COBRA Amendments under the American Recovery and Reinvestment Act

March 2009

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 (the "Act"), often called the stimulus bill. The Act made significant changes to the Consolidated Omnibus Budget Reconciliation Act ("COBRA") and therefore, employers must take immediate action. Employers should immediately consult their payroll specialists or health plan providers to implement the Act's new requirements. For most employers, the effective date of the new COBRA rules is **March 1, 2009**.

Although the federal COBRA rules generally apply to employers with 20 or more employees, the Act applies to all employers covered by state laws that provide for continued medical coverage for eligible employees or their dependents. Most states, with the exception of Alabama, Alaska, Delaware and Michigan, have laws that provide for some level of continued medical coverage. Unlike the federal COBRA rules, many of those state laws do not have a 20-employee threshold. Therefore, the requirements described in this memo apply to most U.S. employers.

Eligibility

The new rules provide a federal subsidy that will cover 65% of employee-paid premiums for employees who lose their jobs due to an *involuntary termination* and become eligible for continued medical coverage between September 1, 2008, and December 31, 2009. According to guidance published by the Internal Revenue Service, "*involuntary termination*" includes an employee's resignation for good reason where an employer action results in a material adverse change in the employment arrangement. The subsidy will also cover 65% of the premium payments for an individual's qualified beneficiaries. Individuals will remain responsible for 35% of the premium payment for their continued coverage and the continued coverage of their beneficiaries.

If the former employer is paying any portion of the premium, such as under a severance or reimbursement arrangement that is excluded from the employee's gross income, then the subsidy program applies only to the remaining employee-paid portion (if any). The subsidy is not available if the employer pays the entire COBRA premium. The subsidy is available, however, if the employer provides a taxable severance benefit in an amount designed to cover the cost of the COBRA premium. To illustrate, assume the employee portion of the COBRA premium is $1,000. The employee-paid portion under the subsidy would be $350. If the employer reimburses the employee for this amount and the amount is excluded from employee's gross income, the employer is treated as paying the premium and the subsidy for the remaining $650 is not available. If the employer instead provides the employee with a severance payment that is taxable, the employee is still eligible for the entire subsidy. Generally, an individual who lost coverage due to a reduction in hours is not eligible for the subsidy.

The subsidy will continue for employees who were involuntarily terminated until the earlier of: (1) nine months, (2) the date the individual becomes eligible to be covered under a subsequent employer's health plan, (3) or the date the individual is no longer eligible for COBRA. An individual must notify the former employer of subsequent health coverage, or the individual will be liable for a penalty of 110% of the amount of the subsidy. The subsidy amount will generally not be included in the individual's taxable income, nor will the amount of the subsidy be taken into account for other state or federal benefits programs.

The subsidy is phased out after an individual's adjusted gross income reaches $125,000, or $250,000 if the individual files jointly. The subsidy is completely eliminated if the individual's adjusted gross income is above $145,000, or $290,000 if the individual files jointly. The entity administering COBRA coverage need not monitor the income limits. If the individual exceeds the income limits, he or she will include the amount of the subsidy on his or her tax return and the amount of the subsidy will be added to the amount of taxes owed. Alternatively, if an individual does not want to report the amount of the subsidy, he or she may notify the entity providing COBRA coverage that he or she would like to opt out of the subsidy and pay the entire premium.

Effective Date

The new rules are effective for the first period of coverage on or after February 17, 2009. For plans on a monthly coverage schedule, the effective date was March 1, 2009. There is a grace period of two pay periods in which the entity providing coverage may credit or refund an individual for overpaid premiums following the effective date of the Act. If the entity does not reasonably expect a credit to be used within 180 days after the overpayment, the entity must refund the overpayment within 60 days.

Enrollment Election

Under the Act, an individual must elect continued coverage within 90 days after the receipt of notice of eligibility. If an individual previously elected COBRA coverage following an involuntary termination after September 1, 2008, the subsidy provided under the Act will be prospective and will not affect premiums previously paid by an individual. The individual will be eligible for the subsidy for up to nine months from the date of enactment of the Act.

Individuals who were involuntarily terminated after September 1, 2008, and who did not elect COBRA coverage or who allowed COBRA coverage to lapse must be given another opportunity to elect coverage on a prospective basis. The individual must elect coverage within 60 days after receipt of the notice of the opportunity to make a late election. This additional election period does not apply to state COBRA provisions unless a state has elected to provide a similar additional election period.

Electing a Different Enrollment Option

At the time of election, the employer may, at its option, provide an individual with the option to change his or her coverage levels. The new coverage level must have the same or lower premiums and the same coverage level must be available to regular employees who are not subject to COBRA. Further, the different enrollment option may not substitute coverage under a flexible spending arrangement or be limited to vision, dental, counseling or referral services, or an onsite medical facility maintained by the employer.

Reimbursement Procedure

The entity that provides COBRA coverage and collects the individual's portion of the premium will initially pay 65% of that portion. The entity will report the amount of the premium paid on the entity's annual tax return. The amount of the subsidy will be considered a tax credit against payroll taxes that the entity owes. If the amount of the subsidy is greater than the taxes owed, the amount of the subsidy that exceeds the taxes owed will be treated as an overpayment of payroll taxes. Similarly, if an entity overstates the amount of the subsidy paid, the reimbursement will be treated as an underpayment of payroll taxes. The Act defines payroll taxes as wage withholding amounts and the employer and employee portions of FICA taxes. If the coverage is provided by insurance, the insurer will initially absorb the subsidy and will then receive the reimbursement.

The Act provides that the IRS will issue regulations or other guidance about the method of reporting the subsidy amounts and recovering the reimbursement.

Notice

Entities providing COBRA coverage must provide a notice to all individuals who become (or became) eligible for COBRA coverage beginning on or after September 1, 2008 and ending on December 31, 2009, including those individuals who elected not to receive continued COBRA coverage prior to the enactment of the Act. As required by the Act, the Department of Labor recently issued four model notices, which are summarized below. The enhanced notice includes information such as the availability of the subsidy, how to enroll in continued coverage, the ability to elect COBRA even if coverage was declined prior to the Act's enactment, the opportunity to choose a different level of coverage, if applicable, the contact information for the plan administrator, and the individual's obligation to notify the COBRA entity of any subsequent health coverage. Below is a brief summary of each model form of notice:

1. Model General Notice, full version. This notice contains information that must be provided to each individual who is eligible for Federal continued COBRA coverage between September 1, 2008 and December 31, 2009, because of either a voluntary or an involuntary termination.
2. Model General Notice, abbreviated version. This notice may be provided in lieu of the full version to individuals who (1) experienced a loss in coverage due to a voluntary or involuntary termination on or after September 1, 2008, (2) elected Federal continued COBRA coverage and (3) are still enrolled.
3. Model Alternative Notice. This notice is for individuals who experience a loss of coverage due to either a voluntary or an involuntary termination between September 1, 2008, and December 31, 2009, and who are eligible for continued coverage under applicable state law.
4. Model Notice in Connection with Extended Election Periods. This notice should be provided to individuals who were involuntarily terminated between September 1, 2008, and February 16, 2009, and who did not elect Federal COBRA continuation coverage or who elected continued coverage and subsequently discontinued such coverage. Eligible individuals must receive a copy of the notice within 60 days after the date of enactment of the Act (*i.e.,* by **April 18, 2009**).

The actual model notices may be obtained at the COBRA information page on the Department of Labor's website (**http://www.dol.gov/ebsa/COBRA.html**).

Failure to provide a proper notice will be treated as a violation of COBRA and may subject an entity to the penalties that apply to other COBRA violations.

The webpage listed above also includes additional details about the subsidy, including informational posters for the workplace.

Gunderson Dettmer's lawyers are available to assist in addressing questions you may have regarding the issues discussed in this Alert. Please contact the Gunderson Dettmer attorney with whom you regularly work. Contact information for our attorneys can be found at **www.gunder.com**.