

# LOWENSTEIN SANDLER PC CLIENT ALERT

## EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

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### STIMULUS LAW PROVIDES TEMPORARY HELP FOR TERMINATED EMPLOYEES TO PURCHASE COBRA COVERAGE - SWIFT COMPLIANCE ACTION REQUIRED BY EMPLOYERS

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**On February 17, 2009, President Barack Obama signed into law The American Recovery and Reinvestment Tax Act of 2009 (the "Act"). This Alert summarizes the key provisions of the Act relating to COBRA. Plan Administrators must take immediate action to implement these new COBRA requirements.**

#### **Federal Government Will Temporarily Subsidize COBRA Costs**

Though most separated employees have the right to continue coverage under their former employer's group health plan for up to 18 months following termination of employment, the high cost of COBRA coverage often makes it unaffordable for separated employees to do so. The Act temporarily makes COBRA coverage more affordable by reducing the maximum percentage of the applicable COBRA cost that "assistance eligible individuals" can be required to pay from 102% to 35%. The Federal government will subsidize the remaining 65% of the cost by giving employers a tax credit that can be applied against current payroll and income tax deposits.

Federal COBRA generally applies only to

group health plans of employers who have 20 or more employees. However, the Act applies to employers who are subject to state COBRA requirements as well. Depending on the particular state, these requirements can apply to employers with as few as two employees.

#### **How the Subsidy Works**

The subsidy applies to all "assistance eligible individuals" — defined as individuals who elect COBRA coverage as a result of an involuntary termination of employment occurring (or that has occurred) on or after September 1, 2008 and before January 1, 2010. Assistance eligible individuals are only required to pay 35% of their COBRA premiums for up to nine months of coverage.

Under the Act, the Federal Government will "reimburse" employers for the remaining 65% of the COBRA premium. This will be accomplished by allowing an employer to take a tax credit against its liability to deposit payroll and federal income taxes withheld from the employee's compensation as of the date the assistance eligible individual's COBRA premium payment is received. To the extent that an employer's costs for COBRA coverage exceed the amount of its liability for payroll and income taxes, the Federal government will credit

or refund the excess in the same manner as if it were a tax overpayment.

It appears that the subsidy applies to the actual COBRA premiums charged individuals — even if an employer charges less than the maximum COBRA premium (102% of the applicable premium cost). For example, if COBRA would normally cost \$1,000 per month, but an employer charges an assistance eligible individual only \$500 per month during a six month severance period, beginning March 1, 2009, the individual may only be charged \$175.00 (35% of \$500), and the employer will receive a tax credit of \$325 (even though the employer's total cost is \$825 per month (\$1000 - \$175)). In contrast, if the employer charged the full cost of COBRA, it would receive a tax credit of \$650 (65% of \$1000). Accordingly, it can be beneficial to an employer to charge an assistance eligible individual 35% of the maximum COBRA premium in order to obtain the greatest tax credit. In contrast, an employer that provides COBRA without charge receives no credit.

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The Act includes an income threshold as a condition on an individual's entitlement to the premium subsidy. In general, in order to be eligible, an individual's modified adjusted gross income (AGI) cannot exceed \$125,000 (or \$250,000 for joint filers). If a taxpayer's AGI exceeds \$145,000 (or \$290,000 for joint filers), then the amount of the premium subsidy for all months during the taxable year must be repaid through a corresponding increase in the taxpayer's income tax liability for the year). The amount of the premium subsidy that must be repaid will be reduced proportionately for taxpayers with AGI between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for joint filers).

#### **Duration of the Subsidy**

Under the Act, the subsidy will end on the earliest of the following:

- The first date an eligible individual is eligible for coverage under another group health plan or for Medicare coverage;
- Nine months after the first day of the first month in which the subsidy applies;
- The end of the maximum COBRA continuation coverage period; or
- For individuals who elected coverage during a special enrollment period, the end of the maximum COBRA continuation coverage period that would have applied if the individual had actually elected coverage when first entitled.

#### **Special Election Period for Eligible Individuals Who Previously Declined COBRA**

An assistance eligible individual who previously declined COBRA coverage must be afforded a new (second) opportunity to elect COBRA coverage. The election period commences as of

February 17, 2009 and ends 60 days after the plan administrator provides the notice. Accordingly, employers and/or health plan administrators will need to review their records to determine those individuals who were offered COBRA as a result of an involuntary termination occurring on or after September 1, 2008, and who declined the coverage, so that they can be given a second opportunity to elect the coverage at the reduced cost.

Coverage begins under these special election procedures on the first period of coverage beginning after the date of the enactment of the Act. For plans operating with a calendar month period of coverage, this will mean that coverage will begin on March 1, 2009. Coverage terminates on the date the coverage would have normally terminated based on the eligibility date triggered by the qualifying event.

For example, assume that an employee's coverage under an employer's group health plan terminated on September 1, 2008 as a result of an involuntary termination of employment on the same day. His maximum COBRA period would normally expire on February 28, 2010 (after 18 months). If he initially declined COBRA coverage, he must be given a second chance to elect COBRA to begin effective March 1, 2009.

For group health plans that apply pre-existing condition exclusions, an assistance eligible individual who elects coverage during the special election period will not be treated as having a break in coverage.

#### **Procedures for Eligible Individuals Who Are Currently On COBRA**

The COBRA cost for assistance eligible individuals who previously elected

COBRA coverage must be reduced to 35% of the COBRA cost (assuming they are currently being charged more than that). Under the Act, the subsidy applies to premiums paid for periods of coverage beginning on or after the date of the enactment of the Act. For most employers, this will be March 1, 2009. Although this does not provide much time for employers and plan administrators to implement the changes made by the Act, if an assistance eligible individual pays the full COBRA premium for March and April 2009, the plan administrator is required to apply a credit against future COBRA premiums in an amount equal to the overpayment — but only if the plan administrator reasonably expects the overpayments to be fully applied within 180 days. Alternatively, the employer can issue a full refund to the individual within 60 days. Plan administrators should communicate this information to assistance eligible individuals when the notice described below is provided.

#### **Notice Requirements**

In addition to the current COBRA-mandated notice requirements, assistance eligible individuals must be provided with written notice advising them of the availability of the subsidy. Employers may either amend their existing notices to conform to these requirements or use a separate notice.

The Act requires employers and/or plan administrators to include the following along with this additional notice:

- The forms necessary for establishing eligibility for the premium reduction;
- The name, address and telephone number of the plan administrator;
- A description of the Special Election Period;

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- A description of the assistance eligible individual's obligation to notify the plan administrator of eligibility for subsequent coverage under another group health plan or eligibility for Medicare benefits;
- A prominently displayed description of the right to a reduced premium and any conditions on entitlement to the reduced premium; and
- A description of the option to enroll in different coverage, if permitted by the employer.

Plan administrators are also required, within 60 days after the date of enactment of the Act, to provide individuals who can elect coverage under the special election period with this additional notification. A failure to do so will be treated as a failure to comply with the COBRA notice requirements.

The Act requires the Department of Labor to publish model notices within 30 days after the date of its enactment.

### Action Items for Employers and Plan Administrators

Implementation of the requirements of the Act requires employers who sponsor group health plans to take swift action. Among the steps that employers should take to implement the requirements of the Act are the following:

- Identify all employees who have been involuntarily terminated since September 1, 2008 and determine whether or not they have elected COBRA;
- Prepare notices and election forms for distribution to all such former employees who previously declined COBRA coverage;
- Prepare notices for all such former

employees who are currently receiving COBRA coverage;

- Prepare notices for employees who will or may be involuntarily terminated during the remainder of 2009;
- Develop procedures to allow "high income" individuals to waive the subsidy;
- Work with third-party COBRA vendors and payroll agents to implement the lower COBRA charges and to obtain the corresponding tax credits.

**If you have questions regarding the COBRA provisions of the Act or need assistance in implementing the new requirements, please contact any of the attorneys in Lowenstein Sandler's Employee Benefits and Executive Compensation Practice Group.**

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