

ADVISORY

SULLIVAN & WORCESTER LLP EMPLOYMENT & BENEFITS ADVISORY

COBRA SUBSIDY AND OTHER BENEFITS DEVELOPMENTS

Additional Guidance On Federal COBRA Subsidy

As described in our two recent advisories, dated [March 27](#) and [February 26](#), the American Recovery and Reinvestment Act ("ARRA") generally provides a federal subsidy for the cost of group health plan continuation coverage for up to nine months for employees (and their eligible dependents) who lost or will lose coverage due to an involuntary termination of employment from September 1, 2008 through December 31, 2009. In addition, ARRA provides a special COBRA enrollment election right for some of these individuals. The Internal Revenue Service has recently provided additional guidance on how certain provisions of this new law work.

The Subsidy Calculation. Under ARRA, an "assistance eligible individual" need only pay 35% of the cost of continuation coverage. (For more information on this definition, please see our [prior advisory](#).) The IRS has now clarified that the federal subsidy will only apply to the amount the employee is paying *after* taking into account any employer provided subsidy.

Example: The cost of continuation coverage under the PenCo group health plan is \$1,000 a month but PenCo only charges terminated employees the 40% active employee rate. Prior to ARRA, Stephanie would pay \$400 per month for COBRA continuation coverage. But assuming the various requirements of the ARRA subsidy are satisfied, she would only need to pay \$140 per month (35% of \$400). PenCo will continue to pay its \$600 share and the government will now subsidize \$260 (65% of \$400).

The IRS has clarified that no government subsidy is available where an employer pays for the entire cost of continuation coverage. This is particularly important because, as noted, the government subsidy is available for only up to nine months after an individual becomes an assistance eligible individual (or, if later, shortly after enactment of ARRA). The federal subsidy ends at the earlier of: (1) the first date the individual becomes eligible for Medicare or other group health plan coverage (after any required waiting period); (2) the date that is nine months after the first day of the first month for which the premium reduction provisions apply; or (3) the date the individual ceases to be eligible for COBRA continuation coverage.

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Example: Prior to ARRA, PenCo would typically pay the full cost of COBRA continuation coverage for six months and a terminated employee would pay the full \$1,000 cost of coverage thereafter. After ARRA, if PenCo continues to pay the full \$1,000 a month for the first six months, no government subsidy is available during that time. For the next three months, assuming that the various requirements of the ARRA subsidy are satisfied, an assistance eligible individual will only need to pay \$350 per month and the government will subsidize \$650 per month. Thereafter, no further federal subsidy will be available.

Example: Jack is involuntarily terminated on October 2, 2008 and is an assistance eligible individual. Jack elects to continue his former employer's group health coverage under COBRA, rather than enrolling in the group health plan of his spouse, which has its annual open enrollment in June, with coverage effective each July 1. Assuming the period of coverage coincides with the calendar month, Jack is eligible for the federal subsidy for the period March 1, 2009 through June 30, 2009.

Definition Of Involuntarily Terminated. The federal subsidy is available only to those individuals who were or will be "involuntarily terminated" between September 1, 2008 and December 31, 2009. To help employers administer the subsidy, the IRS has provided a definition of "involuntarily termination" that includes any severance from employment as a result of the exercise of the employer's authority to terminate employment, other than due to the employee's implicit or explicit request, where an employee is willing and able to continue performing services. Thus, where the employee retires or quits and accepts benefits in order to avoid a potential layoff, the individual is considered to be involuntarily terminated. In addition, an involuntary termination may be deemed to occur where an employee quits due to a material negative change in the employment relationship.

Starting The Subsidy. The subsidy is available for the first period of coverage beginning on or after February 17, 2009. Where a plan requires that continuation coverage be paid for the entire calendar month, the plan cannot prorate the premium for February in order to apply the subsidy for a portion of February. Where, however, the plan requires an individual to pay a pro rata portion of the monthly premium for the first partial month of coverage, the subsidy is available for the individual's first partial month of coverage. For example, if an employee is terminated on February 20, 2009, and is required to pay a pro rata portion of the cost of coverage for February (eight days), the subsidy would be available for the first February payment. If, on the other hand, the plan provides that payment for the entire month of February was made on February 1, no subsidy would be available until the March 1st payment.

Special COBRA Enrollment Right. An individual who does not have COBRA continuation coverage as of February 17, 2009 (because he or she did not initially elect COBRA or was unable to pay the premiums, for example), but would have been eligible for the federal subsidy if the election were in effect (in other words, is otherwise an assistance eligible individual) is allowed a second opportunity to elect COBRA continuation coverage under ARRA. This right extends to the spouse and dependent children of the former employee if they were covered by the group health plan on the day before the involuntary termination. (This is the case even if the former employee initially elected individual only COBRA continuation coverage.)

If elected pursuant to this special enrollment right, coverage begins with the first period of COBRA continuation coverage beginning on or after February 17, 2009. For plans that require COBRA continuation coverage be paid for based on a calendar month, the first period of coverage begins March 1, 2009, even if the plan otherwise requires individuals who lose coverage before the last day of the month to pay a pro rata portion of the premium. For plans that require COBRA continuation coverage be paid for based on a monthly period computed from the date of the loss of coverage, the first day of coverage is the monthly period corresponding to the day after the initial loss of coverage.

Example: If the last day of coverage for an individual was October 3, 2008 and the first period of COBRA continuation coverage would have run from October 4, 2008 through November 3, 2008, COBRA continuation coverage elected under this special enrollment right would begin March 4, 2009.

Subsidy Only Available For Qualified Beneficiaries. The IRS has indicated that no subsidy is available for individuals who are not "qualified beneficiaries" under COBRA, even if state law requires coverage. Thus, for example, although state law may require coverage for a child who is no longer a dependent for federal income tax purposes, the federal subsidy will not necessarily be available unless the assistance eligible individual already had, for example, family coverage that included other "qualified beneficiaries" under COBRA.

Repayment For Subsidies Not Collected. ARRA contemplated that an employer may continue to collect the full cost of COBRA continuation coverage (or any amount charged after any employer subsidy) during March and April of 2009, provided that the employer reimburse or credit the individual for any missed federal subsidy. Although not specifically addressed in the guidance, employers should undertake to reimburse or credit any missed subsidy. An employer may apply a credit as long as it is reasonable to believe that it will be used within 180 days of the payment of the full premium amount. If the credit cannot be used within 180 days, a refund must be made within 60 days of the payment of the full premium amount.

Interaction With State Mini-COBRA Laws. Although ARRA provides that the federal subsidy itself is available with respect to continuation coverage available under state mini-COBRA laws, the new guidance clarifies that the special COBRA enrollment right (described above) will be available only if applicable state law allows for it.

Other Benefits Developments

Increased Limit On Excludable Transportation Benefits. Under the Internal Revenue Code, employers are permitted to provide various

transportation benefits (such as transit passes) on a tax-free basis to employees. These benefits, like the exclusion for parking, can be provided directly by the employer or an employee can use pre-tax dollars to fund the benefit, in each case up to certain monthly limits and adjusted annually for inflation.

Prior to ARRA, the 2009 federal income tax exclusion limits were \$120 per month for transportation benefits, and \$230 per month for parking benefits. ARRA increases the limit for transportation benefits to \$230 per month. Unfortunately, for employers in Massachusetts, things are never so easy. The Massachusetts tax law will not automatically recognize the increased limit for transportation benefits and so while up to \$230 per month is now excludable federally for transportation benefits, in Massachusetts, only \$120 per month (the old limit) is excludable (although for Massachusetts income tax withholding purposes, the full \$230 per month can be treated as excludable).

Expanded HIPAA Special Enrollment Rights Under SCHIP Legislation. Under the recently enacted Children's Health Insurance Program Reauthorization Act of 2009, effective April 1, 2009, employees or dependents eligible for Medicaid or coverage under the State Children's Health Insurance Program ("SCHIP") must be allowed to enroll mid-year into their employer's group health plan when they cease to be eligible for Medicaid or SCHIP coverage or when they become eligible for premium assistance. An employee must be afforded 60 days to enroll after such an event. (Note that this differs from the normal 30-day special enrollment period required by HIPAA for other types of special enrollment rights.)

This new provision may require an amendment to your welfare plan document and will require additional employee communications. With respect to communications, however, the new law directs the U.S. Department of Labor and Department of Health and Human Services to develop a model notice by February 4, 2010 and provides that employers will not be obligated to provide information prior to the first plan year is beginning after the date on which the model notice issued.