

TO MASLON CLIENTS AND OTHER FRIENDS

FEDERAL STIMULUS ACT REQUIRES HEALTH PLANS TO PROVIDE 65% REIMBURSABLE COBRA PREMIUM SUBSIDY – BEGINNING MARCH 1, 2009

February 19, 2009

Executive Summary. On February 17th, the President signed the \$787 billion stimulus package, known as the American Recovery and Reinvestment Act of 2009 (the "2009 Recovery Act"). This Act requires employers (or insurers) to subsidize 65% of the COBRA premiums otherwise charged to certain involuntarily terminated employees (and their covered dependents), beginning as soon as March 1, 2009. The subsidy applies to employees who 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 subsidy through tax credits against its employment taxes or other taxes, as provided in the 2009 Recovery Act. The 2009 Recovery Act requires employers and health plan administrators to take immediate actions. These will include giving new types of COBRA notices and changing COBRA payment procedures, as summarized below.

Group Health Plans Must Provide COBRA Premium Subsidy. 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 subsidized period will begin March 1, 2009. This premium reduction (the "premium subsidy") 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 subsidy, 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 subsidy is available, the plan may either refund the excess or use it to offset the individual's share of future COBRA premiums.

"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 subsidy is not retroactive to September 2008, but may continue after December 31, 2009, during a maximum nine-month period after the subsidy begins. NOTE: The term "involuntary termination of employment" is not defined, but we are waiting to see if future guidance

might allow a premium subsidy for employees who accept termination under a "window" or "buyout" severance program.

Tax Credits to Reimburse Plans for Providing Premium Subsidy. The entity to which continuation premiums are paid will be reimbursed for the cost of any premium subsidy it is required to provide, by taking credits against its payroll taxes (or obtaining a tax refund) as provided in Section 6432 of the Internal Revenue Code (added by the 2009 Recovery Act). 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 subsidy. 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.

Immediate Notice of Second Chance to Elect Continuation Coverage. Group health plan administrators must soon provide a new "second chance" continuation notice to all former employees (and their covered dependents) who were entitled to elect COBRA continuation coverage for any reason during the period from September 1, 2008, through February 17, 2009. This "second chance" notice is given by sending the general premium subsidy notice described below, within 60 days after February 17, 2009. NOTE: This notice is not limited to eligible individuals.

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 an eligible individual 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 subsidy). 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.

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 that began when the eligible individual lost coverage due to the employment termination.

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 the 2009 Recovery Act. This is in addition to changes allowed during an open enrollment period.

General Notice of Premium Subsidy and Option to Change Continuation Coverage. Group health plan administrators must provide a premium subsidy notice to all individuals who 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 serve as the "second chance" notice). NOTE: This premium subsidy notice is not limited to eligible individuals.

The premium subsidy notice must include the following:

- A prominent description of the availability of the premium subsidy, and the rights of eligible individuals to receive the premium subsidy (and conditions on those rights);
- The forms or other information needed to qualify for the premium subsidy;
- A description of the "second chance" election for eligible individuals who had been eligible for continuation coverage through February 17, 2009, but were not enrolled on that date;
- The name, address and telephone number necessary to contact the plan administrator or anyone else who has information about the premium subsidy;
- 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; and
- If available under the plan, an eligible individual's option to elect different continuation coverage during a 90-day period after receiving the notice.

Any failure to give the premium subsidy notice is subject to the same penalties as failure to give other COBRA notices.

Model Notice. The U.S. Department of Labor is required to publish, within 30 days after February 17, 2009, a model notice for group health plan administrators to comply with the premium subsidy requirements described above.

Time Limit for Premium Subsidy. The premium subsidy provided for an eligible individual will not apply to any month of continuation coverage (a) for which the eligible individual does not pay his or her 35% share of the premium, or (b) beginning on or after the earliest of the following:

- The date in which the individual first become eligible for coverage under any other group health plan other than 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 subsidy received during the other coverage.);
- Nine months after the beginning of the first month when the premium subsidy applies to the individual; or

- 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 Subsidy. Generally, the premium subsidy 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

A former employee who is an eligible individual and earns more than certain amounts in a calendar year may receive the premium subsidy 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 subsidy that all of them receive during the year. That 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 subsidy for all eligible periods.

Immediate Action Items. Because the 2009 Recovery Act is now in effect, each group health plan should promptly:

- Identify each eligible individual who must receive the "second chance" notice described above, because he or she became eligible for continuation coverage during the period beginning September 1, 2008, and ended February 17, 2009, for any reason.
- Prepare to give the "second chance" notice within 60 days after February 17, 2009. However, plan administrators may prefer to wait for the model notice to be published by the U.S. Department of Labor within 30 days after February 17, 2009.
- Prepare to begin giving the general premium subsidy notice described above, which may be the other modal notice to be published by the U.S. Department of Labor.
- Determine which entity involved with the plan will pay for the premium subsidy and take the payroll tax credit.
- Prepare to track premium payments actually made by (or on behalf of) eligible individuals, and track the related monthly premium subsidy amounts to be credited against the paying entity's payroll taxes.
- Revise other procedures as needed to make the premium subsidy system work.
- Prepare new notices to advise eligible individuals when they reach the maximum time limit for the premium subsidy.

- We urge you to consult with us very soon, to discuss implementing the premium subsidy. For this purpose, you may contact any member of our employee benefit team or our 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.

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