

DOL ISSUES NEW COBRA FORMS:
DEADLINE OF APRIL 18, 2009, FOR EMPLOYERS
TO PROVIDE THE REQUIRED NOTICES

March 24, 2009

To Our Clients and Friends:

The American Recovery and Reinvestment Act of 2009 (“ARRA”) provides a COBRA subsidy for up to nine months in the form of a premium reduction for employees who are involuntarily terminated from employment from September 1, 2008, through December 31, 2009, and their qualifying dependents. In essence, the COBRA premiums charged to eligible employees and their qualifying dependents (collectively referred to below as “qualified beneficiaries”) for continued health care coverage – which could be as high as 102% under COBRA¹ – would be reduced by 65% for up to nine months. Although the subsidy is financed by the U.S. government, the subsidy is “paid” by the employer and “reimbursed” by the government by way of employment tax credits.

To implement this change, employers must notify qualified beneficiaries who became or become entitled to elect COBRA coverage due to a qualifying event occurring during this time period of the availability of the premium reduction. ARRA specifically requires that employers must provide notice by **April 18, 2009**, to qualified beneficiaries who became entitled to the subsidy from September 1, 2008, through February 16, 2009. The Department of Labor (the “DOL”) has published on its website FAQs and four forms of model notices to assist employers in fulfilling this obligation (www.dol.gov/COBRA).

ELIGIBILITY FOR THE COBRA SUBSIDY

A qualified beneficiary under COBRA whose COBRA opportunity relates to the employee being involuntarily terminated during the period from September 1, 2008, through December 31, 2009, is eligible for the subsidy. The qualified beneficiary must be eligible for COBRA coverage and elect COBRA coverage when first offered or during the “extended election period” described below.

¹ COBRA is the acronym for the law that added the requirement that group health plans offer employees and their qualifying dependents the opportunity to continue to participate in a group health plan after certain qualifying events, including termination of employment. A plan may require payment of 102% of the full premium cost for such coverage. The COBRA provisions in ARRA reflected Congress’s sentiment that, in the current environment, laid-off employees may not be able to afford the full premium cost for the COBRA coverage.

Involuntary termination. Although ARRA does not define involuntary termination, the DOL and IRS have stated that an involuntary termination is any termination initiated by or at the direction of the employer. Further guidance from the DOL is expected soon. A termination due to gross misconduct is not covered since it results in a disqualification from COBRA benefits.

The "extended election period." If an employee was involuntarily terminated during the period from September 1, 2008, through February 16, 2009, and the qualified beneficiary did not elect COBRA coverage or elected COBRA coverage but later dropped the coverage, the qualified beneficiary must receive a notice of the subsidy by April 18, 2009, and must be allowed to elect COBRA coverage within 60 days after the notice is provided (an "Extended Election Notice"). If the election is made, the coverage will be effective during the period of coverage beginning on or after February 17, 2009. Note that under this special election, a qualified beneficiary may elect COBRA without electing the subsidy (for example, if a qualified beneficiary is ineligible for the subsidy as a result of having income in excess of the thresholds described below).

THE PREMIUM REDUCTION

Those eligible will receive a reduction in their COBRA premiums. A form is provided in the model notices for requesting the premium reduction ("Premium Reduction Request Form"). Eligible qualified beneficiaries pay only 35% of the plan COBRA premiums for up to nine months. Where an employer provides a further subsidy to the COBRA premium (for example, an employer could charge \$600 but only charges \$400), it appears that the 35% applies to the subsidized premium (\$400, in our example).

Expedited appeals for denial of premium subsidy. A qualified beneficiary may request an expedited DOL review of a denial of premium subsidy.

Duration of the subsidy. The premium reduction is generally available for a nine-month period and ceases to be available if the qualified beneficiary becomes eligible for coverage through Medicare or another group health plan, including a group health plan of a spouse. In that case, the qualified beneficiary must notify the plan administrator; otherwise, continuation of the premium subsidy could result in a penalty imposed on the qualified beneficiary equal to 110% of the premium provided after eligibility ceased. A form for providing this notification is included in the model notices.

Phase out for highly compensated individuals. The subsidy phases out for individuals whose modified adjusted gross income exceeds \$125,000, or \$250,000 for those filing joint returns. Individuals with modified adjusted gross income exceeding \$145,000, or \$290,000 for those filing joint returns, do not qualify for the subsidy. If during a year a qualified beneficiary receiving a premium subsidy has income at these levels, all or a portion of the premium reductions may be recaptured by an increase in the qualified beneficiary's income

tax liability. The Premium Reduction Request Form does not require individuals to disclose their income. If an individual's nine months of potential premium subsidy overlaps with both the 2009 and 2010 calendar years, the individual should consider the availability of the subsidy for each year. Note that all qualified beneficiaries must be provided with the notice even if their incomes exceed the phase-out thresholds.

PAYROLL TAX CREDIT

The employer may recover the remaining 65% of the premium by taking the subsidy amount as a credit on its employment tax returns.

Supporting documentation. Employers must maintain supporting documentation for the credit claimed, including:

- Documentation of *prior* receipt of the employee's 35% share of the premium.
- In the case of insured plans, a copy of an invoice from the insurance carrier and proof of timely payment of the full premium. For self-insured plans, proof of premium amount and coverage.
- Declaration of the employee's involuntary termination (presumably this requirement may be satisfied by the employee's statement in the Premium Reduction Request Form).
- Report of taxpayer identification numbers of all qualified beneficiaries and subsidy amounts as well as proof of eligibility for COBRA and election.

Impact on payroll reporting. Overstatement of reimbursement is a payroll violation. Accordingly, an employer must be careful in its determinations as to eligibility for the subsidy and the timing of request for payroll credits. Reimbursement for an amount in excess of the payroll taxes owed is treated in the same manner as an overpayment of payroll taxes resulting in either a credit or refund.

Other changes made by new COBRA provision. The new law also provides employers with the flexibility to permit qualified beneficiaries to change their health insurance option when making COBRA elections. The change must be to an option with the same or lower premium available to other employees. A template election form is provided in the model forms.

THE MODEL NOTICES

The DOL issued four packages of notices and forms which are to be used in different scenarios as described in the heading on each package. Employees are not required to use the model notices. However, given the complexities of administering this subsidy layered on

top of the otherwise applicable COBRA rules, the model notices provide a safe harbor for ensuring the technicalities of the notice and election requirements are satisfied.

The notices are as follows:

- Extended Election Notice – for those who are or would be eligible but are not enrolled with qualifying events that occurred during the period from September 1, 2008, through February 16, 2009. ***This notice must be provided by April 18, 2009.***
- Supplemental Notice – for those *currently* enrolled in COBRA due to qualifying events occurring on or after September 1, 2008. ***This notice must be provided by April 18, 2009, to those with qualifying events through February 16, 2009.***
- General Notice – for those who have not yet received an election notice. This notice is to be used for qualifying events occurring on or after September 1, 2008, through December 31, 2009.
- Alternative Notice – for State continuation requirements.

Penalties for failure to provide the required notices. Failure to provide the notice by ***April 18, 2009***, to qualified beneficiaries who became entitled to the subsidy from September 1, 2008, through February 16, 2009, is treated as a failure to provide adequate notification under COBRA, which among other penalties and consequences may result in a penalty of up to \$110 a day from the date of failure under ERISA.

Please feel free to contact us with any questions.

This memorandum was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax law.

Lawrence K. Cagney
+1 212 909 6909
lkcagney@debevoise.com

Jonathan F. Lewis
+1 212 909 6916
jflewis@debevoise.com

Elizabeth Pagel Serebransky
+1 212 909 6785
epagelserebransky@debevoise.com

Alicia C. McCarthy
+1 212 909 7249
acmccarthy@debevoise.com

Charles E. Wachsstock
+1 212 909 6943
cewachsstock@debevoise.com