

EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION UPDATE

2009 Economic Stimulus Package Provides for COBRA Subsidies IMMEDIATE ACTION REQUIRED

February 20, 2009

The American Recovery and Reinvestment Act of 2009 (commonly being referred to as the Stimulus Bill), signed by President Barack Obama on February 17, 2009, includes significant temporary changes in the rules regarding continuation of health benefits rules (COBRA). These changes require immediate action by employers and health plan administrators. The new law provides that, for a period of up to nine months, the federal government will subsidize 65 percent of the applicable COBRA premiums for “assistance eligible individuals” who became or become eligible for COBRA coverage as a result of an *involuntary termination* between September 1, 2008, and December 31, 2009.

The COBRA provisions of the Stimulus Bill are effective immediately and employers will need to take immediate steps to comply with the new rules beginning with the first period of COBRA coverage following the date of enactment—for most situations that will be March 1, 2009. Unfortunately, the new COBRA requirements are somewhat complicated and will require several actions on the part of employers, COBRA administrators and assistance eligible individuals in a very short time period.

Impacted Coverage

The new rules affect continuing health coverage under both federal and state law. Thus, for example, small employers (those who employ fewer than 20 employees) who are otherwise exempt from COBRA may have obligations under state continuation coverage laws. The new rules do not apply to coverage under a health flexible spending arrangement under a cafeteria plan.

Individuals Entitled to the Subsidy

The Stimulus Bill provides that “assistance eligible individuals” are eligible for the COBRA subsidy. An “assistance eligible individual” is defined by the Stimulus Bill as any employee (plus covered dependents) who is, or becomes, eligible for COBRA continuation coverage due to an *involuntary termination of employment* that occurred, or occurs, between September 1, 2008, and December 31, 2009, and who elects continuation coverage. It does not appear to apply to continuing coverage that is offered to same-sex partners or other domestic partners unless such persons are dependents of the covered employee within the meaning of the federal income tax rules and, as such, would otherwise be entitled to COBRA coverage.

The premium subsidy provisions of the Stimulus Bill do not apply if the person became eligible for COBRA coverage as a result of a voluntary termination of employment or if the termination of employment occurred prior to September 1, 2008, even if COBRA was elected after that date. Under COBRA, coverage need not be provided for terminations resulting from gross misconduct. We would expect that standard to apply for purposes of applying the subsidy rules. Termination of employment for poor performance is generally not considered gross misconduct for COBRA purposes and, therefore, would be considered an involuntary termination for purposes of the subsidy.

The Stimulus Bill does not define involuntary termination. Thus, it is not yet clear how the Stimulus Bill will apply to employees who may have terminated under circumstances that may be referred to as, or may be otherwise considered to be, “voluntary” (e.g., window programs or constructive terminations). It will be important for employers to identify all employees who were terminated during the applicable period and the reason for the termination. Determinations can then be made as to whether there are any special situations that will need further analysis.

Special subsidy rules apply in the case of high income individuals. These are discussed below.

Second Chance to Elect Coverage

The Stimulus Bill provides that assistance eligible individuals who do not have a COBRA election in effect on February 17, 2009, must be given a second chance to

make a COBRA election. The individual must be provided with a notice of the right to make the election and information related to the subsidy (see below), and the applicable election period expires 60 days after the date on which the individual is notified. For any person electing coverage pursuant to this “second chance” provision of the new law, the continuing coverage does not relate back to the individual’s termination date. Rather such coverage is effective prospectively only, beginning with the first period of coverage beginning on or after February 17, 2009 (normally, March 1, 2009, for monthly coverage periods), and such coverage will not extend beyond the date on which the individual’s COBRA continuation period would have expired if the qualified beneficiary had initially elected COBRA coverage due to involuntary termination.

The Stimulus Bill also provides that, in the case of a person who elects coverage under these second chance provisions, a gap in coverage due to the failure to previously have elected COBRA coverage is not counted toward a break in creditable coverage for purposes of applying preexisting conditions.

Expiration of Subsidized Coverage

The federal subsidy for COBRA continuation coverage does not apply for months of coverage beginning after the first of the following to occur: (i) the date the eligible individual becomes eligible for coverage under another group health plan, a flexible spending arrangement, on-site care provided by an employer or Medicare, (ii) the nine-month anniversary of the date on which the subsidy first applies to such eligible individual, or (iii) the date on which

the COBRA period otherwise expires for such person. The eligible individual must notify the group health plan when such individual becomes eligible for other coverage and the failure to do so will result in a penalty equal to 110 percent of the premium subsidies provided after the termination of eligibility.

We note that the provisions of the Stimulus Bill relating to early termination of the subsidy when the person becomes eligible for other coverage are different from the COBRA provisions relating to the same type of circumstance. Thus, it is possible that person could lose eligibility for the subsidy even though COBRA coverage would continue.

Employer Option to Permit Election of Alternative Coverage

Employers may, *but are not required to*, permit assistance eligible individuals to elect to enroll in coverage under a plan offered by that employer that is different from the coverage that was (or could have been) elected by the eligible individual at the time of the termination of employment. This option is only available if the premium for the alternative coverage does not exceed the premium for the coverage in which the eligible individual was enrolled at the time the termination of employment occurred, the alternative coverage is offered to active employees of the employer and the alternative coverage is not limited coverage (i.e., coverage only for dental, vision, counseling or referral services, a flexible spending account or for on-site services). If this option is offered and elected by an assistance eligible individual, the alternative coverage

will continue for the duration of the applicable COBRA period, including any period after the end of the premium subsidy.

Notice Requirements

All persons who experience or experienced a qualifying event during the period between September 1, 2008, and December 31, 2009, regardless of whether the qualifying event was the result of an involuntary termination of employment, must be notified of the availability of the premium subsidy and, if the plan permits an election of alternative coverage, the option to elect the alternative coverage. These notice requirements may be met by amendment of existing notices or by the inclusion of separate documents with notices that are already required. The notices must include the following information:

- The forms necessary to establish eligibility for the premium subsidy;
- The contact information (name, address and telephone number) for the plan administrator, or any other person maintaining the relevant information in connection with the premium subsidy;
- A description, displayed in a prominent manner, of the individual's right to the subsidy and any conditions on entitlement to the subsidy;
- A description of the extended election period for eligible individuals to make "second chance" elections;
- A description of the eligible individual's obligation to notify the group health plan upon becoming eligible for other coverage and a description of the penalty for failure to comply with the notice obligation; and

- If applicable, a description of the individual's right to elect alternative coverage.

The Department of Labor is required by the Stimulus Bill to prescribe model notices by March 19, 2009 (30 days after enactment of the Stimulus Bill). The notice of the extended election period to make "second chance" elections must be provided by April 18, 2009 (60 days after enactment of the Stimulus Bill). Employers may want to issue the "second chance" election notice as soon as possible since the election period runs for 60 days following delivery of the notice.

How the Subsidy Works

The premium subsidy under the Stimulus Bill works as follows. The assistance eligible individual pays 35 percent of the applicable COBRA premium and is treated as though he or she had paid the full COBRA premium. The employer is not permitted to pay the 35 percent on behalf of the eligible-assistance individual. The Stimulus Bill does not address situations where an employer may already subsidize all or a portion of the COBRA premium. In addition, although the Stimulus Bill provides that the "person to whom the premiums are payable" recovers the 65 percent premium subsidy through credits for federal payroll taxes, how this mechanism will work in operation is subject to some confusion for the reasons discussed below.

The Stimulus Bill provides that "the person to whom premiums are payable" is treated as having paid federal payroll taxes (i.e., federal income tax withholdings and employer and employee share of FICA taxes and FICA withholdings) in an amount equal to the subsidy that is provided. To the extent that the amount of the subsidy is greater than the

premium recipient's payroll tax liability, the excess amount is treated as an overpayment of payroll taxes and the excess is credited or refunded in the same manner as an actual overpayment of payroll taxes. If there is an overstatement of the subsidy, such overstatement is treated as an underpayment of payroll taxes. As noted above, the reimbursement is contingent on the payment of the reduced premium by the assistance eligible individual (or a person other than the employer).

The Stimulus Bill generally defines the "person to whom premiums are payable" as: (i) in the case of a plan under which some or all of the coverage is not provided by insurance, the employer maintaining the plan, or (ii) in the case of a fully insured plan, the insurer providing the coverage.

The premium subsidy provisions of the Stimulus Bill seem to assume that the provider of the subsidy is the same person entitled to the payroll tax credit. It is not clear under the Stimulus Bill what happens if it is not the same person. For example, in a fully insured arrangement, the insurance company will be the recipient of the COBRA premium and be entitled to the payroll tax credit, but the subsidy may be provided by the employer (if, for example, the insurer refuses to provide the subsidy). In this situation, there is no mechanism under the Stimulus Bill for the employer to take a credit against its payroll taxes for the amount of the subsidy because the employer is not the "person to whom premiums are payable."

The person entitled to reimbursement for the subsidy must file a report including (i) an attestation of involuntary termination for each covered employee, (ii) the amount

of payroll taxes offset by the premium payments for each applicable reporting period and the estimated offsets for the subsequent reporting period, and (iii) a list of the TINs of all covered employees, the amount of subsidy reimbursement for each covered employee and other qualified beneficiaries, and a designation as to whether the subsidy reimbursement is for coverage of one or two or more individuals. Obviously, coordination among the employer and the service providers will be necessary in order to provide the information required in the report.

Transition Rule

To take into account operational issues in implementing the premium subsidy provisions and the immediate effective date of the provisions, the Stimulus Bill contains a transitional rule relating to the payment and reimbursement of the subsidy. If an assistance eligible individual pays the full premium for the first period of COBRA coverage for which the subsidy is effective or the immediately subsequent period (in most cases, March and April of 2009), the person to whom the premium is payable is required to either reimburse the amount of the premium paid in excess of the subsidized amount or apply the difference as a credit against future payments. The person to whom the premium is payable is reimbursed for the subsidy in the same manner as described above.

The transition rule also provides that, unless it is reasonable to believe that a credit will be used by the individual within 180 days after payment of the full premium, then the reimbursement option must be followed with the reimbursement being made within

60 days. If, during the 180-day period, it becomes unreasonable to believe that the credit will be used during the remainder of the 180-day period, the reimbursement is required to be made within 60 days after that determination is made.

Special Rules for High Income Individuals

The Stimulus Bill provides that if a premium subsidy is provided with respect to a high income individual, the amount of the subsidy is added to such individual's federal income tax. It does not appear that the subsidy would be included for purposes of FICA tax. Generally, high income individuals are those with modified adjusted gross income of \$125,000 or more (\$250,000 or more in the case of a joint tax return). There is a phase-in for income levels between \$125,000 and \$145,000 (\$250,000 and \$290,000 for a joint return), which provides that only a specified percentage of the premium is includable in income. A high income individual is permitted to make a permanent election to waive the right to premium assistance. A high income individual who wishes to make that election must notify the person to whom premiums are reimbursed. The election is to be made in accordance with rules established by the Secretary of the Treasury, which apparently will be provided in the future.

Expedited Appeal to Secretary of Labor

The Stimulus Bill provides that if an individual who requests treatment as an assistance eligible individual is denied such treatment by the group health plan, the Secretary of Labor, in consultation with

the Secretary of the Treasury, will provide expedited review of the denial. The individual is required to apply to the Secretary for such review and the Secretary is required to make the determination of eligibility within 15 business days after receipt of the application. The Secretary's decision is a *de novo* review and will be final (i.e., there are no appeal procedures). A reviewing court is required to give deference to the Secretary's determination.

Immediate Actions for Employers

The Stimulus Bill contains many new requirements and there are still open questions notwithstanding the immediate effective date. The following are some immediate actions that employers should be taking to facilitate compliance:

- Identify all covered employees whose employment terminated since September 1, 2008, and the reason for such termination.
- Provide notice to all assistance eligible individuals who are currently receiving COBRA coverage explaining the subsidy.
- Provide "second chance" notices to assistance eligible individuals who are not currently receiving COBRA coverage.

- Review and revise notices for assistance eligible employees who are involuntarily terminated after February 17, 2009, but prior to December 31, 2009.
- Contact COBRA administrators, insurance companies and payroll providers to develop and coordinate compliance plans.

If you have any questions about the matters raised in this Client Update, please contact your usual Mayer Brown lawyer, or one of the lawyers listed below. To learn more about our Employee Benefits & Executive Compensation practice, please visit <http://www.mayerbrown.com/employeebenefits>.

Debra B. Hoffman

+1 312 701 7219

dhoffman@mayerbrown.com

Ryan Liebl

+1 312 701 8392

rliebl@mayerbrown.com

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