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Client Alert – March 6, 2009

Stimulus Bill Provides Subsidy for COBRA Premiums

The American Recovery & Reinvestment Act (the "Stimulus Bill") was signed into law on February 17th and will have significant impacts on many of our business clients and colleagues.

The Stimulus Bill includes major changes to the Consolidated Omnibus Budget Reconciliation Act ("COBRA") that will immediately impact employers who are subject to COBRA. Generally, the COBRA rules apply to employers who offer a group health plan and have 20 or more employees

Premium Assistance. The Stimulus Bill provides a subsidy designed to help certain former employees and their dependents (referred to as "assistance eligible individuals" or "AEIs") pay for COBRA or state insurance continuation coverage (collectively COBRA coverage).

For most group health plans, the subsidy will be available with respect to COBRA premiums beginning in March 2009. The subsidy is generally equal to 65% of the amount the AEI would otherwise be required to pay for COBRA coverage.

If the employer chooses to pay any portion of the AEI's premium, no subsidy is available for that portion. For example, if under a severance program, the employer pays one-half of the COBRA premium, the 65% subsidy would apply to the remaining premium payable by the AEI. Employers should consider this limitation in designing severance programs for employees who might otherwise be eligible for the subsidy.

The subsidy is available for medical, dental, and vision coverage and health reimbursement accounts but not flexible spending accounts (cafeteria plans). High deductible health plans offered in conjunction with a health savings account are eligible for the subsidy but the HSA is not.

Eligibility for Subsidy. An AEI is an employee or dependent who loses health coverage due to an *involuntary* termination of employment between September 1, 2008 and December 31, 2009; who elects COBRA coverage either when COBRA coverage is initially offered or during

the special election period provided by the Stimulus Bill (described below); and who is a qualified beneficiary under COBRA. Although not entirely clear, dependents added after the qualifying event (other than newborns or children placed for adoption with the former employee) may not be covered.

AEIs who lost their health coverage on or after September 1, 2008 and either failed to timely elect COBRA or elected COBRA and later terminated the coverage must be given a new 60-day period in which to elect COBRA and obtain the subsidy.

Coverage under this special 60-day election period will *not* be retroactive to the original qualifying event, but will begin with the first coverage period beginning after enactment (March 1) and will end on the date coverage would otherwise have ended if it had commenced on the date of the qualifying event.

Phase-Out of Subsidy. The subsidy will be phased out for AEIs who have adjusted gross incomes of \$125,000 to \$145,000 (\$250,000 to \$290,000 for joint returns) through a recapture mechanism. These high-income individuals - *not the employer or the group health plan* - will be required to repay, as additional taxes, subsidy amounts for which they are ineligible.

To avoid the repayment requirement, high-income individuals may elect to permanently waive the COBRA subsidy. The structure of the phase-out and recapture make it unnecessary for employers to consider the income limitations when making subsidy payments or when taking payroll tax credits (described below).

How Subsidy Works. The AEI or someone on his or her behalf (other than the Employer) must pay 35% of the COBRA premium which will be treated as having been paid in full. *The employer, however, must initially pay the remaining 65%.* The employer is reimbursed for its 65% through a credit in the amount of the subsidy it paid with the credit being applied against the employer's payroll tax obligations, including (i) employee federal income tax withholdings, (ii) employee FICA withholdings, and (iii) the employer's FICA taxes. The IRS has issued a revised

Form 941 (Employer's Quarterly Federal Income Tax Return) to address the new payroll tax credits, see <http://www.irs.gov/pub/irs-pdf/f941.pdf>

Employers should work closely with their vendors to ensure timely payment by the AEI and the employer of their respective portions of the premium and to assure accurate record-keeping to allow for swift recovery of the subsidy payments.

During a brief transition period covering only March and April 2009, if an AEI pays the full cost of coverage, the employer may either refund to the AEI the 65% amount he or she paid, or credit that amount against future premiums due from the AEI *provided* it is reasonable to assume that the credit will be used by the AEI within 180 days. In either case, the employer will receive reimbursement of the 65% paid as described above.

Duration of the Subsidy. The subsidy is payable for a maximum period of 9 months but is not available for any period of COBRA coverage beginning prior to enactment (2/17/09). For example: an AEI whose COBRA coverage began November 1, 2008 would pay the full COBRA rate for 4 months (November 2008 thru February 2009), he or she would then have subsidized coverage available for 9 months (March thru November 2009), and would then be required to pay the full COBRA rate for the remaining 5 months of COBRA eligibility.

An AEI loses eligibility for the subsidy (but not for COBRA coverage) if he or she becomes *eligible* for other group health coverage or Medicare, *regardless* of whether the AEI actually enrolls. Coverage for only dental and/or vision care, cafeteria plans, HRAs or employer-maintained on-site clinics does not count as eligible coverage under this rule.

Option to Change Coverage. Employers may, but are

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not required to allow AEIs to elect an alternate coverage option and still qualify to receive the subsidy if (i) the AEI elects the alternate coverage within 90 days after receiving notice of the enrollment option, (ii) the premium for the alternate coverage is less than or equal to the premium for the coverage in which the individual was enrolled at the time of the qualifying event, (iii) the alternative coverage is a plan available to active employees, and (iv) the coverage is not limited to dental, vision, counseling or referral services, a cafeteria plan or an on-site clinic providing limited services.

Communication & Disclosures. Administrators must communicate the availability of the subsidy to eligible COBRA beneficiaries within 60 days of enactment, or by April 18, 2009. The law requires that notices be provided to qualified beneficiaries (employees and their dependants) with respect to all qualifying events that occurred between September 1, 2008 and February 17, 2009, even those not connected with a termination of employment.

Notices must advise qualified beneficiaries of the subsidy availability, the requirements to qualify and the forms required to file for the subsidy. The Department of Labor is required to provide model notices and forms within 30 days of enactment (March 19, 2009).

FAQs concerning the subsidy are available at the IRS and DOL websites at:

<http://www.irs.gov/newsroom/article/0,,id=204708,00.html>
<http://www.dol.gov/ebsa/cobra.html>

If you have questions concerning the above please contact the author of this Client Alert, Carol A. Christiansen, Esquire, or the firm attorney with whom you usually work.

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