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Stimulus Package Requires Subsidized COBRA Payments in 2009

By: Alan M. Levy

The American Recovery and Reinvestment Act of 2009 – the economic stimulus package signed by President Obama on February 17, 2009 – includes a requirement that employers subsidize the COBRA continuation of health insurance premium payments of “involuntarily terminated” employees and then be reimbursed through tax credits for those payments. These rules will have an immediate impact on severance arrangements and reductions in force.

THE SUBSIDY AND THE ELIGIBILITY RULES

An “assistance eligible individual” (“AEI”) is any employee “involuntarily terminated” between September 1, 2008 and December 31, 2009. Both those who first become AEIs on or after February 17, 2009 and those who were terminated earlier can begin to receive the subsidy as of March 1, 2009. The program requires the AEI to pay 35% of the employee COBRA premium in the same manner as the original COBRA rules provided, and the employer must then pay the remaining monthly amount for coverage. However, the subsidy must end upon the earliest of (1) nine months of employee payments, (2) eligibility for group insurance elsewhere, or (3) eligibility for Medicare. A penalty of 110% of any subsidy paid by the employer will be assessed to any AEI (or his/her qualified beneficiary) who does not promptly notify the employer if either of the latter two events occurs.

An AEI who declined COBRA continuation prior to February 17, 2009, or whose coverage lapsed due to lack of monthly payments prior to that date, must be given the opportunity to restart the benefit effective March 1, 2009, subject to his/her 35% payments for that period and the same employer subsidy stated above. If the AEI makes employee COBRA payments for the new nine-month period which exceed the 35% figure, the employer must return the overpayment or use it as a dollar-for-dollar credit toward the AEI’s future payments in this program.

THE TAX CREDIT

The employer is reimbursed for its 65% share of the premiums by a credit against payroll taxes, using a Form 941 or 941c. This must be done with a report (which IRS is supposed to develop and provide) which will include:

- 1) Attestation of the involuntary termination of each AEI for whom the employer has paid the subsidy during that tax reporting period.
- 2) The amount of the credit claimed to offset tax payments for the reporting period.
- 3) An estimate of anticipated tax credits to be taken in the next reporting period.
- 4) The taxpayer identification numbers of all AEIs being reported.
- 5) The amount of the subsidy reimbursement being claimed for each AEI employee and any qualified beneficiary.¹
- 6) An accounting of which subsidies are for one person and which for two or more (i.e., single and family).

If the reimbursement amount is less than the payroll tax, it is to be taken as a credit which reduces that tax payment. If it is greater than the tax credit, the excess is to be returned to the employer like any other payroll tax overpayment.

SPECIAL RULES

- A. The 65% subsidy/reimbursement is not available for employees with modified adjusted gross income ² over \$125,000 for individual filers or \$250,000 for joint filers during the tax year in which they receive the subsidy. Also, the employer cannot be reimbursed for any part of the AEI's 35% share of the premium payment (as when a severance agreement provides for higher post-termination employer payments, or when a health plan or labor contract calls for employees to pay something less than 35% of the premium).

¹ "Qualified beneficiary" is defined by the original COBRA rules.

² As the term is used in personal income tax filings.

- B. To receive the tax credit reimbursement, the employee must have made the 35% payment, and the employer then added the 65% subsidy. A tax credit cannot be claimed in anticipation of such payments.

- C. If the employer offers a variety of health insurance programs, the AEI may elect to use COBRA to allow enrollment in and payments for one which has a lower premium than that he/she utilized immediately prior to the "involuntary termination." However, this reduction cannot be used to enter programs which only provide dental, vision, counseling, or referral services, first aid or wellness programs available through on-site clinics or similar facilities, or flexible spending arrangements.

NOTICES AND ENROLLMENTS

Anyone who becomes an AEI on or after February 17, 2009 must receive a notice of COBRA continuation rights which explains the subsidy rules in a clear and prominent manner. This must include:

- 1) Any forms necessary for utilizing the subsidy.

- 2) The contact information for the authorized person who can explain the program.

- 3) The 110% penalty for the AEI or his/her qualified beneficiary who fails to notify the plan of an event ending COBRA coverage.

- 4) An explanation of how to enroll in whatever alternative insurance program may be available and subject to the subsidy.

- 5) The time table for notice, election, payment, and response, which is the same as in the original COBRA system.

Every AEI terminated prior to February 17, 2009 must be notified by April 18, 2009 of the right to start or re-start his/her COBRA coverage effective March 1, 2009 by electing to enter the program with the subsidy. These people must be told in that notice that they cannot obtain or extend COBRA continuation for any period past the date their rights under the original COBRA rules permitted and that the subsidy is for nine months regardless of whether their regular COBRA period

continues after that date. They must also be fully informed of any alternative insurance plan available to them under the same rules as for post-February 17, 2009 termination.

IMMEDIATE IMPACT ON SEVERANCE AND R.I.F.

Because the employer's reimbursement is limited to 65% of the COBRA premium, severance agreements, reductions in force incentives, and similar arrangements which provide post-termination health insurance benefits greater than that amount are now of concern. Alternative forms of payment for the equivalent of the employee's 35% share are better choices than shorter periods of fully paid COBRA premiums.

Another issue is the exclusion from this subsidy for employees whose personal income tax filings exceed the \$125,000.00/\$250,000.00 caps. These income figures are not limited to compensation from the employer offering the health insurance benefit. Moreover, that income is for the year in which the subsidy is paid. This requires a determination of income during the year of the involuntary termination, at a time when no one knows whether or when the employee will be reemployed and earn enough to reach the cap which had not been met when he/she terminated. Highly paid employees may wish to avoid tax questions by declining the subsidy.

FINAL COMMENTS

Some of these rules undoubtedly will be clarified or further detailed as the U.S. Department of Labor and the Internal Revenue Service issue model notices, forms, and regulations which are due within the next 30 days. Questions such as the definition of a "voluntary termination" (same as original COBRA rules?) should be addressed. State rules may also be announced because the federal statute authorizes retention of all state laws about health insurance continuation. Lindner & Marsack, S.C. will continue to monitor these developments and inform you of them as they occur.

If you have any questions about the issues raised by this e-alert, please feel free to contact Alan M. Levy at (414) 273-3910 or by e-mail at alevy@lindner-marsack.com