

NEW COBRA CHANGES REQUIRE IMMEDIATE ATTENTION

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA), which includes significant changes to group health plan continuation rules under the Consolidated Omnibus Budget and Reconciliation Act (COBRA). Among the changes, qualified beneficiaries who lost or will lose group health plan coverage because of a covered employee's "involuntary termination of employment" between September 1, 2008 and December 31, 2009, will be entitled to a temporary premium subsidy for up to 9 months of their COBRA continuation coverage.

These terminated employees (and their qualified beneficiaries) will only be required to pay 35% of the monthly COBRA premium, while the employer or the health plan (either a self-insured employer group health plan or an insurance company) will be required to initially subsidize the remaining 65 % of the monthly COBRA premium. The amount subsidized, however, can be recovered through payroll tax credits or direct reimbursements from the U.S. Treasury.

The changes also include new COBRA notice requirements and obligations; an extended COBRA election period; and an employer's option to allow an individual to elect within certain restrictions a plan other than the one the individual was covered under at the time the involuntary termination of employment.

Given that part of the changes are enforced through federal income tax provisions (which are inapplicable to most local employers and employees), implementation of these changes in Puerto Rico will present unique challenges to employers and plan administrators.

Who is entitled to the subsidy? Individuals who are qualified beneficiaries under COBRA are entitled to the subsidy if they became or become eligible for COBRA between September 1, 2008 and December 31, 2009 by reason of an "involuntary termination of employment" and elect COBRA coverage. These individuals are referred to as "assistance-eligible individual" (AEI)". The AEI must be an individual:

- who is currently covered by COBRA by reason of an involuntary termination of employment occurring on or after September 1, 2008 and before January 1, 2010; *or*
- who was previously eligible for COBRA coverage by reason of an involuntary termination of employment on or after September 1, 2008 but did not elect COBRA; *or*
- who was previously eligible for COBRA coverage by reason of an involuntary termination of employment on or after September 1, 2008, elected COBRA, but was no longer covered as of February 17, 2009 (because, for example, the individual did not pay the required premium); *or*
- who is eligible for COBRA coverage by reason of an involuntary termination during the September 1, 2008 to December 31, 2009 period.

A dependent child or spouse of an involuntarily terminated employee who meets the definition of a qualified beneficiary under COBRA is also eligible for this assistance. Individuals who become entitled to COBRA due to *other qualifying events*, such as voluntary terminations of employment, divorce or loss of dependent status, are not eligible for the subsidy.

When does the premium assistance begin? The subsidy applies to the first period of coverage beginning after February 17, 2009. Since such premiums are paid on a monthly basis, the subsidy entitlement will generally commence on March 1, 2009.

ARRA permits the plan sponsor to charge the AEI the full premium for the first two months to which the subsidy is applicable (*i.e.*, March and April). However, the plan sponsor receiving any such full premium must repay the excess 65% within 60 days or provide the individual with a credit of such amount against future COBRA premiums. If the plan sponsor selects the credit approach, it must have a reasonable basis to believe the credit will be used within 180 days of the overpayment.

How long does the subsidized COBRA coverage last? The COBRA premium subsidy will generally be available to individuals for 9 months from commencement of the subsidy, but not longer than the period of COBRA coverage, which is generally 18 months from the date of the involuntary termination of employment. The subsidy will be cut off sooner if the individual fails to pay the required premiums timely, becomes eligible for coverage under Medicare or is covered by another group health plan. Other coverage that provides only dental, vision, counseling, referral services, coverage under a flexible spending arrangement, or limited treatment that is provided in an employer on-site medical facility (consisting primarily of first-aid, wellness and preventive care) does not result in disqualification from receiving the subsidy.

An individual eligible for the subsidy is required to *notify* the group health plan if his right to the subsidy ends by reason of eligibility for other group health coverage or Medicare. Failure to do so may be subject to an income tax penalty equal to 110% of the subsidy that is actually provided to the individual. Given that most Puerto Rico residents are not subject to federal income taxes, this enforcement mechanism will essentially be inoperative.

How much is the subsidy? The AEI is required to pay 35% of the COBRA premium. The recipient of the premiums (*i.e.*, the employer, plan administrator or insurance carrier) needs to make up the difference (65%) or consider such amount as having been paid. The qualified beneficiary's employer *cannot* pay for the COBRA coverage and then claim a subsidy for the other 65 percent.

Further, if the employer already partially subsidizes COBRA directly as part of a termination or severance agreement, the AEI need only pay 35% of the premium not covered by the agreement. The employer then ends up having to continue paying the portion of the premiums it agreed to pay, as well as 65% of the portion of the premium that would have otherwise been paid by the AEI. Obviously, this significantly punishes the employer for having agreed to subsidize part of the COBRA coverage.

How does the payroll tax credit work? The plan sponsor or insurance carrier recoups the subsidy by claiming a credit equal to the subsidy against the required payroll taxes or by requesting reimbursement from the U.S. Treasury. Only the person "to whom the COBRA premiums are payable" is entitled to the employment tax credit or reimbursement.

Payroll taxes are defined as income tax withholding, employee FICA withholding, and employer FICA taxes. Most employers in Puerto Rico, however, will not have federal income tax withholding obligations. In such cases, such employers may encounter the "cash flow" predicament of subsidizing 65% of the insurance premium on monthly basis and having to claim the credit on the *quarterly* FICA returns.

Plan sponsors that claim a credit must provide "attestations of involuntary terminations" with respect to the individuals with respect to whom the credit is claimed. The plan sponsor must also provide a report on the credit claimed and an estimate of the credit to be claimed for the next reporting period. In addition, the plan sponsor must report the following: the taxpayer

identification number of all covered employees; the amount of subsidy reimbursed with respect to each covered employee and qualified beneficiaries; and a designation as to whether the subsidy reimbursement is for coverage of one individual or two or more individuals.

The IRS has updated Form 941 (which is used by stateside employers to payroll tax obligations) to take into account the COBRA premium subsidy. Form 941-PR, which is used in Puerto Rico, should be updated soon.

Second Chance to elect COBRA. If an employee was involuntarily terminated on or after September 1, 2008, but either did not elect COBRA continuation coverage or elected continuation coverage but terminated same prior to February 17, 2009, he or she will have a new election period to enroll in COBRA coverage and obtain premium assistance. This election period began February 17, 2009 and ends 60 days after the plan administrator provides the individual with *notice* of his or her rights to this special election period and premium subsidy. If an AEI elects COBRA coverage under this special election window, coverage will be effective as of the first period of coverage after February 17, 2009 (generally March 1, 2009). However, that individual's maximum period of COBRA coverage will be determined as if the individual had timely elected COBRA coverage as of the original qualifying event.

Is the Subsidy Considered Taxable Income to the AEI? ARRA amends the U.S. Internal Revenue Code to exempt the subsidy from taxable income, unless the individual's yearly income exceeds certain "high-income" levels. For these individuals the total or partial amount of the subsidy is recaptured when the annual income tax returns are filed. These provisions, however, would only be applicable to those Puerto Rico residents who are required to file federal income tax returns.

What are the new COBRA notice requirements? In addition to the COBRA general and election notices, employers must inform COBRA-eligible individuals about their new COBRA rights under

the Act **no later than April 18, 2009**. The new information must be provided to any individual who became or becomes a qualified beneficiary—not just to individuals who were involuntarily terminated—during the period beginning September 1, 2008, and ending December 31, 2009.

Failing to distribute the required notice by April 18, 2009 will be treated as a failure to comply with the COBRA notice requirements (*i.e.*, could subject the employer or a plan to a penalty of **up to \$110 per day** under ERISA).

Employers may revise their current notices or include the new information as a separate document, but regardless, the new notices must be distributed on an ongoing basis for all new qualified beneficiaries through December 31, 2009. Employers must also send new COBRA notices to individuals who are entitled to the Second Chance to elect COBRA coverage (described above).

The Secretary of Labor is to provide model notices by March 19, 2009, however, employers are not required to use the model notice. In the past, Spanish language versions of the COBRA notices were not timely available, therefore employers may wish ensure compliance with the April 18 deadline by drafting new and/or revised notices without waiting for the model notice.

What information is required to be included in these notices? AEI must be provided with notice with following information: (1) any forms necessary for establishing eligibility for premium assistance; (2) the name, address, and telephone number of the plan or other party where the individual can receive information relating to the COBRA premium subsidy; (3) in the case of an AEI who is entitled to the Second Chance to elect COBRA coverage, a description of the extended election period and the deadline for making an election; (4) a description of the individual's obligation to notify the plan that he or she is eligible for coverage under another group health plan or Medicare and the penalty for failure to provide this notice; (5) a prominently displayed

description of the individual's right to a reduced premium and any conditions on entitlement to the reduced premium; and (6) if the employer has elected the option of permitting the individual to enroll in a plan that is different to the one he/she was covered under at the time of the original qualifying event, a description of such option.

What Should Employers and Plan Administrators Do Now? The COBRA provisions in ARRA are effective for most employer-sponsored health plans beginning March 1, 2009. Accordingly, the following actions should be taken immediately:

- Revise and update COBRA communication materials.
- Review severance plans and other agreements that provide employer paid COBRA subsidy in light of this newly required.
- Employers should contact their third party administrator, COBRA administrator and/or insurance company to allocate responsibility for complying with the various ARRA requirements (most notably, the COBRA premium payment methodology to take into account the subsidy, procurement of the tax credits and reimbursements, and notice requirements).
- Identify all employees whose employment terminated on or after September 1, 2008 and evaluate whether it was due to an involuntary termination of employment. Also identify their qualifying dependents.
- Implement a procedure for handling receipt of COBRA premiums for periods beginning on or after March 1 for those individuals who may be assistance-eligible individuals.
- Provide written notice as required by the Act to individuals who are eligible for the subsidy as soon as possible, but no later than April 18, 2009.
- Identify individuals entitled to the Second Chance to elect COBRA coverage and provide notice

allowing them to elect to receive the COBRA coverage and the premium subsidy.

- Decide whether to allow eligible individuals to change their health plan options.
- Develop procedures to reinstate the 100 percent COBRA premium charge if the individual continues to be eligible for COBRA coverage after termination of the subsidy.

Author: Jorge L. Capó Matos

Note: *Because of the general nature of this Labor Newsletter, nothing herein should be considered as legal advice or a legal opinion. For further information, please contact our labor and employment lawyers.*

LABOR AND EMPLOYMENT LAW DEPARTMENT

Jorge L. Capó-Matos
Luis A. Núñez-Salgado
Pedro A. Delgado-Hernández
Yldefonso López-Morales
José Fco. Benítez-Mier
Carlos E. George
Debbie E. Rivera-Rivera

María E. Santori-Aymat
Ana M. Santiago-Ramírez
Dimitri González-Izquierdo
Enrique González-Quñones
Yadhira Rodríguez Quñones
Massiel Bermúdez Ríos

O'NEILL & BORGES

American International Plaza, Suite 800
#250 Muñoz Rivera Ave.
San Juan, P.R. 00918-1813
Tel. 787-764-8181
Fax. 787-753-8944