

**COBRA AND THE ECONOMIC STIMULUS BILL
– PREMIUM SUBSIDIES, “SECOND CHANCE” ELECTIONS, AND MORE**

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- I. **The Big Picture.** The American Recovery and Reinvestment Act of 2009 (the “Act”) – commonly referred to as the Economic Stimulus Bill – was enacted on February 17, 2009. Pub. L. No. 111-5.
- A. *Big Changes.* As a result of the enactment of this Act, we are experiencing (and trying to come to grips with) the most far-reaching set of changes to COBRA since COBRA was originally enacted almost 25 years ago.
- B. *Immediate Effect.* Because the law was given immediate effect and requires employers (and others) to take certain steps within 60 days after enactment, there has been very little time to pause and reflect on these changes. Instead, employers (and others) have had to scramble to figure out what is required and to comply.
- C. *Changes Are Not Permanent.* Although they represent a big change and are already in effect, the COBRA changes in the Act are not intended to be permanent.
1. By their terms, they will not apply to anyone experiencing a “qualifying event” after the end of this year. Consequently, following a transition period in 2010, the need to comply with these new provisions will essentially “go away,” assuming, of course, that Congress does not act to extend the law!
 2. In the meantime, however, employers (and others) have to comply or they will be exposed to significant penalties and potential liability.
- D. *A Lot of Questions.* The big picture is fairly clear, but there are still a lot of questions at a “nuts and bolts” level.
- E. *Every Employer is Affected.* The COBRA changes in the Act affect almost every employer, including employers that are too small to be subject to COBRA.
1. Anyone anywhere who was involuntarily terminated between September 1, 2008, and the end of 2009 could potentially qualify for the premium subsidy and will need to be notified about it.
 2. If they were involuntarily terminated between September 1, 2008, and February 17, 2009, and COBRA coverage was not in effect on February 17, 2009 – either because it was not elected or because it lapsed after being elected – they will also need to be given a second opportunity to elect COBRA.

II. **Overview of the Changes Made to COBRA.** The COBRA provisions in the Act make three major changes to the “old” COBRA rules:

- A. *Premium Subsidy.* A “qualified beneficiary” who is also an “assistance eligible individual” is only required to pay 35% of the cost of COBRA coverage in order to obtain that coverage. Pub. L. No. 111-5, § 3001(a)(1). *More information on the premium subsidy is provided later in this outline.*
- B. *Second COBRA Election Period.* A “qualified beneficiary” who is also an “assistance eligible individual” must be given a second opportunity to elect COBRA if certain conditions are met. Pub. L. No. 111-5, § 3001(a)(1). *More information on the second election period is also provided later in this outline.*
- C. *Opportunity to Change to Other Coverage.* If the employer is offering multiple levels of coverage to its employees – for example, if the employer is offering both a premium HMO option and a more basic PPO option – the employer may choose to give “assistance eligible individuals” the opportunity to elect COBRA coverage under a different coverage option if the premiums for that other coverage option do not cost more than the premiums for the coverage option previously elected by the participant. Pub. L. No. 111-5, § 3001(a)(1)(B).
 - 1. *Employers Are Not Required to Do This.* This provision is permissive, not mandatory. Employers may offer this opportunity if they wish, but they are not required to do so.
 - 2. *Comparison to “Old” COBRA Rule.* Prior to the enactment of the Act, the coverage elected under COBRA was required to be identical to the coverage that was in effect on the day prior to the “qualifying event,” although a COBRA “qualified beneficiary” could elect to change his/her coverage during the employer’s open enrollment period if the employer offered more than one level of coverage.

Important Note Regarding Health FSAs. These changes apply to all group health plans that are subject to COBRA, with the exception of health flexible spending accounts (“health FSAs”). *Health FSAs are not affected by the COBRA provisions in the Act and continue to be subject to the “old” COBRA rules.*

III. **Are You Subject to COBRA?** Every employer that offers a “group health plan” to its employees is subject to COBRA, with the exception of the following:

- A. *“Federal Government.”* The federal government is not subject to COBRA, although the federal government is required to offer COBRA-like coverage to employees who are covered by its group health plan under a separate law. State and local governments are subject to the COBRA requirements found in the Public Health Service Act (42 U.S.C. §§ 300bb-1 - 300bb-8).

- B. *“Church Plans.”* A group health plan is not subject to COBRA if the plan is maintained by a church or by a convention or association of churches that is exempt from tax under Code § 501. Code § 4980B(d)(3); ERISA § 4(b)(2). A “church plan” may include a group health plan maintained by a hospital, clinic, school, or university that is controlled by or affiliated with a church or religious denomination.
- C. *“Small Employers.”* A group health plan is not subject to COBRA during a calendar year if “all employers maintaining such plan normally employed fewer than 20 employees on a typical business day during the *preceding* calendar year.” ERISA § 601(b) (emphasis added). In determining whether or not an employer qualifies for the “small employer” exception, the following should be noted:
1. *Must Count All Employees.* The employer has to count *all* of its employees, not just those who have chosen to participate in the group health plan. Treas. Reg. § 54.4980B-2, Q&A-5(c).
 2. *Must Count Part-Time Employees.* In counting its employees, the employer also has to count part-time employees, even if they are not eligible for benefits. Treas. Reg. § 54.4980B-2, Q&A-5(c). Under the regulations, part-time employees are counted as a fraction of an employee. Treas. Reg. § 54.4980B-2, Q&A-5(d & e).
 3. *Must Count Employees of Related Employers.* The employer also has to count the employees of any “related employers” and, in some situations, their “successors.” Code § 414(t) (providing that the Code § 414 “controlled group” and “affiliated service group” rules apply for purposes of the Code’s COBRA provisions); Treas. Reg. § 54.4980B-2, Q&A-2.
 4. *But Some People Are Not Counted.* Although the regulations require all common law employees to be counted, they also provide that persons who are not common law employees should not be counted. Persons who should not be counted as an employee include self-employed individuals, such as partners in a partnership or members of an LLC, independent contractors and their employees, and the directors of a corporation (if they are not otherwise employed by the corporation). Treas. Reg. § 54.4980B-2, Q&A-5(c).

IV. **What’s a “Group Health Plan”?** COBRA applies to “group health plans.”

- A. *Definition.* For COBRA purposes, a “group health plan” is essentially defined as:
1. A “plan, fund, or program”;
 2. That is “established or maintained by an employer”;
 3. For the purpose of providing or paying the cost of “medical care”;
 4. To “individuals who have an employment-related connection to the employer,” including employees, former employees, the employer, and their families.

- B. *Examples of Group Health Plans.* Under this definition, plans that offer any of the following benefits will normally be considered to be a “group health plan”:
1. Major medical coverage;
 2. Dental or vision coverage;
 3. Health flexible spending accounts (Health FSAs);
 4. Health reimbursement accounts (HRAs); and
 5. Employee assistance programs (if they are staffed by trained counselors who provide some form of counseling as opposed to merely referring employees to some other provider).
- C. *Examples of Plans that Are Not Group Health Plans.* On the other hand, offering the following types of benefits will not normally cause a plan to be considered to be a “group health plan”:
1. Cancer insurance, hospital insurance, and other similar policies (if the policy pays a fixed amount per day without regard to other coverage or the expenses actually incurred by the insured); and
 2. Health Savings Accounts (“HSAs”) (if they are not subject to ERISA under DOL Field Advice Bulletin 2004-1).

V. **What Does COBRA Require?** In a nutshell, what COBRA requires is this:

- A. *Employer Must Offer Continued Coverage if a Qualifying Event Takes Place.* An employer is required to offer continuation coverage to a “qualified beneficiary” if the qualified beneficiary’s coverage under a “group health plan” would otherwise be lost as a result of a “qualifying event.”
- B. *Election of Coverage and Payment of Required Premiums.* If the qualified beneficiary wants to continue his/her coverage, he/she is required to return a COBRA election form and is required to pay the applicable premium for that coverage.
- C. *Duration of Continued Coverage.* A qualified beneficiary may continue coverage for up to 18 or 36 months (or, in some cases, 29 months) or until coverage is lost as a result of some other event, such as becoming entitled to Medicare or becoming covered under another group health plan.

VI. **What About Small Employers (Less Than Twenty Employees)?** Because COBRA does not apply to employers with fewer than twenty employees, many states, including Kansas, have attempted to fill that “gap” by enacting their own COBRA-like statutes. These statutes are commonly known as “*mini-COBRA*” statutes.

- A. *State Authority.* The authority to enact these statutes is derived from the authority the states have to regulate insurance companies. Unlike federal COBRA, these state statutes do not, as a general rule, attempt to regulate employers directly. This is due to the fact

that ERISA preempts most state laws that attempt to regulate the terms and conditions of employer-sponsored group health plans. See ERISA § 514.

- B. *Typical Provisions.* A typical “mini-COBRA” statute requires insurance companies to include certain provisions in their policies of group health insurance as a condition of receiving state approval to issue policies in that state. Typically, for example, a “mini-COBRA” statute might require a group insurance contract to include a provision giving persons insured under that contract the right to continue coverage for a limited period of time at their own expense after coverage under the group contract would otherwise be lost. Such a provision might apply even if the employer itself was not subject to COBRA.
- C. *Kansas Mini-COBRA Statute.* The Kansas “mini-COBRA” statute is fairly limited in scope. It applies only if a group health plan is not subject to COBRA (among other conditions) and permits coverage to be continued for a maximum of eighteen months (among other provisions). See K.S.A. 2008 Supp. 40-2209(i) and (j).

2008 Amendment: The Kansas “Mini-COBRA” statute was amended by the Legislature in 2008. The 2008 amendment made two changes:

- (1) First, the maximum coverage period was extended from six months to eighteen months; and
- (2) Second, the employer (and not the insurance company) is now required to provide “reasonable notice” to the employee and his/her covered dependents of the right to continuation of coverage and to collect the applicable premiums for such continuation coverage.

L. 2008, ch. 164, § 5.

- D. *Conversion Rights.* In addition to these “mini-COBRA” statutes, many states also have statutes requiring insurance companies to offer “conversion” rights to individuals who lose coverage under a group health insurance contract. Under such a provision, individuals have the right to “convert” their coverage under a group health insurance contract to an individual policy of insurance. The Kansas conversion statute requires conversion rights to be provided if coverage is lost at the end of the eighteen-month continuation period required under the Kansas “mini-COBRA” statute or, if the plan is subject to COBRA, when the COBRA continuation coverage expires. K.S.A. 2008 Supp. 40-2209(j)(20).
- E. *Impact of the Stimulus Bill.* The COBRA provisions in the Stimulus Bill affect coverage under the Kansas mini-COBRA statute as follows:
1. Continued coverage under the Kansas mini-COBRA statute qualifies for the premium subsidy;
 2. But individuals who did not elect to continue their coverage when that opportunity was originally offered are not entitled to a “second chance”; and

3. The option to change to coverage that is less expensive does not apply to coverage under the Kansas mini-COBRA statute.

VII. **Which Individuals Do the COBRA Changes Affect?** The COBRA changes are focused on “assistance eligible individuals”; however, certain notices will need to go to all COBRA “qualified beneficiaries” (as explained in more detail later in this outline).

A. *Which Individuals Are Considered to be “Assistance Eligible Individuals”?* An “assistance eligible individual” is defined as an individual:

1. Who is (or was) eligible for COBRA continuation coverage at any time between September 1, 2008, and December 31, 2009;
2. Whose eligibility is (or was) the result of the “involuntary termination” of a covered employee’s employment during that same time period; and
3. Who elected COBRA when it was offered to him/her, either when it was first offered or, if applicable, during the second election period.

Pub. L. No. 111-5, § 3001(a)(3).

B. *Scope of this Definition.* The term “assistance eligible individual” includes not just employees who are (or will be) involuntarily terminated during this time period, but also other “qualified beneficiaries,” such as spouses and dependent children, who are (or were) receiving their coverage through the employer as a result of another individual’s employment.

VIII. **Premium Subsidy.** An “assistance eligible individual” may elect and receive COBRA continuation coverage without having to pay the full amount of the premium that would otherwise be due.

A. *Amount of Subsidy.* Under the Act, an “assistance eligible individual” is only required to pay 35% of the normal COBRA premium. Pub. L. No. 111-5, § 3001(a)(1)(A).

B. *Duration of Subsidy.* The subsidy will be available until the *earliest* of the following events:

1. The individual has received the subsidy for nine months;
2. The individual becomes “eligible for coverage under any other group health plan,” other than a group health plan providing only limited benefits, such as dental or vision coverage;
3. The individual becomes eligible for Medicare; or
4. The individual is no longer eligible for any further COBRA continuation coverage, for example, because the individual has received coverage for the maximum possible period or because the individual failed to pay his/her share of the required premium on a timely basis.

Pub. L. No. 111-5, § 3001(a)(2).

- C. *Becoming Eligible for Other Coverage.* Becoming “eligible for coverage under any other group health plan” encompasses a wide range of situations:
1. If an “assistance eligible individual” becomes eligible for coverage at a new place of employment, the premium subsidy will be lost, even if the individual did not sign up for that coverage. Pub. L. No. 111-5, § 3001(a)(2)(A)(i).
 2. It also appears that the premium subsidy will be lost if the individual is eligible to be covered under a group health plan offered by his/her spouse’s employer.
 - a. Under HIPAA “special enrollment,” an employee has the right to enroll himself/herself, his/her spouse, and/or his/her dependents in the group health plan of his/her employer if they are otherwise eligible for coverage under that plan and if coverage under some other plan has been lost. See Code § 9801(f); ERISA § 701(f); PHS § 2701(f).
 - b. Under HIPAA, special enrollment rights must be exercised within 30 days of the event or the rights may be lost. However, some employers may allow a longer period of time for the exercise of special enrollment rights.
 3. An “assistance eligible individual” who becomes “eligible for coverage under any other group health plan” (including, for this purpose, Medicare) is required to notify the group health plan for which the premium subsidy is being provided. This notice must be provided in writing in accordance with whatever rules may be established by the Department of Labor. Pub. L. No. 111-5, § 3001(a)(2)(C).
- D. *Penalty Tax.* An individual who receives a subsidy to which he/she is not entitled will be subject to a 110% penalty tax on that subsidy. Code § 6720C (as added by Pub. L. No. 111-5, § 3001(a)(13)). How this will be enforced is not certain.
- E. *Right to Expedited Administrative Review.* If an individual’s request to be treated as an “assistance eligible individual” is denied by a group health plan, the individual has the right to an expedited administrative review.
1. For most group health plans, the review will be provided by the Department of Labor. For plans that are not subject to Title I of ERISA, such as church plans and governmental plans, the review will be provided by the Department of Health and Human Services (“HHS”).
 2. The procedures for requesting a review will be developed by the Department of Labor, HHS, and the IRS.
 3. If a review is requested, a determination must be made within 15 business days after receipt of the appeal.
 4. A reviewing court is required to “grant deference” to any such determination.

Pub. L. No. 111-5, § 3001(a)(5).

- F. *Timing/Transition Rule.* For most group health plans, the premium subsidy became available on March 1, 2009.
1. By the time “assistance eligible individuals” are notified of the subsidy, however, it is possible that they might already have paid the entire COBRA premium for March, April, and/or even May 2009.
 2. Accordingly, the Act provides for the following transition rule: If an “assistance eligible individual” pays 100% of the cost of his/her COBRA premiums during the first 60 days following the effective date of the Act – that is, between February 17, 2009, and April 18, 2009 – the employer must:
 - a. Reimburse the individual for 65% of the premiums paid during this time period; or
 - b. Provide a credit to the individual in an amount equal to 65% of the premiums paid during this time period to be used to offset future premiums over the next 180 days.

Pub. L. No. 111-5, § 3001(a)(12)(E).

- G. *Employer Tax Credit.* An employer, that is required to provide a subsidy for the cost of COBRA premiums, will be “made whole” through a credit against the amount of its payroll taxes.
1. The credit will normally be equal to the difference between the full amount of the COBRA premiums and the amount that was actually paid by an “assistance eligible individual.”
 2. To claim this credit, an employer must complete a revised IRS Form 941.

Code § 6432 (as added by Pub. L. No. 111-5, § 3001(a)(12)(A)).

- H. *“Recapture” Provision for Certain High Income Taxpayers.* For most taxpayers, the premium subsidy will not be includible in their taxable income. The situation changes, however, for certain high income taxpayers.
1. If the “modified adjusted gross income” of an “assistance eligible individual” exceeds \$125,000 (or, in the case of taxpayers filing a joint return, \$250,000), a “phase in” will apply and a portion of the subsidy will become taxable.
 2. If the taxpayer’s “modified adjusted gross income” exceeds \$145,000 (or, in the case of a taxpayer filing a joint return, \$290,000), the entire amount of the subsidy will be taxable.
 3. The tax is designed to recapture the amount of any excess subsidy received by an individual. For this reason, the amount of the tax is equal to the amount of the excess subsidy.

4. Taxpayers who are concerned that their income will exceed these thresholds may make a permanent election to waive their subsidy by notifying the employer in writing.

Pub. L. No. 111-5, § 3001(b).

- I. *Tax Reporting.* The IRS has not announced any tax reporting requirements to date; however, it seems likely that some type of reporting will be required to implement the “recapture” provision for high income taxpayers.

IX. **Notices.** The Act requires plan administrators to provide two different sets of notices to individuals:

- A. *Information Regarding the Premium Subsidy.* Information about the premium subsidy must be provided to *all* “qualified beneficiaries” (and not just “assistance eligible individuals”) who became entitled to elect COBRA as a result of any “qualifying event” that took place between September 1, 2008, and December 31, 2009.

1. If the “qualified beneficiary” is an “assistance eligible individual” *and* the “qualifying event” took place before February 17, 2009, the additional information must be provided by Saturday, April 18, 2009.
2. If the “qualifying event” took place on or after February 17, 2009, the additional information must be provided at the same time as the COBRA election notice.
3. If the “qualifying event” took place before February 17, 2009, but the “qualified beneficiary” is *not* an “assistance eligible individual,” the Act requires the additional information to be provided but does not set forth a specific deadline.

Pub. L. No. 111-5, § 3001(a)(7)(A & B).

- B. *Second Chance Election Form.* If an individual is entitled to a second opportunity to elect COBRA, information about this second opportunity must be provided along with the additional information regarding the premium subsidy. Pub. L. No. 111-5, § 3001(a)(7)(C). As noted, the deadline for providing this information is April 18, 2009.

X. **Consequences of Noncompliance.** The Act provides that an employer that fails to comply with the new requirements that were added by the Act will be treated as failing to comply with COBRA. The consequences of failing to comply with COBRA could potentially include the following:

- A. *Excise Tax under the Code.* A group health plan that fails to satisfy the COBRA requirements in the Code is subject to a tax of \$100 per day for each failure during the “noncompliance period.” Code § 4980B(b).

1. *Inadvertent Failure Rule.* The excise tax will not be imposed for any period if it can be established to the satisfaction of the IRS that none of the persons who could be liable for the tax knew, “or exercising reasonable diligence would have known, of the failure to comply with COBRA.” Code § 4980B(c)(1).

2. *Grace Period Rule.* The excise tax does not apply to failures due to reasonable cause (and not willful neglect) that are corrected within 30 days after any person liable for the tax knew, “or exercising reasonable diligence would have known, of the failure to comply with COBRA.” Code § 4980B(c)(2).
3. *Correcting a Failure with Respect to a Qualified Beneficiary.* To correct a failure with respect to a qualified beneficiary, the failure must be “retroactively undone to the extent possible” and “the qualified beneficiary must be placed in a financial position which is as good as such beneficiary would have been in had such failure not occurred.” Code § 4980B(g)(4).
4. *Persons Liable for the Excise Tax.* The tax is imposed on the employer maintaining the plan (except for multi-employer plans, in which case the tax is imposed on the plan itself).
 - a. This could include other entities within the same “controlled group” as the employer and successor employers. Treas. Reg. § 54.4980B-2, Q&A-2(a).
 - b. In some situations, a successor employer could include an asset purchaser if the purchaser continues the seller’s business and the seller ceases all group health plans in connection with the sale. Treas. Reg. § 54.4980B-2, Q&A-2(a) and 54.4980B-9, Q&A-8(c).

Additionally, a plan administrator or other person who has assumed responsibility for COBRA compliance could potentially be liable for the excise tax, unless the employer’s act or failure to act “made the person unable to comply with its responsibilities” under COBRA. H.R. Rep. No. 101-247, at 59 (1989).

5. *Statute of Limitations.* The IRS takes the position that there is no statute of limitations for COBRA violations.
- B. *Statutory Penalties under ERISA.* The plan administrator of a group health plan that is subject to Title I of ERISA is subject to a penalty of up to \$110 per day for a failure to provide either an initial COBRA notice or a COBRA election notice on a timely basis. ERISA § 502(c)(1)(A); DOL Reg. § 2575.502c-1. The penalty would be payable to the participant or beneficiary who was entitled to receive the notice.
- C. *Private Cause of Action.* In addition to seeking recovery of the statutory penalty, an individual may seek recovery of the benefits that would have been paid by the plan (with an offset for the COBRA premiums that would have been paid) if the individual can establish that he/she was entitled to elect COBRA but that COBRA was not properly offered.
1. Note that the employer (and not the underlying insurance company, COBRA administrator, or third party administrator) would be liable in this situation.
 2. Whether the employer would have a cause of action against the underlying insurance company, COBRA administrator, or third party administrator would depend on the terms of the underlying agreement with the employer.

COBRA Premium Subsidy – Who Gets What When

(does not apply to Health FSAs)

	Situation	Premium Subsidy Package	Second Chance Election Form	Existing COBRA Election Notice and Forms
#1	Qualifying Event On or After 9-1-08 and Before 2-17-09 <u>and</u> :			
	#1(a) - COBRA was elected and was still in effect as of 2-17-09	Required for all qualified beneficiaries. If the qualifying event was an “involuntary termination” of employment, deadline for providing is 04-18-09.		
	#1(b) - COBRA was not elected <u>or</u> was elected but was no longer in effect as of 2-17-09	Required for all qualified beneficiaries. If the qualifying event was an “involuntary termination” of employment, deadline for providing is 04-18-09.	If the qualifying event was an “involuntary termination” of employment, must be provided along with the Premium Subsidy Package.	
#2	Qualifying Event On or After 2-17-09 <u>and</u> COBRA election form has:			
	#2(a) - Already been sent	Required for all qualified beneficiaries. Deadline is same as normal COBRA deadline.		
	#2(b) - Not yet been sent	Required for all qualified beneficiaries. Deadline is same as normal COBRA deadline.		Required for all qualified beneficiaries. Must be sent together with Premium Subsidy Package.

Note: Situation #1 assumes that the qualified beneficiaries already received the COBRA election notice and form as part of the employer’s general COBRA compliance procedures.