

To: Clients and Friends
From: Smith & Downey
Date: February 18, 2009
Re: URGENT - Stimulus Act - *IMMEDIATE ACTION REQUIRED*

Overview. As part of the relatively broad "safety net" contained in the just-signed American Recovery and Reinvestment Act of 2009 (widely known as "the Stimulus Act" and likely to be called "ARRA"), the Congress created a program to reduce the costs of health care continuation benefits for qualifying individuals.

These new rules require immediate action by most employers with employee health plans. Although these provisions are styled as a "subsidy" to individuals, they actually create a federally-mandated and funded continuation premium "discount" for individuals that must be carefully implemented and administered by employers.

Note that, even more so than is typical, the language of this new piece of legislation raises a number of unanswered questions, and contains a number of ambiguities, that will require clarification. In the meantime, employers will be required to operate using good faith, reasonable interpretations of the language of the new rules.

Costs That Are Subsidized. The federal subsidy is provided for a portion of qualifying COBRA premiums, a portion of governmental plan PHSA premiums, and a portion of qualifying State law continuation premiums.

Note that, because the subsidy applies to State law continuation premiums in addition to COBRA and PHSA premiums, the Act impacts employers ordinarily not concerned with COBRA or the PHSA (e.g. churches and private employers with fewer than 20 employees).

Health Flexible Spending Account continuation premiums are not subsidized under the Act.

Eligible Individuals. The Act provides that an individual is eligible for the federal subsidy if:

- (a) the event giving rise to the coverage was an involuntarily termination of employment occurring between 9/1/08 and 12/31/09; and
- (b) the individual (or someone other than the employer) pays 35% of the actual continuation premium.

The subsidy is available regardless of income, but the amount of the subsidy credited during a tax year for an eligible individual is partially or fully "recaptured" (i.e., added to the taxpayer's income tax liability for the year) for any taxpayer with modified adjusted gross income for that year of over \$125,000 (or over \$210,000 for a joint return), if the eligible individual is the taxpayer or the taxpayer's spouse or dependent. The recapture is phased-in for taxpayers with adjusted gross income between \$125,000 and \$145,000 (or between \$210,000 and \$250,000

for joint returns). The entire amount is recaptured if the taxpayer's income is above those ranges. An individual may waive his or her right to the subsidy (and avoid having to deal with the recapture of the subsidy) by making a permanent election (using a form to be provided by the IRS) and notifying the employer or insurer of that election. The IRS is to issue regulations on this issue.

Note that individuals whose qualifying event was a reduction in hours are not eligible for the subsidy.

Duration of Subsidy. The federal subsidy is available for nine months, but is not retroactive. That is, even though individuals whose qualifying event was as long ago as 9/1/08 may qualify for the subsidy, the subsidy generally applies only to periods beginning on or after 3/1/09.

Early Termination of Subsidy. The federal subsidy terminates before the end of the individual's nine-month subsidy period if the individual becomes eligible for Medicare or other employer-provided health coverage (not including coverage under plans providing only dental, vision, counseling or referral services, and not including coverage under Health Flexible Spending Accounts or Health Reimbursement Arrangements).

Individuals who fail to inform the employer, in writing, of the occurrence of one of these early termination events face a penalty equal to 110% of the subsidy.

(Note that these early termination of subsidy events are different than the COBRA/PHSA-early termination of coverage events because of actual coverage after the date of the COBRA or PHSA election by another health plan (without a pre-existing condition limitation affecting the Qualified Beneficiary), and because of entitlement to Medicare after the date of the COBRA or PHSA election.)

Amount of Federal Subsidy. The federal subsidy equals the 65% portion of the continuation premium that is not paid by the individual.

Collecting the Subsidy. Employers are responsible for providing the subsidy to eligible individuals (by discounting their continuation premiums) and "collecting" a reimbursement of the subsidy from the federal government. The reimbursement is accomplished through a credit applied by employers to their federal income and payroll taxes due to the Treasury. (That is, the employer must actually pay the subsidy amount and then recover it by offsetting it against amounts it owes to the Treasury.)

In cases in which the income and payroll taxes due to the Treasury are less than the amount of subsidy reimbursement due from the Treasury (e.g., in the case of multiemployer plans that must "front" the subsidy), a direct payment may be sought from the Treasury.

Transition Rule. The Act contains special provisions that apply in cases in which subsidy-eligible individuals pay their full March and April 2009 premiums. In these cases, the employer must

either refund the 65% subsidy amount to the individuals within 60 days or credit it against their future premiums (if the employer reasonably expects the crediting against future premiums to cover the past-due subsidies due within 180 days).

Second Chance Election Rule. The Act provides certain individuals with a "second chance" to elect COBRA or PHSA coverage they may have waived. Specifically, individuals whose qualifying event was an involuntary termination of employment occurring on or after 9/1/08 and who did not elect COBRA or PHSA coverage when they were first eligible to do so must be provided with a second Qualifying Event Notice within 60 days after the President signs the Act (i.e., by 4/18/09) that informs them that they may elect continuation coverage within 60 days of the date of that second Notice.

If they elect continuation coverage under this second chance rule, the continuation coverage becomes effective on 3/1/09 and ends on the date the continuation coverage would have ended had they initially elected COBRA or PHSA coverage. The Act adds that the gap in coverage between their Qualifying Event and 3/1/09 may not be counted as a gap in coverage under HIPAA's 63-day gap rule for pre-existing condition exclusion purposes.

Document Requirements. Employers must revise their Qualifying Event Notices to reflect the availability of the subsidy. (The statute does not require the DOL to revise its model Qualifying Event Notice until mid-March, so many employers will be required to make these revisions before government safe harbor language is available.)

Note that the statute does not appear to require changes to the Initial COBRA/PHSA Notice.

Required Employer Actions.

1. Immediately revise the employer's Qualifying Event Notice with the required information about the subsidy.
2. On or before 4/18/09, notify all affected individuals about the subsidy.
3. On or before 4/18/09, provide the "second chance" election notice to affected individuals whose qualifying event was involuntary termination of employment on or after 9/1/08.
4. If necessary, implement the special transition rule for March and April 2009.
5. Implement the required waiver of subsidy procedure for higher income individuals.
6. Implement operating procedures to reflect all of the above, including preparing and providing all required notifications and installing the mechanisms for providing the discounted rate to eligible individuals and collecting the reimbursement of the federal subsidy through the offset of amounts due to the Treasury.

7. Coordinate all of the above with the employer's TPA, insurance carrier, stop-loss carrier, and other service providers.

Please contact us if we can be of assistance with your attempts to comply with these new rules.