



February 17, 2009

## ***Important Update: Changes to COBRA and Commuter Benefits under the Economic Stimulus Package***

President Obama signed the American Recovery and Reinvestment Act (the Act) into law today. Provisions of this Act include significant changes to commuter benefits programs under Code §132(f) and COBRA continuation of coverage. The following summarizes these changes.

### **A. COMMUTER BENEFITS**

The Act creates financial parity between the parking and commuter (transit and vanpool) benefits under Code §132(f). Effective for months beginning on or after March 1, 2009, the monthly exclusion amount for employer-provided commuter benefits will increase from \$120 per month to \$230 per month.<sup>1</sup> This parity requirement only applies for the 2009 and 2010 tax year (January 1-December 31).

### **B. COBRA**

#### **BRIEF OVERVIEW**

The Act contains significant changes for COBRA including a 65% subsidy of COBRA premiums for 9 months for certain eligible individuals. This subsidy is available effective March 1, 2009.

The Act also provides a Special Election Period for qualified individuals who experienced an involuntary termination on or after September 1, 2008 and were eligible for COBRA but did not elect such coverage (and are not covered by another group health plan or Medicare). Employers must provide notice of this special election opportunity by April 19, 2009. The Department of Labor (DOL) plans to issue model notices on or before March 18, 2009.

The final bill does not contain the House's original proposal to extend COBRA to Medicare eligibility for individuals over age 55 or employed for 10 or more years with the employer.

The following provides further detail on these new requirements.

#### **PREMIUM SUBSIDY**

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<sup>1</sup> This dollar amount is adjusted annually for inflation.

The Federal Government will subsidize **65%** of the COBRA premiums for qualified beneficiaries who are *assistance eligible individuals* for a period of no more than 9 months. This means a COBRA qualified beneficiary, or person other than the employer paying the premium on their behalf (e.g. the parent of a qualified beneficiary), will be treated as having paid the COBRA premium in full if they pay 35% of the premium.<sup>2</sup>

A COBRA qualified beneficiary is an assistance eligible individual if:

- The qualified beneficiary elects COBRA coverage<sup>3</sup>,
- The qualifying event with respect to the covered employee is the loss of group health plan coverage due to involuntary termination of employment, and
- The qualifying event occurs during the period beginning on or after September 1, 2008 and ending December 31, 2009.

The subsidy is available to all group health plans eligible for COBRA except a health flexible spending account (FSA).

#### **STATE LAW “COBRA-LIKE” REQUIREMENTS**

The Act extends the premium subsidy to state programs that provide comparable continuation of coverage. This likely includes state programs for small employers that are not currently covered by federal COBRA. In many cases these state requirements are purely insurance requirements (i.e. former employee pays the insurance company directly for continuation of coverage). If there is no employer involvement under these continuation programs, the insurer is likely responsible for compliance and eligible for the government reimbursement.

#### **REIMBURSEMENT**

##### *EMPLOYER PAYROLL CREDIT*

Generally, the employer (in the case of a group health plan subject to federal COBRA requirements) will receive a reimbursement for the amount of premiums not paid by the assistance eligible individual by virtue of the Act. This will be 65% of the COBRA premium (unless the employer directly subsidizes the total COBRA premium).

Upon receipt of the assistance eligible individual’s premium payment the employer may reduce payroll taxes in an amount equal to the portion of such reimbursement related to the premium. Payroll taxes include wage withholdings, employee FICA taxes and employer FICA taxes. If the amount exceeds the payroll tax liability, the Internal Revenue Service (IRS) will provide a credit or refund.

##### *I PAY A PORTION OF MY FORMER EMPLOYEES COBRA PREMIUMS, WHAT IS THE IMPACT?*

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<sup>2</sup> The amount of the premium used to calculate the reduced premium is based on the amount that the employee would generally be required to pay for COBRA (e.g. 102% of the applicable premium). If the employer pays a portion of the COBRA premium the employee’s amount is based on their reduced premium. (*See discussion below*)

<sup>3</sup> See special election period information for a special rule pertaining to individuals who are otherwise assistance eligible individuals but did not elect COBRA.

The availability of the reimbursement is based on the amount of premiums that would otherwise be paid by an assistance eligible individual without the Act. It appears that arrangements made by the employer to pay a portion of the COBRA premium (e.g. certain severance agreement) are not considered for purposes of the subsidy and reimbursement.

Therefore, if the employer agrees to pay a portion of the employee's COBRA premiums, the subsidy is based only on the employee's portion of the premium and not the employer's contribution or the total premium. Employers paying the entire COBRA premium are not eligible for any reimbursement.

Employers will need to review any such agreements in light of these changes.

#### **DURATION OF THE SUBSIDY**

The premium subsidy is available to an assistance eligible individual for a limited period of time.

The subsidy ends the earlier of:

- The first date that the assistance eligible individual becomes eligible under any other group health plan<sup>4</sup> or is eligible for benefits under Medicare (Title XVIII of the Social Security Act),
- 9 months after the first month that the individual receives the subsidy,
- The end of the maximum COBRA period, or
- The end of the maximum period under any state "COBRA-like" requirement.

The assistance eligible individual has the obligation to notify the group health plan in writing if he or she becomes eligible for other group health plan coverage or Medicare. Failure to do so may result in a penalty imposed on the individual of 110% of the premium reduction unless the failure was due to reasonable cause.

#### **SPECIAL ELECTION PERIOD**

There is a special COBRA election period available to individuals who would otherwise be an assistance eligible individual but did not elect COBRA continuation of coverage when it was initially offered (or elected and later dropped coverage).

Individuals who were involuntarily terminated on or after September 1, 2008 must be notified of their ability to elect continuation of COBRA coverage and receive the subsidy. They will have the opportunity to elect COBRA on or after the date of enactment and ending 60 days after the date a notification is sent to the individual.

COBRA coverage will be offered from the first period of coverage on or after the enactment of the Act. The period of coverage is a monthly or shorter period in which premiums are charged. For most plans this will be March 1, 2009.

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<sup>4</sup> Other group health plan coverage does not include dental or vision standalone plans, coverage under a health FSA or access to an on-site medical facility.

Under this provision the duration of coverage is measured from the original qualified event date.

*Example*

Bob was involuntarily terminated and experienced a COBRA qualifying event November 1, 2008. COBRA premiums were too expensive and Bob did not elect to continue coverage. Under the Act, Bob's former plan will need to notify Bob of his right to elect COBRA and the availability of the premium subsidy. Bob has 60 days from the date of the notification to elect COBRA. If he elects COBRA coverage he pays a premium of 35% of the COBRA rate.

Bob elects coverage and pays the premium starting March 1, 2009. Bob's COBRA coverage is prospective (not retroactive), but the 18-months of continuation of coverage is measured from November 1, 2008.

If the assistance eligible individual was without health coverage beginning on the date of the COBRA qualified event and ending with the first period of coverage under the Act (March 1, 2009), this period will be disregarded for purposes of determining whether the individual had a 63-days break in coverage under the creditable coverage rules.

**OPTIONAL – ALTERNATIVE COVERAGE**

Employers that offer a variety of group health plan options (e.g. HMO, PPO, Qualified High Deductible Health Plans) may allow the assistance-eligible individual to enroll in COBRA coverage that is different from the coverage held at the time of the qualified event.

In order for an individual to take advantage of this option:

- The employer must make the option available,
- The premium associated with the alternative coverage must be less than the premium associated with the current coverage,
- The alternative coverage was offered to active employees as part of open enrollment, and
- The alternative coverage is not a standalone vision or dental plan, a health FSA or HRA plan or an onsite medical facility.

The assistance eligible individual has 90 days after notification of this option to elect to enroll in alternative coverage.

**NOTIFICATION REQUIREMENTS**

*QUALIFIED BENEFICIARY NOTICES*

1. Election Notice

The Election Notice must include the following in order to be considered sufficient notice of the premium subsidy:

- Availability of a premium reduction with respect to the COBRA coverage

- The option (if available) to enroll in different coverage under the employer's plan including a description of the other available coverage options,
- Forms necessary to establish eligibility for the premium reduction,
- Contact information (including name, address and phone number) to the plan administrator and any other person maintaining information in connection with the premium reduction (e.g. COBRA administrator),
- A description of the extended election period,
- A description of the obligations of the qualified beneficiary to notify the plan of eligibility for other group health plan coverage or eligibility for benefits under Medicare and the penalty for failing to provide such notice, and
- A prominent description of a qualified beneficiary's right to reduced premium and any condition on entitlement to the reduction in premium.

This notice may take the form of an amendment to the existing notice forms or by inclusion of a separate document with the election notice.

## 2. Notice in Connection with Extended Election Periods

The plan administrator must provide notice of the special enrollment period to all individuals who involuntarily terminated on or after September 1, 2008 and are not receiving COBRA continuation of coverage. This notice should contain the information described above and must be provided by April 18, 2009. A model notice should be issued by the Department of Labor (DOL) on or before March 19, 2009.

Failure to provide this notice is treated as a failure to comply with notice requirements under COBRA.

### *IRS NOTIFICATION*

The employer will need to submit reports to the IRS in a time and manner to be determined that include:

- An attestation of the involuntary termination of employment of each employee claiming the subsidy;
- The amount of payroll taxes offset by the reimbursement;
- The tax identification numbers of all covered employees;
- The amount of the subsidy reimbursed with respect to each covered employee, and
- The type of coverage (one individual or two or more individuals) associated with the subsidy.

### **OVERPAYMENT**

As this transition is happening very quickly, it is likely that many participants will pay the full COBRA premium, even though they may be eligible for the premium subsidy. In the event of an overpayment, the employer has the option of reimbursing the individual the difference or applying the overpayment as a credit toward future premium payments.

However, when using the credit option the employer must have a reasonable belief that the credit will be used within 180 days from the date the individual made the full payment. If not, the employer must reimburse the individual within 60 days.

## **SPECIAL RULES FOR HIGH INCOME INDIVIDUALS**

### *HIGH INCOME INDIVIDUALS – RECAPTURE TAX*

Generally, the full subsidy will not be available to certain high income individuals. An individual with adjusted gross income for the taxable year exceeding \$145,000 (\$290,000 for a joint return) will need to repay the subsidy for all months received during the taxable year. This is handled by an increase in the taxpayer's liability for the year equal to such amount, referred to as the *recapture tax*.

If the taxpayer's adjusted gross income is between \$125,000 and \$140,000 (or \$250,000 and \$290,000 for joint filers) the premium subsidy is available on a proportionate basis for the taxable year. The taxpayer will be subject to a reduced recapture tax bases on their adjusted gross income.

It is important to note that an individual who does not satisfy the income threshold to receive a full or partial subsidy in 2009 may nevertheless be eligible in 2010 assuming the adjusted gross income falls below the required levels.

### *Waiver*

Individuals may waive the right to the premium subsidy for all periods of coverage. This waiver is permanent and the individual must provide written notice to the employer. The waiver avoids the recapture tax should the income threshold be exceeded. However, the waiver applies to all periods of coverage regardless of tax year. Therefore if an individual waives their premium subsidy in 2009 he or she may not claim the subsidy in 2010 even if their income falls below the threshold.

## **APPEAL OF A SUBSIDY DENIAL**

An individual who requests the subsidy and is denied by the group health plan may appeal the determination to the DOL. The DOL (in consultation with the IRS) shall provide an expedited review of any such denial. The DOL must make its determination within 15 business days after receipts of an individual's application for review.

## **C. ACTION ITEMS**

- If applicable, adjust dollar threshold for commuter expenses. Employees should have the opportunity to increase their election.
- If applicable, determine whether you will make alternative coverage options available.
- Review all the individuals that terminated employment on or after September 1, 2008 and provide proper notification of the new subsidy under COBRA. This includes:

- Developing proper notices –DOL model notices should be available March 19, 2009.
- Update election notice and provide to qualified beneficiaries with qualifying events going forward.
- Send notice to current COBRA qualified beneficiaries that are assistance eligible employees eligible for a subsidy, and
- By April 18, 2009, send the special election notice to individuals who are otherwise assistance eligible individuals but are not receiving COBRA continuation of coverage.
- Track qualified beneficiaries receiving the subsidy and comply with the proper reporting requirements to the IRS.
- Collect waivers from highly compensated employees forgoing the subsidy.
- If applicable, discuss these requirements with your COBRA administrator to ensure they have the proper notices and reporting process in place to assist you in your compliance obligations.

For more information see

- Copy of the Act [http://www.house.gov/billtext/hr1\\_legtext\\_crb.pdf](http://www.house.gov/billtext/hr1_legtext_crb.pdf) (Commuter Benefits pg 69) (COBRA pgs 396-427)
- Summary of the Act [http://www.house.gov/billtext/hr1\\_cr\\_jesb.pdf](http://www.house.gov/billtext/hr1_cr_jesb.pdf) (Commuter Benefits pg 139) (COBRA pgs 212-227)

The *Employee Benefits Bulletin* is designed to highlight various employee benefit matters of general interest to our readers. It is not intended to interpret laws, regulations or to address specific client situations.



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