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The massive \$787.2 billion economic recovery package signed into law as the American Recovery and Reinvestment Act of 2009 (ARRA) by President Obama on February 17, 2009, will impact employers in several ways. One of the major components of the ARRA is the COBRA subsidy and tax credit available to employers who pay for part of the COBRA premium for terminated employees. As a result, there are additional burdens, pitfalls and hidden costs on the vast majority of employer-sponsors of group health plans.

## Stimulus Package: An In-Depth Look at the New COBRA Subsidy in the ARRA

By Steven J. Friedman, Susan K. Hoffman and J. René Toadvine

The American Recovery and Reinvestment Act of 2009 (ARRA or “the Act”), the stimulus legislation signed on February 17, 2009, by President Obama, contains sweeping revisions to the group health plan continuation coverage provisions contained in the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). The new provisions impose additional burdens and hidden costs on the vast majority of employer-sponsors of group health plans. For information regarding the other employment-related provisions of the stimulus bill see Littler’s ASAP, *Besides COBRA: What Does the Stimulus Package Have for Employers*.

The key concept contained in the new COBRA provisions involves the creation of a new “qualifying event” that provides a 65% COBRA premium subsidy for eligible, involuntarily terminated employees (and their covered dependents). The subsidy is effective on and after the date of enactment (February 17 or for “monthly period of coverage” plans, March 1, 2009). The Act requires the employer to “front” the subsidy by collecting only 35% of the applicable COBRA premium. The employer is then reimbursed from the employer’s quarterly federal payroll tax transmittals for the 65% COBRA premium subsidy (or with a direct payment, if payroll tax transmittals are insufficient). It is unclear how the subsidy will work when employers are already subsidizing COBRA premiums. Further guidance on the actual application of the subsidy will need to be provided.

Under the Act, the employer may elect to make available to these subsidy-eligible employees any other broad-based medical coverage option that is also offered to active employees that has the same or a lower premium than the option in which the employee was enrolled prior to termination. The subsidy ends for any covered individual no later than the earlier of nine months after the first day of the first month the subsidy coverage begins or on the date COBRA would otherwise expire. However, the subsidy will end earlier for a covered individual if he or she becomes eligible for coverage: (1) under another group health plan (other than coverage consisting of only dental, vision, counseling or referral services, or a combination thereof, or coverage under a health flexible spending account or a health reimbursement arrangement); or (2) under Medicare or Medicaid. The subsidy does not apply to health care flexible spending accounts.

## Subsidy Eligible Individuals Under the Act

A subsidy-eligible employee must otherwise be eligible for COBRA coverage (which means that the “gross misconduct” exclusion will still apply), and must have been involuntarily terminated on or after September 1, 2008, but on or before December 31, 2009 (and become eligible for COBRA coverage during that period). If the election period had already expired on the Act’s effective date, the employer is required to provide a COBRA notice and a new 60-day election period to any subsidy-eligible former employee who did not elect COBRA. The effective date of such coverage would be the enactment date of the new law (February 17). However, for purposes of determining the maximum COBRA period, the COBRA “qualifying event” is the date coverage is lost on account of the employee’s termination of employment.

The period of noncoverage may not be counted toward any pre-existing condition exclusion. The “retroactive” COBRA notice must be provided within 60 days after enactment of the new law. Any denial of eligibility (such as a gross misconduct determination) will be subject to expedited review under the auspices of the Department of Labor (DOL).

## Refunds for Subsidy-Eligible Individuals Who Paid Full Premiums

Any subsidy-eligible former employee who is paying full COBRA premiums when the law is enacted also will be entitled to the subsidy commencing as of the date of enactment (or for “monthly period of coverage” plans, March 1, 2009). The employer will be required to refund the excess (retroactive to the enactment date) or provide a credit in future premium payments for the employer-maintained overpayment (to be made up within six months). Of course, the employer will be entitled to recoup these amounts from quarterly payroll tax transmissions.

## Income Limitations on Subsidy Recipients

Although the subsidy is available to all assistance-eligible individuals, up to 100% of the subsidy will be assessed as an additional income tax for those classified as “high income individuals.” For these individuals, the subsidy becomes assessed as an additional tax on a sliding scale. For single filers, the phase-in starts at a modified adjusted gross income (AGI) of \$125,000 with full 100% tax assessment for those earning at least \$145,000, and, for joint filers, the phase-in starts at a modified AGI of \$250,000, with full 100% tax assessment for those earning at least \$290,000. A “high income individual” may waive the subsidy by notifying his or her employer and paying the full COBRA premium, thereby avoiding having to report the subsidy and paying the subsidy back in the form of income tax on his or her annual income tax return.

## Employer Notice Requirements

The Act requires employers to amend COBRA notices to inform all individuals who become eligible for COBRA between September 1, 2008 and December 31, 2009, of the following:

1. A description of the eligibility rules for the 65% subsidy;
2. An eligible individual’s ability to make a COBRA election even if COBRA was initially declined;
3. The option to elect other same premium or lower-premium coverage if available;
4. How the subsidy may be elected; and
5. An explanation of an individual’s obligation to notify the plan of eligibility for other group plan coverage.

This notice may either be incorporated into other COBRA materials explaining election rights or be sent with other COBRA materials as a separate notice.

The notice requirement becomes effective April 18, 2009, and the DOL has been directed to issue a model notice for employer use by March 19, 2009.

## Effective Dates

The ARRA became effective February 17, 2009, and, technically, COBRA provisions must be immediately revised to reflect the subsidy. However, the ARRA contains a grace period of two full COBRA billing periods subsequent to the Act's effective date within which to commence the subsidy, provided appropriate premium credits (or refunds) are provided in subsequent periods.

## Impact on Employers

While the reimbursement of the subsidy appears to make these provisions cost-neutral to the employer, it, in fact, does not. In general, COBRA beneficiaries have significantly worse experience than active employees as a group – primarily because of the cost of COBRA coverage, but also because former employees with high medical expenses may be less likely to obtain other coverage as quickly as healthier (often younger) former employees. While the subsidized coverage may be more attractive to those former employees with less expectation of high medical expenses, the fact remains that laid-off employees have limited resources and purchasing medical care may be of lower priority to those with less claims experience, even at subsidized rates. In addition, the retroactive election period (of at least 60 days) afforded to those who were laid off on or after September 1, 2008, and who did not originally elect COBRA, is likely to lead to elections of coverage by those who did not expect high medical bills when they were laid off but who have developed serious medical conditions in the interim. Thus, we expect that the pattern of higher-than-average COBRA experience will continue.

## What Should Employers Do Now to Comply with the COBRA provisions?

Employers should take steps to ensure timely compliance with the provisions of the ARRA. First, individuals should be identified who are eligible for the subsidy (*i.e.*, those who were involuntarily terminated beginning September 1, 2008). Second, if an employer maintains another same-cost or lower-cost plan, the employer should determine if it will offer eligible individuals the choice of that plan (or plans) or the coverage normally made available to COBRA-eligible individuals. Third, the employer must also decide how affected individuals will be notified of this new law, particularly whether a notice will be provided imminently or whether the employer will wait to provide the notice after the DOL issues a “model notice.” Finally, the employer's payroll processes must be reviewed and changed to meet the requirements of the new law.

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