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COBRA SUBSIDY AFFECTING EMPLOYERS AND INSURERS

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The **economic stimulus legislation** that President Obama is expected to sign into law next week includes the Health Insurance Assistance for the Unemployed Act of 2009. The Act provides a subsidy of 65% of the COBRA premiums for employees who were involuntarily terminated between September 1, 2008 and December 31, 2009. The employer (or insurer for insured plans) can promptly claw back the premium by withholding the payment as a credit against Federal payroll taxes. The subsidy is expected to take effect March 1st and is available for a maximum of nine months. The employer must send an additional COBRA notice and, for individuals who are eligible for the subsidy but have not yet elected COBRA, the employer must provide a special 60-day election period.

A number of administrative issues and open questions exist, and employers and insurers have about two weeks to figure them out. Fortunately, the legislation does not include a proposal provision that would have allowed any employee (who terminates employment for any reason) who is either age 55 or has 10 years of service to remain on COBRA until age 65. The following is a summary of the new COBRA subsidy:

Eligible Individuals

Employees who were involuntarily terminated between September 1, 2008 and December 31, 2009 and who are otherwise eligible for COBRA continuation coverage

are eligible for the subsidy. Spouses or dependents associated with a terminated employee (e.g., a dependent of an employee who is covered by the group health plan immediately prior to the employee's termination of employment) may independently elect COBRA coverage and may independently receive a subsidy. For example, if an employee and spouse were eligible for and began receiving subsidized COBRA coverage and they subsequently divorced, the subsidy would be available with respect to each.

All individuals who are involuntarily terminated are eligible for the subsidy — not just those who are terminated due to a reduction in force. Many employers have questioned how individuals who voluntarily agree to separate from service as part of a reduction in force will be treated for purposes of the COBRA subsidy. The legislation does not answer this question, although it is likely to be addressed in Treasury guidance. It is a critical issue because, if the IRS subsequently determines that a voluntary termination was misclassified as involuntary, the employer may not be eligible for reimbursement of the subsidy. Insurance companies should be particularly concerned about the outcome of this issue because they must rely on such designations from their employer-account holders.

Means Testing

The conference agreement to the legislation adds a new income threshold for terminated workers. Terminated workers are ineligible for the subsidy if, during the year the subsidy would have

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been received, their adjusted gross income ("AGI") exceeds \$145,000 (or \$290,000 for joint filers). For taxpayers with AGI between \$125,000 and \$145,000 (or \$250,000 and \$290,000 for joint filers), the amount of the subsidy will be reduced proportionately. The implementation of this "means testing" will fall substantially on the terminated worker (i.e., at the end of the year, if the individual's gross income is above the threshold, the mechanism for repayment is an increase in the taxpayer's income tax liability for the year equal to the amount of the subsidy received on such individual's tax return). Employers must keep track of the amount of COBRA continuation coverage paid on behalf of each individual and will need to report this information to the IRS, presumably on Forms W-2. Terminated workers are permitted to make a permanent election (at the time and in the manner as the Secretary of Treasury may prescribe) to waive the receipt of the premium subsidy for all periods of coverage.

Eligible Coverage

Generally, all group health plans subject to COBRA constitute eligible coverage for purposes of the subsidy. For example, medical, dental, vision, and health reimbursement arrangements qualify as eligible coverage. In contrast, health flexible spending arrangements are not eligible coverage for purposes of the subsidy. Coverage under state law that requires continuation coverage comparable to the continuation coverage required under Federal COBRA rules is also eligible coverage, as is continuation of coverage under requirements that apply to health plans maintained by the Federal government or a state government.

It should be noted that an employer may, but is not required to, allow qualified beneficiaries to change their coverage

options under the plan in conjunction with electing COBRA coverage to coverage that has the same or lower health insurance premiums.

Amount of the Subsidy

The amount of the subsidy is 65% of the COBRA premium. The COBRA premium is the amount charged to the beneficiary. If the employer is already subsidizing COBRA, perhaps under a severance agreement, it appears that the subsidy is calculated on the actual amount the qualified beneficiary is required to pay (not on the full cost of active employee coverage).

Effective Date

The subsidy applies beginning with the first period of coverage after the date President Obama signs the bill. In other words, if the date of enactment is February 16 as expected, and a plan requires qualified beneficiaries to pay COBRA premiums monthly, that means that the subsidy will begin on March 1.

There is also a transition rule for individuals who pay 100% of their COBRA premiums during the first 60 days after the date of enactment. In such a case, the employer/insurer may either (i) reimburse the individual for 65% of the premiums paid, or (ii) provide a credit for such amount to offset future premiums (provided it is reasonable to believe that the credit would be used within 180 days).

Period of Coverage

The subsidy is generally available for nine months. However, the subsidy will not extend the maximum period of coverage required to be provided under COBRA (typically 18 months for individuals whose employment was terminated involuntarily). An individual ceases to be eligible for the subsidy on the date that the individual becomes eligible for Medicare

or for coverage under another group health plan. (Generally, a qualified beneficiary loses eligibility for continuation of coverage upon enrollment in, not eligibility for, other health coverage.)

If an individual becomes eligible for other health coverage, the individual must notify the group health plan in writing. The Secretary of Labor is expected to provide guidance on the time and manner of notice that will be required. If the individual does not provide notice, a penalty of 110% of the subsidy provided after termination of eligibility will apply.

From a practical standpoint, the individual also has the option to stop paying COBRA premiums. The subsidy is only required to be paid for months that the qualified beneficiary actually pays a COBRA premium. Therefore, if the individual does not pay a premium for a particular month, a subsidy is not required, and no penalty for failure to notify the group health plan would apply.

Special Election Requirement

Individuals who would have been eligible for the subsidy but are not currently receiving COBRA coverage must be given a special 60-day period in which to elect coverage. This is true for individuals who did not elect COBRA and for those who elected and then discontinued coverage. The 60-day election period begins on the date that notice of the special election period is provided to the individual. For individuals who elect it, coverage will be retroactive to the first period that begins after the date of enactment of the legislation (which, as discussed above, will generally be March 1 for most plans).

Employer Notice Requirements

The notice of COBRA continuation coverage that a plan administrator is

required to provide to qualified beneficiaries under current law must now contain additional information. The Department of Labor is required to provide a model notice for this purpose within 30 days of the date of enactment of the legislation. A new notice must also be provided to individuals who are entitled to the special election for coverage. COBRA notices must be provided to all individuals who terminate employment between September 1, 2008, and December 31, 2009, not just to those who were terminated involuntarily. A violation of the new notice requirements will be considered a violation of the regular COBRA notice requirements (and, therefore, subject to the same penalties).

Entity Responsible for Subsidizing Coverage

The entity to which premiums are payable (and the entity eligible for the payroll tax credit) is either (1) the multiemployer group health plan, (2) the employer if subject to COBRA, or (3) the insurance company for an insured plan not covered by either (1) or (2).

Refundable Payroll Tax Credit

The 65% COBRA subsidy paid by employers for terminated employees will take the form of a refundable payroll tax credit on the employer's quarterly employment tax returns, i.e., Forms 941. The employer is permitted to offset any payroll tax liabilities with the amount of the COBRA subsidy. However, in the event that the subsidy exceeds the employer's payroll tax liabilities, the employer will receive a tax refund.

Employers having the ability to reduce their payroll tax deposit requirements by the amount of the COBRA subsidy credit will probably attempt to claim such credit as soon as possible. COBRA

subsidy payments are treated as if the employer deposited payroll taxes to the U.S. Treasury on the day the subsidy payment for the qualified beneficiary is *received*. The meaning of the date “received” is the date the health plan, employer, or COBRA administrator receives the COBRA premium payment from the qualified beneficiary. The employer/insurer does not earn the credit on the date on which it pays its portion of the premium. Therefore, employers should exercise caution with respect to the date on which they claim the COBRA subsidy credit because the IRS generally determines penalties for late payroll tax deposits by comparing the actual deposits received to the employer’s payroll tax liabilities as reported on Schedule B of Form 941.

The IRS will likely expand reporting for Form 941 to capture the specific dates on which the employer claims the COBRA subsidy credits. It will be important for the employer to carefully track the dates on which payments are received from qualified beneficiaries because those will be the dates on which the payroll tax credits arise. Employers claiming COBRA subsidies prematurely may trigger late deposit penalties.

Reporting Requirements

The legislation requires any entity eligible for reimbursement of the subsidy (i.e., the employer or insurer) to submit such reports as the Secretary of Treasury may require, including (i) an attestation of the involuntary termination of employment of each covered employee on the basis of whose termination entitlement to reimbursement of premiums is claimed, (ii) a report of the amount of payroll taxes offset for a reporting period and the estimated offsets of such taxes for the next reporting period, and (iii) a report containing tax identification numbers of all covered employees, the amount of

subsidy reimbursed with respect to each covered employee and qualified beneficiaries, and a designation with respect to each covered employee as to whether the subsidy reimbursement is for coverage of one individual or two or more individuals. The conference report indicates that these reports are required to be provided at the same time as the deposits of the payroll taxes would have been required, absent the offset, or such times as the Secretary specifies.

From a practical standpoint, the attestation requirement creates multiple concerns. For example, payroll tax deposits are usually sent electronically. Employers are not currently permitted to attach additional information and, therefore, it is unclear as to how employers will provide information “at the same time” as the conference report indicates. In addition, insurance companies providing the subsidy for participants in insured plans may have concerns about submitting attestations that will include information not available to them. For example, insurance companies will need to rely on representations from the employer regarding whether or not an employee was terminated involuntarily.

Appeal Rights

Eligible individuals who are denied a COBRA subsidy may submit an appeal, which will be reviewed by the Secretary of Labor or Health and Human Services (in consultation with the Secretary of Treasury) within 15 days. The Secretary’s determination is *de novo* and is the final determination.

Next Steps for Employers and Insurers

The first step for employers is to begin identifying which employees have terminated employment since September 1, 2008, to determine which of

those terminations were involuntary, and to identify the former employees who are currently receiving COBRA coverage.

Benefits and payroll departments will also need to coordinate their efforts, in

conjunction with plan administrators, to determine how they will share information. Reliance on outside vendors who administer COBRA will not relieve the employer from having to perform many of these subsidy-related requirements directly.

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