

MASLON

TO MASLON CLIENTS AND OTHER FRIENDS

HEALTH PLANS MUST GIVE 65% COBRA PREMIUM REDUCTION – AND NOTIFY POTENTIALLY ELIGIBLE INDIVIDUALS BY APRIL 18, 2009

Updated March 24, 2009

Executive Summary

1. Temporary COBRA Premium Reduction. The American Recovery and Reinvestment Act of 2009 ("ARRA") requires employers (or insurers) to reduce by 65% the COBRA premiums otherwise charged to certain involuntarily terminated employees (and their covered dependents), beginning as soon as March 1, 2009. The premium reduction applies if the employees were involuntarily terminated during the period starting September 1, 2008, and ending December 31, 2009; and is available for up to nine months. The employer (or insurer if it pays the subsidy) may recoup the 65% premium reduction through a Federal subsidy. The subsidy is obtained by taking tax credits against employment taxes or other taxes, as provided in ARRA. ARRA requires employers and health plan administrators to take immediate actions. These include giving new types of COBRA notices, some by April 18, 2009, and changing COBRA payment procedures, as summarized at the end of this memo.

2. New Model COBRA Notices from DOL. On March 19, 2009, the U.S. Department of Labor (the "DOL") published model forms for these notices, as discussed below. You may download the model notices from the DOL's web site, at www.dol.gov/ebsa/COBRAmodeInotice.html, or call one of our lawyers for copies.

Group Health Plans Must Provide COBRA Premium Reductions

1. 65% Premium Reduction. Group health plans that offer COBRA continuation coverage must reduce the COBRA premiums they charge to "eligible individuals" (as defined below) to 35% of the COBRA premium otherwise payable by them, for monthly (or shorter) coverage periods that begin on or after February 17, 2009. For most plans, the first premium reduction period began March 1, 2009. This premium reduction (the "premium reduction") will reduce the eligible individuals' cost by 65%, and may continue for up to nine months. Group health plans that are exempt from COBRA must also provide the premium reduction, if they offer similar continuation coverage under State law or any other federal law. For this purpose, a group health plan does not include a medical expense spending account under a "cafeteria plan" described in Section 125 of the Internal Revenue Code. If an eligible individual pays more than 35% of a continuation premium for either of the first two coverage periods in which the premium reduction is available, the plan may either refund the excess or use it as a credit against the individual's share of future COBRA premiums (if the credit is usable within 1980 days after the overpayment).

2. "Eligible Individuals." "Eligible individuals" include employees and their spouses and dependents who have been covered by a group health plan and become eligible for continuation of coverage under COBRA (or any similar law), because the employee's employment was

involuntarily terminated (except for gross misconduct) during the period from September 1, 2008, through December 31, 2009. The premium reduction is not retroactive to September 2008, but may continue after December 31, 2009, during a maximum nine-month period after the premium reduction begins.

NOTE: The term "involuntary termination of employment" is not defined, but we are waiting to see if future guidance might allow a premium reduction for employees who accept termination under a "window" or "buyout" severance program.

3. Tax Credits to Reimburse Plans for Providing Premium Reduction. The entity to which continuation premiums are paid will be reimbursed for the cost of any premium reduction it must provide, by taking credits on Treasury Form 941 against its payroll taxes (or obtaining a tax refund) as provided in Section 6432 of the Internal Revenue Code (added by ARRA). However, the credit for an eligible individual may not be taken unless the other 35% of the premium is paid by the eligible individual (or anyone else, other than the employer). If the plan is self-insured, the credit will be taken by the employer sponsoring the plan. If the plan is insured, the insurer may take the credit if it pays the cost of the premium reduction.

NOTE: Employers may **not** be reimbursed for their payment of any part of an eligible individual's continuation premiums as part of a severance package.

4. New Option to Change Continuation Coverage. A group health plan may be amended to allow an eligible individual to choose (as continuation coverage) a medical coverage enrollment option that is different (and no more costly) than the one covering him or her before the employment termination. In that case, the eligible individual may elect the different option within 90 days after receiving notice of this choice, as required under ARRA. This is in addition to changes allowed during an open enrollment period. If the plan is amended for this purposes, a notice of this choice should be included in each of the following notices. The DOL model notices include this option, if needed.

Required Notices of Eligibility for Premium Reduction and COBRA

1. Extended COBRA Election Period.

(a) Notice due by April 18, 2009. . Group health plan administrators must send a new "second chance" continuation notice, by April 18, 2009, to all employees and other qualified beneficiaries (as defined by COBRA) who:

(i) had a "qualifying event" (as defined by COBRA), regardless of the type of event, during the period that began September 1, 2008, and ended February 16, 2009; and

(ii) either did not elect COBRA continuation coverage, or did elect coverage but discontinued it before the maximum coverage period expired.

NOTE: This notice is not limited to individuals eligible for the premium reduction.

(b) Contents. This notice must include (i) information and forms for the new "second chance" 60-day period to elect COBRA coverage, if the individual's qualifying event was the involuntary termination of a covered employee; and (ii) information on the 65% premium reduction.

(c) DOL Model Notice. The DOL has published a model notice for this purpose, called the "Notice in Connection with Extended Election Periods." Plans may use this model notice, or a similar notice that works with their procedures and other notices. The model notice includes the information required by ARRA and forms for eligible individuals to apply for COBRA and the premium reduction.

(d) Eligibility for Extended Election Period. If a covered employee's employment was involuntarily terminated on or after September 1, 2008, but the former employee (or any of his or her dependents who became eligible for continuation coverage due to that termination) did not elect continuation coverage or ended that coverage before it expired, the eligible individual will have a "second chance" to elect continuation coverage (with the premium reduction). If the maximum period for the eligible individual's COBRA continuation has not expired, his or her new election may be made during the period beginning February 17, 2009, and ending 60 days after the eligible individual receives a "second chance" continuation notice.

(e) Period of Coverage after Second Chance Election. The "second chance" election will generally provide coverage as of March 1, 2009, but only for the remaining months of the original 18-month COBRA period. The original period began when the eligible individual lost coverage due to the employment termination.

(f) Penalties. Any failure to give the "second chance" notice is subject to the same penalties as failure to give other COBRA notices.

2. General Notices of Rights to COBRA and Premium Reduction. Group health plan administrators must provide a general notice of COBRA and premium reduction rights to all individuals who became (or will become) entitled, during the period from September 1, 2008, through December 31, 2009, to elect COBRA continuation coverage for any reason. This notice may be included with the usual COBRA notice (or be given as part of the "second chance" notice).

NOTE: This general notice is not limited to eligible individuals.

(a) Contents of General Notice. The general COBRA and premium reduction notice must include the following:

(i) a prominent description of the availability of the premium reduction, and the rights of eligible individuals to receive the premium reduction (and conditions on those rights);

(ii) the forms or other information needed to qualify for the premium reduction;

- (iii) the name, address and telephone number necessary to contact the plan administrator or anyone else who has information about the premium reduction;
- (iv) if available under the plan, an eligible individual's option to elect different continuation coverage during a 90-day period after receiving the notice; and
- (v) a description of an eligible individual's obligation to notify the plan administrator if the individual becomes eligible for other group health coverage, and the penalty for not doing so.

(b) DOL Model Notices. The DOL has published three model notices for this purpose:

(i) General Notice (abbreviated version). The abbreviated version of the DOL model "General Notice" (or a similar notice) must be sent by April 18, 2009, to all former employees and other qualified beneficiaries who:

- (A) had a qualifying event, regardless of the type of event, on or after September 1, 2008;
- (B) have already elected COBRA coverage, and
- (C) still have COBRA coverage.

The model abbreviated notice includes information about the 65% premium reduction and other rights under ARRA, but does not include information about electing COBRA.

(ii) General Notice (full version). The full version of the DOL model "General Notice" (or a similar notice) must be sent by April 18, 2009, to all former employees and other qualified beneficiaries who:

- (A) had a qualifying event, regardless of the type of event, during the period that began September 1, 2008;
- (B) have not elected COBRA; and either
 - (1) have not been sent a COBRA election notice, or
 - (2) were sent an election notice on or after February 17, 2009, that did not include the information required by ARRA (concerning the 65% premium reduction).

This full version includes information on the 65% premium reduction, plus all information required in a COBRA election notice.

(iii) Alternative Notice – State COBRA only. Insurers must send the DOL model "Alternative Notice" (or a similar notice), by April 18, 2009, to individuals who:

(A) are not eligible for Federal COBRA; and

(B) became eligible for continuation coverage under Minnesota law (or a similar State law), regardless of the type of event, during the period on or after September 1, 2008.

Continuation coverage rules vary among States, and insurers should modify this model notice as necessary to work with applicable State laws. Insurers may also find the abbreviated version of the model General Notice useful for certain situations.

(c) Penalties. Any failure to give the general COBRA and premium reduction notices is subject to the same penalties as failure to give other COBRA notices.

Time Limit for Premium reduction

The premium reduction provided for an eligible individual will not apply to any month of continuation coverage (1) for which the eligible individual does not pay his or her 35% share of the premium, or (2) beginning on or after the earliest of the following:

(a) The date in which the individual first becomes eligible for coverage under any other group health plan, except a plan providing limited coverage, such as dental benefits or a flexible spending account (If the individual does not notify the subsidized plan about the other coverage, he or she must pay a penalty to the Federal government, equal to 110% of any premium reduction received during the other coverage.);

(b) Nine months after the beginning of the first month when the premium reduction applies to the individual; or

(c) The end of the maximum period of the individual's continuation coverage based on the involuntary employment termination. For this purpose, the maximum period for any "second chance" election of COBRA will end at the same time that continuation coverage would have ended if it had been elected when first available to the individual.

Income Limits for Tax-free Premium reduction

1. General Tax Treatment of Premium Reduction. Generally, the premium reduction provided for an eligible individual is not treated as taxable income. However, that is not true if a former employee's income is too high, as explained below.

2. Taxation of Premium Reduction for Some Former Employees. A former employee who is an eligible individual and earns more than certain amounts in a calendar year may receive the premium reduction from a group health plan, along with any eligible dependents, but the

former employee's income taxes will be increased by an amount up to 100% of the premium reduction that all of them receive during the year. This tax is phased in for modified adjusted gross income amounts between \$125,000 and \$145,000, or between \$250,000 and \$290,000 if the former employee files a joint tax return.

NOTE: This tax does not affect the health plan or the employer, but the former employee may avoid it by asking the plan to waive the premium reduction for all eligible periods.

Action Items due by April 18, 2009

Because ARRA is now in effect, each group health plan should, before April 18, 2009:

1. Identify each eligible individual who must receive the "second chance" notice described above, because he or she became eligible for continuation coverage (for any reason) during the period beginning September 1, 2008, and ended February 17, 2009.
2. Prepare to give the "second chance" notice by April 18, 2009. This may be done with the model DOL "Notice in Connection with Extended Election Periods."
3. Prepare to give the general premium reduction notice described above, by April 18, 2009. This may be done with one of the following notices, whichever applies:
 - (a) the abbreviated version of the model DOL "General Notice" for qualified beneficiaries who are already enrolled for COBRA continuation coverage;
 - (b) the full version of the model DOL "General Notice" for each qualified beneficiary who has not yet enrolled for continuation coverage:
 - (i) if he or she has not received any COBRA notice, or
 - (ii) if he or she received a COBRA notice without information about the 65% premium reduction; or
 - (c) the DOL model "Alternative Notice" (or a similar notice), if the plan provides continuation coverage under a State law, rather than the Federal COBRA law.
4. Determine which entity involved with the plan will pay for the premium reduction and take the payroll tax credit.
5. Prepare to track premium payments actually made by (or on behalf of) eligible individuals, and track the related monthly premium reduction amounts to be credited against the paying entity's payroll taxes.
6. Revise other procedures as needed to make the premium reduction system work.

Action Items Due after April 18, 2009

- 1. COBRA.** Employers (or insurers) that are required to comply with the Federal COBRA rules must send the following notices (whichever applies) to all former employees and other qualifying beneficiaries who have a qualifying event (regardless of the type of event) on or after April 18, 2009, and on or before December 31, 2009:
 - (a) if the individual has not elected COBRA coverage, send the full version of the DOL model General Notice (or a similar notice); or
 - (b) if the individual has elected COBRA coverage, send the abbreviated version of the DOL General Notice (or a similar notice).
- 2. State COBRA.** Insurers that are required to comply with State COBRA laws must send the DOL model "Alternative Notice" (or a similar notice) to persons who become eligible for continuation coverage under Minnesota law (or a similar State law), but are not eligible for Federal COBRA, during the period that began on April 18, 2009, and ends December 31, 2009.
- 3. Notice of Termination of Premium Reduction.** Prepare new notices to advise eligible individuals when they reach the maximum time limit for the premium reduction.

Contact Us

We urge you to consult with us very soon, to discuss sending the notices required by ARRA and implementing the 65% premium reduction. For this purpose, you may contact the following members of our employee benefit team and employment law team. Our employee benefit team includes, among others, Mark Baumann (612-672-8339) and Larry Koch (612-672-8322); and our employment law team includes, among others, Howard Tarkow (612-672-8348), Andre LaMere (612-672-8375) and Jessica Pecoraro (612) 672-8390.

Limited Use of Tax Advice

Treasury Circular 230 requires our firm to add the following statement to this memo, because this memo is not intended to be a formal tax opinion that would satisfy the Circular's rules for such opinions:

Any tax advice included in this memo is not intended to be used, and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed under the Internal Revenue Code.

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