

## **COBRA SUBSIDIES UNDER THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009: HOW WILL THEY IMPACT BUSINESSES?**

---

By Suzanne M. Cerra, Esq. and Katherin Nukk-Freeman, Esq.\*

The American Recovery and Reinvestment Act of 2009 ("ARRA" or the "Act"), enacted on February 17, 2009, will enable thousands of workers who have lost or will lose their jobs during the period September 1, 2008 through December 31, 2009 to continue healthcare coverage at more affordable rates. While the benefit of affording more attainable health care coverage for many is indisputable, the impact of this Act on businesses of all sizes will be significant.

### **Financial Impact of COBRA Subsidies Under ARRA: What is the Subsidy and WHO Pays It?**

The subsidy requirements discussed in this article apply to employers with group health plans that are covered by the Consolidated Omnibus Budget Reconciliation Act (COBRA).<sup>1</sup> Though ARRA also applies to group health plans that are subject to similar health care continuation requirements under state law, as well as group health plans sponsored by unions, the requirements for the subsidy under those plans apply only at the insurer or union plan level (not at the employer level).

### **How does the subsidy work?**

Under ARRA, if an "assistance-eligible individual" (AEI) elects to continue healthcare coverage under COBRA, the federal government will subsidize 65% of the "applicable premium" for the continuation coverage for up to 9 months.<sup>2</sup>

Under the Act, an AEI is generally an individual (1) who is a qualified beneficiary as the result of an involuntary termination during the period September 1, 2008 through December 31, 2009, (2) who is eligible for COBRA continuation coverage at any time during that period, and (3) who elects such coverage.<sup>3</sup> The COBRA subsidy applies to the premium for the covered employee, as well as any dependents who were covered immediately prior to the qualifying<sup>4</sup> event.

A recent Internal Revenue Service Notice defines "involuntary termination" as "severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employee, other than due to the employee's implicit or explicit request, where the employee was willing and able to continue performing services."<sup>5</sup> This includes individuals who elect retirement packages "if facts and circumstances indicate that, absent retirement, the employer would have terminated the employee's services and the employee had knowledge that [he or she] would be terminated."<sup>6</sup> It also includes individuals who lose coverage due to temporary furloughs or layoffs with a right of recall.<sup>7</sup> It even includes employee-initiated terminations if the termination "constitutes a termination for good reason due to employer action that causes a material negative change in the employment relationship for the employee."<sup>8</sup> Under all of these scenarios, AEIs would be eligible for the premium reduction.

Though the employer initially is responsible for submitting the 65% COBRA subsidy directly to the insurer, the full amount of the subsidy is refunded by the US government via a payroll tax credit.

Although the subsidy is ultimately paid by the government (in the form of an offset in tax liability to the employer), employers who sponsor group health plans subject to federal COBRA rules may now need to reallocate funds to cover these subsidy “advances.” For some employers, particularly those laying off a significant percentage of their workforce in order to cut costs and stay in business, advancing the COBRA subsidy payments may be especially challenging.

While it is impossible to predict how many AEs will choose to elect subsidized COBRA coverage, it is likely that far more employees will elect coverage under this new structure because it will be far more affordable than the alternatives. According to a recent study, monthly COBRA premiums for family coverage average \$1,069 per month.<sup>9</sup> With the ARRA provisions in effect, the family cost could be reduced to approximately \$374 per month (with the employer, and ultimately the government, subsidizing the remaining \$695).

It should be noted that the COBRA subsidy is not available to all involuntarily terminated employees. Individuals whose annual gross income exceeds \$125,000 (\$250,000 for those filing joint returns) begin to phase out of eligibility for the subsidy and increase their tax liability if they choose to accept it.<sup>10</sup> Nevertheless, employers are still required to subsidize premiums for those individuals if they elect coverage and do not waive assistance.<sup>11</sup>

### **Employers May Not Receive Immediate Credit for Subsidizing COBRA Premiums Under ARRA**

Employers will be reimbursed for the premium subsidies they advance by claiming a credit on their quarterly federal tax return (Form 941), which has been revised accordingly.<sup>12</sup> The Form 941 is a quarterly return used to report income tax and social security withholdings. The IRS has released question and answer pages for employers explaining how to claim the tax credit.<sup>13</sup> The amount of the COBRA subsidies an employer pays during a quarter will be treated as a payroll deposit as of the first day of that quarter and will be applied towards the employer's payroll deposit liabilities for that quarter.<sup>14</sup>

The effect of this is that the COBRA subsidy payments an employer makes will reduce the amount the employer is required to deposit. For example, if an employer normally has a \$75,000 payroll deposit liability, but advanced \$5,000 in COBRA subsidies, the employer's payroll deposit liability will be reduced to \$70,000. If the total amount of COBRA subsidies advanced exceeds the employer's payroll deposit liabilities, the employer may elect to have the excess payment refunded or applied to offset the following quarter's liabilities.<sup>15</sup> Once a quarterly return is filed declaring an overpayment, it is currently unclear as to how quickly the employer will be reimbursed. Thus, while there is a process for employers to recoup the COBRA subsidies they are required to advance, they are nevertheless faced with the task of accounting for the subsidies in addition to their general payroll practices.

### **ARRA Creates Significant Administrative Burdens for Employers**

While cash flow may only be a burden for some employers, the administrative costs and burdens of implementing the subsidy requirements imposed by ARRA will affect many. Initial notification requirements, as well as the additional administrative burden of tracking premium submissions and claiming subsidy credits, all add to employers' ever expanding obligations.

One of the more onerous administrative requirements of the COBRA subsidy program is identifying and notifying AEIs who were terminated since September 1, 2008 and who are eligible for an extension of the COBRA election period. Under ARRA, AEIs who were involuntarily terminated between September 1, 2008 and February 17, 2009 – who did not elect COBRA or who elected COBRA but chose to discontinue payments before the end of the coverage period – now have a second chance to elect coverage. Once the employer or plan administrator has identified these individuals, it must provide them with a new election period that ends 60 days after the date on which the notice of the new election period is provided. The type of notice to be distributed depends on whether the employee was terminated before or after February 17, 2009, and whether they have elected and/or discontinued COBRA coverage. The penalty for COBRA notice violations will cost employers \$110 per day per violation.<sup>16</sup>

While the subsidy payments are not retroactive to September 1, 2008, AEIs who have been paying full COBRA premiums for coverage periods beginning on or after February 17, 2009 (which, in many cases, will be March 1, 2009) will be entitled to either (1) a reimbursement of 65% of their premium from the employer within 60 days or (2) a credit towards future payments.<sup>17</sup> These initial subsidies and reimbursements may strain the operating budgets of some businesses.

In addition to these onerous notification requirements, the process of tracking premium payments and claiming subsidy credits also creates an additional administrative burden for employers. In order to claim a subsidy credit for premium payments advanced on behalf of AEIs, employers will need to submit information to the IRS, including (1) involuntary termination dates, (2) dates when payments were received, (3) dates when subsidies were paid, and (4) corresponding beneficiary information including social security numbers and whether the subsidy was for one or two or more individuals.<sup>18</sup>

Systems will need to be updated to track the 9-month subsidy period and to inform individuals when the subsidy ends and whether they are eligible to continue COBRA with full premium payments. Additional systems should be implemented to track all premium payments made on behalf of AEIs and to ensure that all subsidy credits are claimed against employment taxes. For those employers who use outside COBRA administrators, they must coordinate responsibilities and procedures for sharing information. Although temporary, subsidizing COBRA premiums may raise multiple challenges for employers in an already challenging time.

### **Employers Should Carefully Review the Terms of Their Separation Agreements Because ARRA Does Create Additional Coverage Options**

Employers who are in the process of implementing workforce reductions and executing severance agreements should carefully review the ARRA provisions to ensure they are getting the maximum benefit of the government subsidy. Though on one hand ARRA requirements create additional burdens on employers, the government funded COBRA subsidies created by the Act offer some additional opportunities for employers when negotiating separation agreements. Employers need to evaluate their obligations under ARRA when determining how to structure these agreements to ensure they are obtaining the maximum benefit.

Employers who agree to pay a portion of an AEI's COBRA premium will be unable to take advantage of the full government subsidy provided under the Act. ARRA specifies that 35% of the "applicable" COBRA premium must be paid by the assistance-eligible individual -or a person other than the individual's employer -and the employer may not claim the subsidy credit until it has received the required 35%.<sup>19</sup> For AEIs terminated since September 1, 2008, employers are required to subsidize 65% of the employee's remaining share of the health care premium, rather than 65% of the total cost of the premium, in order to receive the subsidy credit. Thus, if an employer has agreed to subsidize 50% of an employee's COBRA premium (of \$1,000 per month, for example), the employee is only required to pay 35% of the nonsubsidized portion (\$500). In this scenario, instead of the employee paying \$350 of the total premium and the government ultimately paying the remaining \$650, the employee will only be required to pay \$175 (35% of \$500) and the government will only subsidize \$325 (65% of \$500). The employer, who could have passed the entire portion onto the federal government had it not agreed to subsidize any of the premium, is now responsible for paying \$500 toward the premium. In those instances where an employer has agreed to fully subsidize an AEI's premium, the employee pays nothing and there is NO subsidy owed by the government.

Additionally, employers who wish to maximize the ARRA subsidy as leverage in negotiating separation agreements must be cautious about the coverage loss date. If an employer continues paying health care premiums after an employee's involuntary termination on the same terms as for similarly situated active employees, then the loss of coverage may be deferred if the Plan permits.<sup>20</sup> Thus, for example, an employee who is involuntarily terminated in November 2009 and receives three months of health care continuation (i.e., through February 2010)<sup>21</sup> as part of a severance package, may not be eligible for COBRA subsidies under ARRA if the Plan defines the employee's loss of coverage date to be February 2010. To be eligible for the COBRA subsidy under ARRA, both the involuntary termination and the loss of coverage must occur between September 1, 2008 and December 31, 2009. Thus, under this scenario, neither the employee nor the employer could avail themselves of any ARRA subsidy money.

Additional cost savings for companies and employees also may be possible with the flexibility ARRA permits in allowing employers to offer different coverage options to AEIs. Under COBRA, a qualified beneficiary who elects coverage is required to continue the same coverage that he/she had received prior to the qualifying event. Under ARRA, an AEI may now enroll in a different plan with a lesser premium, so long as the plan is: (1) offered to active employees at the time the election is made, (2) does not provide only dental, vision, referral or counseling services, (3) is not a flexible spending arrangement, and (4) is not limited to treatment at certain on-site medical facilities.<sup>22</sup>

While COBRA subsidies under ARRA undoubtedly present many challenges for already overburdened employers, these government funded subsidies also present certain leverage opportunities at a time when employers are looking to reduce their costs wherever possible.

*\* Suzanne M. Cerra and Katherin Nukk-Freeman are partners with the law firm of Nukk-Freeman & Cerra, P.C. in Short Hills, New Jersey, which specializes in the representation of businesses in employment and benefits matters. Ms. Cerra and Ms. Nukk-Freeman would like to acknowledge Sarah McGinnis for her assistance with this article.*

## COBRA ENDNOTES

1 Federal COBRA applies to employers with more than 20 employees. However, health care continuation rights may also be applicable to small businesses (i.e., those with less than 20 employees) under state laws, including New Jersey , New York and Connecticut .

2 The premium reduction period ends sooner if the individual becomes eligible for coverage under another qualifying group health plan or for Medicare benefits. See Internal Revenue Service Notice 2009-27 at 18 (March 31, 2009).

3 Public Law 111-5, §3001(a)(3).

4 Id. at §3001 (a)(3); §3001 (a)(10)(E).

5 Internal Revenue Service Notice 2009-27 at 5 (March 31, 2009).

6 See id. at 5-6.

7 See id. at 6.

8 See id. at 5. According to Question 7 of IRS Notice 2009-27, an employee who resigns due to a “material change in the geographic location of employment for the employee” will be deemed involuntarily terminated and thereby eligible for the COBRA subsidy. Id. at 7.

9 Familiesusa.org, COBRA Premiums for Family Health Coverage Consume 84 Percent of Unemployment Benefits (Jan. 9, 2009), available at <http://www.familiesusa.org/resources/newsroom/press-releases/2009-press-releases/cobra-premiumsfor-family.html> (last visited April 5, 2009).

10 §139C.

11 § 139C(b)(3).

12 Internal Revenue Service Section on COBRA: Answers for Employers, COBRA Questions and Answers: Form Preparation, FP-9 (2/26/09), available at <http://www.irs.gov/newsroom/article/0,,id=205373,00.html> (last visited April 5, 1009).

13 Internal Revenue Service Section on COBRA: Answers for Employers, available at <http://www.irs.gov/newsroom/article/0,,id=204708,00.html> (last visited April 5, 1009).

14 IRS, COBRA Questions and Answers: Form Preparation, supra at FP-9.

15 See id. at FP-11.

16 Public Law 111-5, §3001(a)(7)(C).

17 Id. at §6432(E).

18 Internal Revenue Service, Section on COBRA: Answers for Employers, COBRA Questions and Answers: Reporting and Documentation, RD-1 (2/26/09), available at <http://www.irs.gov/newsroom/article/0,,id=205376,00.html>

19 Public Law 111-5, §3001(a).

20 IRS Notice 2009-27, *supra* at 8-9.

21 See *id.*

22 Public Law 111-5, §3001(a)(1)(B)(ii).