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COBRA UPDATE

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President Signs Stimulus Bill With Significant COBRA Changes for Employers

The sprawling stimulus legislation that may or may not jumpstart the U.S. economy will almost certainly jumpstart employers' interest in COBRA coverage.

That's because the temporary federal COBRA subsidy for involuntarily terminated employees that is at the heart of the American Recovery and Reinvestment Act of 2009 represents the biggest and highest-profile expansion of the basic COBRA framework in its 23-year history. President Barack Obama signed the Act today, after both houses of Congress approved it last Friday. It would take effect for monthly or other periods of COBRA coverage beginning after today.

Subject to income limitations, employees who are terminated "involuntarily" – a term that is not further defined in the Act or the accompanying Conference Report – between September 1, 2008, and December 31, 2009, and their covered dependents, would be eligible for a subsidy of 65 percent of the premiums they would be required to pay for up to nine months for any group health plan in which they participated at the time of termination, excluding health flexible spending accounts (FSAs). These "assistance eligible individuals" would be required to pay only 35 percent of the premium charged under a plan. Employers would not receive any subsidy payment upfront, but would be able to recover the other 65 percent of premiums in the form of a credit against their income tax withholding and FICA taxes (employer and employee portion). If the premiums due an employer exceeded its tax obligations in any given quarter, the U.S. Treasury would issue a check to make up the difference. This tax credit arrangement also applies to insurers and multiemployer plans to whom COBRA premiums are payable.

This subsidy would not apply to employees (or their dependents) who have an adjusted gross income of more than \$125,000 (\$250,000 for joint filers) in the year in which they would receive a subsidy. If a taxpayer with an income of more than \$125,000 (\$250,000 for joint filers) receives any COBRA premium assistance, that assistance will be added directly to the taxpayer's income tax liability in the relevant year (subject to a phase-in for incomes up to \$145,000 or \$290,000 for joint filers). We would expect future regulations to clarify what would happen to an employer's tax credits in these cases. These high-income terminated employees have the option under the Act to permanently waive the right to premium assistance.

Adding a new complication to COBRA, the Act also would give involuntarily terminated employees and their dependents 90 days to select coverage under a different, lower-cost coverage option than the one they were enrolled in at the time of involuntary termination. Qualified beneficiaries would only have this option, though, if an employer allowed these changes. Moreover, the new coverage option also would have to be offered to active employees and could not be a limited option such as dental, vision or health FSA benefits, or certain treatment provided by on-site medical facilities.

Employees who were terminated as far back as September 1, 2008, and who did not elect COBRA coverage, would effectively have a new election period under the Act. Such employees would have 60 days after they receive the notices required by the Act to elect to start COBRA coverage at the subsidized rate. Their COBRA coverage would start on the enactment date of the Act and would *not* continue past the date that would have been the end of the maximum coverage period had they elected it initially – *i.e.*, generally 18 months after termination. By contrast, employees terminated involuntarily on or after September 1, 2008, who did elect COBRA when initially eligible would be eligible for the new subsidy, but not retroactive to their termination dates. Similarly, the Conference Report clarifies that such an employee who elected COBRA initially but then lost coverage due to nonpayment of premiums would be entitled to the notices and premium subsidy.

Note that the subsidy and new elections are limited to cases of involuntary termination, and not available for other COBRA qualifying events – such as voluntary termination, divorce, reduction in hours or a dependent child reaching a limiting age under a health plan. For many individuals, this subsidy would drop the cost of COBRA coverage below their active employee rate. The subsidy will make COBRA coverage far more attractive to terminated employees, and is not designed to defray any extra claims costs that those qualified beneficiaries generate.

Other Key Points

Expedited review of denials of premium assistance: A qualified beneficiary who requests treatment under a plan as an “assistance eligible individual” and is denied that benefit will have a right to an expedited appeal directly to the Departments of Labor and Treasury. By statute, the secretaries of those departments are to make a determination of eligibility for COBRA premium assistance within 15 business days of when a qualified beneficiary applies for review. The Conference Report clarifies that this review by the federal government would go on, irrespective of whether the individual had also submitted a claim for benefits that would be subject to review under a plan’s claims procedures and ERISA Section 503. The government review would be on a “de novo” basis and reviewing courts would be required by the Act to give deference to this determination.

Notices: Under the Act, information about the new subsidy and the option to enroll in different coverage would have to be added to current COBRA notices or provided in separate documents. This information must include: a) the forms necessary for establishing eligibility for premium reduction; b) the plan administrator’s contact information; c) a description of the 60-day extended election period; d) a description of a qualified beneficiary’s obligation to notify the plan of health coverage under another group plan or Medicare and the penalty for failure to do so; and e) a prominently displayed description of the qualified beneficiary’s right to a reduced premium and the applicable conditions to receiving the reduced premium.

Notices regarding the new subsidy also will be needed for qualified beneficiaries who are eligible for assistance because they were involuntarily terminated and meet the income cutoffs and are already receiving COBRA coverage or are still in their initial election period. These notices would be required to be issued within 60 days of the date this Act is enacted. Model notices are scheduled to be provided by the Secretary of Labor within 30 days of that date. Both deadlines will require extraordinarily quick adjustments in benefit plan administration.

Current employer subsidies: Note that the new federal subsidy is based on the amount of premium a qualified beneficiary would be required to pay. It does not appear that employers that routinely subsidize COBRA coverage for at least some qualified beneficiaries – for example, several months at the active employee rate, based on years of service – will be able to recoup any tax benefits for those contributions.

New penalty on beneficiary: A qualified beneficiary already covered by COBRA coverage who becomes eligible for other group health plan coverage, or otherwise ceases to qualify for premium assistance, and fails, without reasonable cause, to notify the employer providing premium assistance will be required to pay a penalty equal to 110 percent of the premium reduction provided after the qualified beneficiary ceased to qualify for such assistance.

Payroll tax credit: To receive the payroll tax credit, the employer is required to submit reports to the Treasury attesting to the involuntary termination of the former employees receiving the COBRA premium subsidy and the actual amount of payroll taxes offset for the reporting period and the estimated payroll taxes to be offset during the next reporting period. Future guidance will explain how the reimbursements would work for multiemployer plans.

Tax impact on individuals: Premium assistance provided under the Act would not be taxable income to “assistance eligible individuals.”

If you have questions or need assistance, please contact jdunn@stoweassociates.com.

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