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### **Legal Alert: COBRA Subsidy**

#### Overview

The American Recovery and Reinvestment Act of 2009 (“ARRA”), as amended by the Department of Defense Appropriations Act, 2010 (the “Act”), and again by the Temporary Extension Act of 2010, made changes to Federal COBRA and State mini-COBRA laws to make continued health care coverage more attainable to individuals affected by job losses during the current economic downturn. The provisions enacted by ARRA are designed to be temporary; however, they are complex. Recognizing this complexity, the Internal Revenue Service (“IRS”) and the Department of Labor (“DOL”), which have joint jurisdiction over this aspect of ARRA, have published several iterations of guidance (and more is likely to come).

The purpose of this Client Alert is to summarize the new health care continuation rules under ARRA and the subsequent guidance to date. As many of our clients are small employers that are not subject to the Federal COBRA laws, we have attempted to pay special attention to the effect of ARRA on small employers that are subject to continuation coverage rules under State law.

#### Background

The Consolidated Omnibus Budget Reconciliation Act of 1985 put into place the Federal continuation coverage requirement, commonly known as “COBRA,” with respect to group health plans that are subject to ERISA and sponsored by employers with more than 20 employees.

In an effort to provide their residents covered by group health plans that are not subject to Federal COBRA (e.g., because they cover fewer than 20 employees) with the opportunity to purchase continuation coverage, many States, including New York, have enacted “mini-COBRA” laws. For example, a mini-COBRA law might require an insurance carrier insuring participants and beneficiaries of a plan exempt from Federal COBRA to offer such participants and beneficiaries continuation coverage that is analogous to Federal COBRA.

Pursuant to ARRA, the Federal government is subsidizing Federal COBRA and State mini-COBRA premiums paid by “Assistance Eligible Individuals” (“AEIs,” defined below) who lost their group health plan coverage due to an involuntary termination of employment.

*Note:* New York State insurance laws were recently amended to require health insurance policies issued in New York State to offer up to 36 months of continuation coverage for all qualifying events, even if the plan is subject to Federal COBRA. For more information regarding this extension, please see [http://www.ins.state.ny.us/cobra/cobra\\_ext\\_36.htm](http://www.ins.state.ny.us/cobra/cobra_ext_36.htm).

### How does the Federal subsidy work?

The Federal subsidy is available only to Assistance Eligible Individuals. An AEI who elects Federal COBRA or State mini-COBRA continuation coverage and applies for the subsidy will pay 35% of the premium that the plan would otherwise charge for such coverage. The Federal government will pay the remaining 65% through reimbursement to the insurer or former employer. The subsidy is not available to employers paying for continuation coverage on their former employees' behalf (e.g., as part of a severance package).

*Note:* In the case of an insured group health plan subject solely to State mini-COBRA continuation coverage laws, the insurer providing the coverage under the plan is the only person entitled to reimbursement for the premium reduction through the payroll credit. The employer may not take the payroll credit directly, even if it collects the reduced premiums from AEIs and pays the full premium to the insurer.

### Who is an Assistance Eligible Individual?

The criteria to be an Assistance Eligible Individual are the same whether the individual is receiving continuation coverage under Federal COBRA or a State mini-COBRA law. To be an Assistance Eligible Individual, he or she must:

- (1) become eligible for Federal COBRA or State mini-COBRA due to an involuntary termination of employment that occurred between 9/1/08 and 3/31/10, or (2) become eligible for Federal COBRA or State mini-COBRA due to a reduction in hours that occurred between 9/1/08 and 3/31/10 and be involuntarily terminated between 3/2/10 and 3/31/10;
- elect continuation coverage;
- not be eligible for Medicare; and
- not be eligible for coverage under any other group health plan (including a spouse's employer).

(If the AEI is receiving continuation coverage at a subsidized cost and becomes eligible for another group health plan or Medicare, he or she must notify the plan in writing or be subject to a tax penalty.)

There also is an income component to eligibility for the subsidy. If an AEI makes subsidized premium payments during a tax year and has income in excess of \$125,000 (\$250,000 if married) for the same tax year, the Federal government may recapture some or all of the subsidy by increasing the individual's tax liability. An AEI may choose to waive the subsidy to avoid this recapture, however, the subsidy cannot be subsequently elected after it is waived.

### Who is *not* an Assistance Eligible Individual?

The difficulty in evaluating AEI-status often lies in the facts and circumstances that determine whether a person was involuntarily terminated. However, some individuals, while perhaps eligible for Federal COBRA or State mini-COBRA during the requisite period, are clearly not AEIs.

- A child who loses coverage under his or her parent's health plan by aging out of "dependent" status is not an AEI.
- A person who loses coverage under his or her former spouse's health plan due to divorce is not an AEI.
- A non-spouse domestic partner losing coverage due to his or her partner's termination of employment cannot be an AEI unless he or she was covered as his or her partner's tax dependent before termination of employment.
- If an AEI gets married after his or her termination of employment and while receiving subsidized Federal COBRA or State mini-COBRA coverage, his or her new spouse might be eligible to enroll for coverage, but not at the subsidized rate (however, any children born to or adopted by the AEI would be eligible for coverage at the subsidized rate).

In the situations described in the third and fourth bullets above, the employer or insurer, as applicable, would charge the subsidized rate for the AEIs and the non-subsidized rate for the non-AEIs equal to the difference between the total cost of coverage and the cost attributable to the AEIs. If the cost of covering a non-AEI does not increase the cost of covering the AEIs, the cost of covering the non-AEI is zero and the full amount paid for Federal COBRA or State mini-COBRA coverage is eligible for the subsidy.

### How long does the subsidy last?

The subsidy will last for a period of fifteen months, or, if earlier, the first to occur of the following:

- the completion of the period of Federal COBRA/State mini-COBRA continuation coverage;
- the AEI's failure to pay his or her share of the Federal COBRA/State mini-COBRA continuation coverage premium; or
- the AEI's eligibility for coverage under Medicare or another group health plan.

If the AEI lost group health coverage due to a reduction in hours prior to involuntary termination of employment, he or she is entitled to a new election period for COBRA continuation coverage. If elected, the period of COBRA continuation coverage begins with the involuntary termination of employment, and the subsidy begins with the first period of coverage following termination of employment.

If the AEI is still entitled to continuation coverage after the subsidy expires, he or she will be required to pay 100% of the premium charged by the plan for such coverage.

#### How does the AEI secure the subsidy?

A form for electing the subsidy should be included with the notice sent by the employer (descriptions of the notices are below, and samples are posted on the DOL's website). The individual must return the form to his or her former employer affirmatively electing the Federal subsidy. The employer is not allowed to provide the subsidy automatically. If the employer denies the election (for example, because it disagreed with the former employee's classification of him/herself as "involuntarily terminated"), the individual may appeal the denial to the Department of Labor (if the plan is subject to Federal COBRA) or to the Department of Health and Human Services (if the plan is subject to State mini-COBRA).

#### What is an "involuntary termination of employment?"

The IRS has published several examples of involuntary termination of employment in Q&A format (see IRS Notice 2009-27). An "involuntary termination of employment" for purposes of the subsidy is broader than an employer-initiated layoff. Depending on the facts and circumstances, it also could include retirement or resignation by an employee in response to material negative changes in employment circumstances initiated by the employer.

- If an employee's work schedule is reduced from 40 hours per week to 25 hours per week, the reduction, in and of itself, is not an involuntary termination of employment (even if it constitutes a qualifying event for COBRA purposes). However, such employee's resignation in response to the reduction in hours might be an involuntary termination of employment if the reduction is a material negative change in the employment relationship for the employee.
- A termination elected by the employee in return for a severance package, where the employer indicates that a certain number of remaining employees in the employee's group will be terminated after the offer period for the severance package, is an involuntary termination of employment.
- An employee's resignation as the result of a material change in the geographic location of employment is an involuntary termination of employment.

#### What notices must be distributed?

The DOL has posted five model notices on its website. Plan administrators should use the notices containing information about the subsidy through March 2010. Employers may use the DOL models or their own notices (as revised).

- General Federal COBRA Notice: to be sent by plans that are subject to Federal COBRA to all qualified beneficiaries (not just the former employees) who experienced a qualifying event at any time from September 1, 2008 through March 31, 2010, regardless of the type of qualifying event.

- **Model Notice of New Election Period:** to be sent by plans that are subject to Federal COBRA or State mini-COBRA laws to all individuals who (i) experienced a reduction in hours between September 1, 2008 and March 31, 2010 that resulted in the loss of group health coverage; (ii) subsequently experienced a termination of employment at any point between March 2, 2010 and March 31, 2010; and (iii) did not elect continuation coverage when it was first offered (or elected but discontinued the coverage), no later than 60 days following termination of employment.
- **Model Supplemental Information Notice:** to be sent by plans that are subject to Federal COBRA or State mini-COBRA laws to all individuals who (i) experienced a reduction in hours between September 1, 2008 and March 31, 2010 that resulted in the loss of group health coverage; (ii) subsequently experienced a termination of employment at any point between March 2, 2010 and March 31, 2010; and (iii) elected and maintained continuation coverage when it was first offered, no later than 60 days following termination of employment.
- **Model Notice of Extended Election Period:** to be sent by plans that are subject to Federal COBRA or State mini-COBRA laws to all individuals who (i) experienced a termination of employment on or after March 1, 2010; (ii) were provided a notice that did not inform them of their rights under ARRA, as amended; and (iii) did not elect continuation coverage when it was first offered (or elected but discontinued the coverage), before the end of the required time for providing a COBRA election notice.
- **State Mini-COBRA Notice:** to be sent by plans that are subject to State mini-COBRA laws to all qualified beneficiaries (not just the former employees) who experienced (or will experience) a qualifying event at any time from September 1, 2008 through March 31, 2010, regardless of the type of qualifying event. This notice must include the information contained in the General Federal COBRA Notice, to be modified as necessary to reflect applicable State mini-COBRA laws.

*Note:* Some individuals may be entitled to receive multiple notices. Providing these individuals with a single notice that includes all of the required information will satisfy the notice requirement(s), so long as the notice is provided by the earliest date required.

Are AEIs allowed to change their coverage options?

Under ARRA, plans have the option of allowing AEIs the opportunity to elect a less expensive coverage option when they elect Federal COBRA or State mini-COBRA continuation coverage. There are limitations with respect to this rule; for example, the AEI would not be able to substitute his or her group health coverage for a stand-alone dental coverage or a flexible spending account and still receive the subsidy. If the plan allows for a change in coverage, the individual has 90 days after the date of notice to make such change.

## Resources

The DOL and the IRS have both posted guidance on their websites (in particular, see IRS Notice 2009-27). The Department of Labor has also posted an archive version of a webinar that it hosted in conjunction with the Internal Revenue Service.

For more information regarding the changes to COBRA Continuation Coverage under ARRA, as amended by the Act, please visit the United States Department of Labor website at <http://www.dol.gov/ebsa/pdf/fsCOBRAPremiumreduction.pdf>.

The updated COBRA Model Notices can be accessed at:

<http://www.dol.gov/ebsa/COBRAModelnotice.html>

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***This alert is meant to provide general information only, not legal advice. For additional information, please contact Judith Moldover at Lawyers Alliance for New York at 212-219-1800 ext.250.***