



CLIENT MEMORANDUM

American Recovery and Reinvestment Act of 2009: Provision of Premium Subsidy for COBRA Beneficiaries

February 23, 2009

INTRODUCTION

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "Act"), which, among other things, provides for a 65% federal subsidy of COBRA premiums payable by certain employees involuntarily terminated between September 1, 2008 and December 31, 2009 who are otherwise eligible for COBRA during this period, as well as their eligible spouse and dependents. The subsidy, which is payable for up to nine months, is to be funded by the federal government through an offset against the employer's federal payroll taxes (wage withholding and Social Security and Medicare payroll taxes). The subsidy will not begin until the filing of the relevant election forms by the former employee with the plan sponsor.

This new COBRA subsidy will apply to all employers maintaining group health plans, including employers who are not currently subject to the federal continuation of health-care benefits requirements, such as, for example, governmental plans and

plans subject to similar continuation coverage mandated by state or local law. There do not appear to be any exemptions.

In addition, the Act imposes notice and other administrative requirements on plan sponsors, as well as those administering the subsidy on their behalf.

COBRA PREMIUM SUBSIDY

The Act provides for a subsidy from the federal government equal to 65% of the COBRA premiums of "assistance eligible individuals" for up to nine months. This means that an eligible COBRA "qualified beneficiary" (as defined under COBRA) will be deemed to have paid the entire amount of the COBRA premium if he, or someone on his behalf (other than his former employer), pays 35% of the regular monthly COBRA premium. The remaining 65% is initially to be paid by the former employer (the plan sponsor), which will recoup its outlay through an offset against the aggregate amounts it is required to transmit to the federal government as federal payroll taxes. While the subsidy is

available for continued coverage of medical, dental and vision benefits (provided the latter two are combined with medical), it is not available for stand-alone dental and vision benefits, flexible spending accounts, or medical benefits provided through on-site medical facilities.

WHO IS AN "ASSISTANCE ELIGIBLE INDIVIDUAL?"

For purposes of the premium subsidy, an "assistance eligible individual" is any COBRA qualified beneficiary who becomes eligible for COBRA continuation coverage as the result of an involuntary termination of employment that occurs or occurred between September 1, 2008 and December 31, 2009, whether or not such termination was economically driven or in connection with a reduction in force, and who files an election to receive COBRA continuation coverage. An individual whose employment was terminated for gross misconduct remains ineligible for COBRA continuation coverage, consistent with current COBRA continuation coverage rules. As discussed below, *an individual who was involuntarily terminated on or after September 1, 2008 who failed to elect COBRA during the normally applicable COBRA election period following termination will be given a special opportunity to elect COBRA and receive the subsidy.*

If an individual's request to be treated as an assistance eligible individual is denied, he may appeal such denial to the Secretary of Labor, who must render a determination within 15 days from receipt of the application for review. Relevant guidelines concerning the appeals process will be issued by the Department of Labor.

MAXIMUM PERIOD OF SUBSIDY

The maximum period during which an individual will be eligible for the premium subsidy is nine months. The subsidy will end on the earliest of:

- the first day that the individual is eligible for coverage under any other group health plan (other than coverage consisting only of dental, vision, counseling or referral services (or a combination

thereof), a flexible spending arrangement or medical benefits provided through an on-site medical facility) or Medicare,

- the date that is nine months after the date the subsidy began, or
- the date the maximum applicable COBRA continuation period for the individual ends.

Premium subsidies will be made only with respect to periods of continuation coverage beginning after the effective date of the new provisions (March 1, 2009) and the filing of the relevant election forms by the assistance eligible individual with the individual's former employer. Individuals are required to notify their former employer or the plan as soon as they are *eligible* for coverage under another group health plan or Medicare, a change from basic COBRA law which requires notification only when actual coverage begins. If the individuals fail to make this notification, other than in certain limited circumstances, they will be subject to a tax penalty of 110% of the amount of the subsidy for all periods following the date they became ineligible for the subsidy.

SPECIAL COBRA ELECTION OPPORTUNITY

An individual who would have been an assistance eligible individual but for the fact that he did not have a COBRA election in effect on the date the Act was enacted (i.e., February 17, 2009) will be given a special 60-day period to elect to receive subsidized COBRA continuation coverage, following notice from his former employer of this right. An employer must provide notice of this opportunity to any such individual by no later than April 18, 2009 (i.e., 60 days after the date of the Act's enactment). This right to such COBRA continuation coverage generally will begin on or after March 1, 2009, and will end no later than the same date that COBRA continuation coverage would have ended had the individual elected it in connection with his original COBRA qualifying event, with the subsidy being provided for no more than nine months during this period. The period between the original COBRA qualifying event

and the first day of this new election period will not be counted as part of the 63-day elimination period for coverage for pre-existing conditions under current rules.

EMPLOYERS MAY PERMIT INDIVIDUALS TO CHANGE LEVEL OF COVERAGE

Current COBRA provisions permit a COBRA qualified beneficiary to elect to continue coverage only under the health plan by which he was covered at the time his COBRA qualifying event occurred. However, under the Act, employers may voluntarily permit an assistance eligible individual to elect, within the 90-day period following notice by the employer of this opportunity, coverage under any health plan offered by the employer, which coverage will be treated as COBRA continuation coverage. This different coverage opportunity may only be made available to a COBRA qualified beneficiary (i) if this coverage is also offered to active employees at the time such election is made, (ii) the premium for such different coverage does not exceed the premium for the coverage the employee had at the time of the COBRA qualifying event and (iii) this coverage is not for stand-alone dental, vision, counseling or referral services (or a combination of such services), a flexible spending arrangement, or services at an on-site medical facility.

NOTICE REQUIREMENTS

Employers are required to notify affected employees and their eligible spouse and dependents of the availability of the COBRA premium subsidy described above by April 18, 2009. This can be done by amendment of the employer's regular COBRA notice or, alternatively, employers may include this information in a separate notice. The Secretary of Labor has until March 19, 2009 to provide form notices which can be used for this purpose. Employers must also provide notice of the special COBRA election opportunity described above.

The notices must include: (i) the forms necessary to establish eligibility for the premium subsidy; (ii) the contact information of the plan administrator; (iii) a

description of the extended election period; (iv) an explanation of the individual's obligation to advise the former employer when he becomes eligible for coverage under another group health plan or Medicare and the penalty for the failure to so notify the plan; (v) a description (displayed in a prominent manner) of the right to the reduced premium and any conditions on entitlement to such reduced premium; and (vi) a description of the option to enroll in different coverage (if the employer has elected to so permit).

In addition, the employer must provide a notice of the special COBRA election opportunity described above to any assistance eligible individual whose COBRA election period expired prior to February 17, 2009.

MANNER OF REIMBURSEMENT FOR COBRA SUBSIDY

The employer or other person to whom COBRA premiums are payable will be reimbursed for the 65% portion of the premium not paid by the assistance eligible individual through a dollar for dollar offset against the federal payroll taxes (i.e., wage withholding and Social Security and Medicare payroll taxes) the employer is required to remit to the federal government. The employer must file a claim, and the amount equal to the premium reimbursement will be treated as a payment of the payroll taxes owed by the employer to the federal government. Any overstatement of the reimbursement will be treated as an underpayment of payroll taxes. No reimbursement can be made on behalf of any individual unless the 35% portion of the premium has been received from or on behalf of the individual.

The employer will need to file with the federal government a sworn statement that the individual was involuntarily terminated during the applicable period, the amount of the payroll taxes offset and the estimated offsets for the subsequent reporting period, the taxpayer identification numbers of all covered employees and qualified beneficiaries, and a designation with respect to each covered individual as to whether the subsidy reimbursement is for single or family coverage.

The procedures and mechanisms for reporting and transmitting these subsidies have yet to be established by the Department of the Treasury.

SUBSIDY NOT CONSIDERED INCOME FOR PURPOSES OF FEDERAL AND STATE PROGRAMS

The COBRA premium subsidy will not be deemed income or resources for purposes of determining eligibility for assistance or the amount of assistance or benefits under any federal, state or local law.

PREMIUM ASSISTANCE PHASE-OUT FOR HIGH INCOME INDIVIDUALS

Assistance eligible individuals whose modified adjusted gross income for the taxable year exceeds \$145,000 (\$290,000 in the case of joint filers) are not eligible for the COBRA subsidy. Accordingly, if such individuals receive the subsidy and, at the end of the applicable taxable year, it turns out they were ineligible for the subsidy, their income tax will be increased by the amount of the subsidy they received.

For assistance eligible individuals whose modified adjusted gross income for the taxable year exceeds \$125,000 (\$250,000 in the case of joint filers), but does not exceed the cap referenced above, the subsidy will be ratably reduced.

High-income individuals have the option to waive assistance and avoid recapture of the subsidy.

WHAT EMPLOYERS MUST DO NOW

Employers should begin to take steps to implement the new COBRA subsidy provisions. The first steps, which need to be taken within the next 60 days, include the following:

- Identify those employees (if any) whose employment was involuntarily terminated since September 1, 2008.

- Retain information on any employee whose employment is involuntarily terminated through December 31, 2009.
- Determine whether to permit eligible individuals to elect coverage under an eligible plan that is different from their prior plan.
- Prepare and send notices by April 19, 2009 to former employees and their covered spouse and dependents informing them about the new COBRA subsidy and how it will work, including, if applicable, the ability to elect coverage under another plan. Forms of notices for this purpose are required to be available from the Department of Labor by no later than March 19, 2009.
- Prepare supplemental COBRA notices (or amend current COBRA notices) to describe the new COBRA subsidy procedures. Forms of notices for this purpose are required to be available from the Department of Labor by no later than March 19, 2009.

Once information on the mechanics has been published by the Department of Labor, employers will need to work with their payroll and tax departments to establish procedures to file for a refund of the 65% subsidy from the federal government.

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This memorandum was not intended or written to be used, and cannot be used, for the purpose of avoiding tax-related penalties under federal, state or local tax law.

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