverage on a calendar month basis, this means that the subsidy must be made available beginning on March 1, 2009. If an individual pays the full COBRA premium for any subsequent month, the employer (for self-insured plans) or insurance company (for fully insured plans) must either reimburse the individual for the 65% over-payment or provide credit to the individual in the form of future reduced COBRA premium payments.

### **Special Election**

Employees involuntarily terminated between September 1, 2008 and February 17, 2009 who did not previously elect COBRA continuation coverage are provided a 60-day special election period in which to elect COBRA coverage. If the individual elects coverage during this period, coverage begins after the election is made (and does not reach back to the date of termination). In addition, the special election will not extend the maximum period of COBRA coverage beyond the period that would have applied if COBRA coverage had been elected when originally available.

### **New Notices**

The new legislation requires the Department of Labor to create model notices describing the new subsidy rights by March 19, 2009. However, group health plan administrators must start providing updated notices immediately for individuals whose involuntary termination of employment occurs on or after February 17, 2009. For individuals whose involuntary termination of employment occurred prior to February 17, 2009, the employer has until April 18, 2009 to provide notices regarding their new 60-day enrollment rights.

### **Income Limitations**

The full subsidy is available to individuals with adjusted gross income of up to \$125,000 (or \$250,000 for joint filers) in the taxable year in which the subsidy is received. Taxpayers with adjusted gross income between \$125,000 and \$145,000 (or between \$250,000 and \$290,000 for joint filers) are eligible for a reduced subsidy. The individual is responsible for determining whether he or she is eligible for the subsidy – employers are not required to make that determination. If a subsidy is provided to an individual whose income exceeds the threshold, it is up to the individual to repay the amount of the subsidy through an increase in his or her federal income tax.

### **Option to Elect Lower Cost Coverage**

Employers are permitted, but not required, to allow eligible individuals to elect a lower cost COBRA option. An employer that wants to offer this right must provide a notice to eligible individuals and provide up to a 90-day period to elect the lower-cost option.

## Next Steps

Employers are advised to review the Department of Labor's new "Fact Sheet", which is posted on its website (click [here](#) to read). Choate will also provide immediate updates with respect to the new COBRA requirements, particularly when the Department of Labor issues its new model notices. In the meantime, steps to consider include:

- Confirm when the subsidy applies to your group health plan. The effective date is the first coverage period that begins on or after February 17, 2009. As noted above, if coverage under your group health plan is based on the calendar month, this means that the subsidy coverage period began on March 1, 2009.
- Review how your COBRA tracking system needs to be modified to reflect the subsidized premiums for eligible individuals.
- Consult with your payroll department about how information on subsidized premiums should be provided to the payroll department so the credit for the subsidies can be claimed on your payroll tax returns.
- If your COBRA is administered by a third party (often your health insurance carrier), talk with your COBRA administrator about how it plans to implement the premium subsidy rules and provide you with the information you need to get payroll tax credit for the subsidy.
- Update any COBRA continuation coverage notices that you provide to qualified participants. As noted, the Department of Labor will be posting model notices on its website shortly.
- Prepare a list of the individuals who must receive the special election notice going back to September 1, 2008. This will allow you to send out the required notice for these individuals promptly after the Department of Labor issues its model form.

As always, Choate attorneys are available to discuss the regulations with you and assist you in assessing your individual business needs. For more information, please contact your lawyer at Choate or one of the following members of the Labor, Employment & Benefits Group:

<b>Lisa M. Gaulin</b>	617-248-5141   <a href="mailto:lgaulin@choate.com">lgaulin@choate.com</a>
<b>Alison F. Reif</b>	617-248-5157   <a href="mailto:areif@choate.com">areif@choate.com</a>
<b>Thomas E. Shirley</b>	617-248-5145   <a href="mailto:tshirley@choate.com">tshirley@choate.com</a>
<b>M. James Shumaker</b>	617-248-5059   <a href="mailto:mjshumaker@choate.com">mjshumaker@choate.com</a>

© Copyright 2009 CHOATE HALL & STEWART LLP

Information contained herein should not be construed as legal advice or legal opinions on specific facts. The enclosed material is provided for education and information purposes by Choate, Hall & Stewart LLP to clients and others who may be interested in the subject matter.