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sions Enacted by
the American
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THE NEW COBRA SUBSIDY PROVISIONS by Jerry L. Zimmerman

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009 ("ARRA"). ARRA contains sweeping amendments to the Internal Revenue Code. Section 3001 of ARRA requires, under certain circumstances, employers and ultimately the federal government to make premium assistance

the effect of Section 3001 of ARRA on public school districts.

Question: Generally, what is the general concept captured by the COBRA subsidy provisions contained in ARRA?

Answer: Generally, ARRA provides that certain individuals known as "Assistance Eligible Individuals" ("AEIs") are enti-

(3) The ability of the AEI to elect COBRA coverage is due to an involuntary termination of employment, and at the time of the involuntary termination of employment the individual must have group health coverage.

(4) The individual is not eligible for coverage under another group health plan or

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payments for COBRA health plan continuation coverage to certain individuals whose employment was involuntarily terminated on any date from September 1, 2008 through December 31, 2009. The COBRA subsidy provisions are extensive, detailed and **effective immediately**. The United States Department of Labor and the Internal Revenue Service have been rapidly issuing guidance to employers in an effort to enable the employers to comply with the provisions of ARRA. The regulations being issued and the interpretation of the COBRA subsidy provisions of ARRA are a "work in process"; guidance is still being issued. The guidance has been issued in a question and answer format, and this article will continue that format, focusing on

tled to a limited federal subsidy for a limited duration with respect to the premiums paid by AEIs necessary for the AEIs to continue group health insurance coverage after the involuntary termination of the AEI's employment.

Question: Who is an Assistance Eligible Individual?

Answer: An Assistance Eligible Individual or "AEI" is an individual who meets each of the following requirements:

(1) He is eligible for COBRA continuation coverage at any time from the period commencing September 1, 2008 and ending December 31, 2009.

(2) He elects COBRA continuation coverage (or is given the opportunity to elect COBRA coverage).

Medicare.

Question: Since public school districts are generally not subject to the provisions of ERISA, will the COBRA continuation rules under ARRA apply to public school districts?

Answer: Yes, although public school districts are not subject to the provisions of ERISA, or subject to the COBRA continuation coverage provisions set forth in the Internal Revenue Code, public school districts are subject to comparable COBRA provisions set forth in the Public Health Service Act. As such, public school districts are subject to the COBRA subsidy requirements set forth in ARRA.

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THE NEW COBRA SUBSIDY PROVISIONS (CONTINUED FROM PAGE 1)

Question: How much is the subsidy?

Answer: The subsidy is 65% of the monthly premium (which could include the 2% administrative fee) which the AEI would otherwise be required to pay in order to maintain health coverage.

Question: What is the maximum duration for which an AEI may receive the COBRA continuation premium subsidy?

Answer: The maximum duration is nine months. However, if the AEI becomes eligible to participate in another group health plan or to participate in

Medicare prior to the end of the nine-month period, then the duration of the subsidy ends on the date that the AEI is eligible to participate in the group health plan or Medicare.

Question: If the subsidy to the AEI terminates due to his eligibility in another group health plan or Medicare, how is the school district supposed to be aware of that set of facts?

Answer: It is incumbent on the AEI to notify the school district of his eligibility in an alternative plan or Medicare. This requirement, of course, could create payroll tax issues for the employing school district. The school district should have a procedure in place to document any notification it receives from an AEI in which the AEI notifies the school district of his eligibility to participate in another group health plan or Medicare. This aspect of the law is critical because if the school district allows the subsidy after it has been notified by an AEI that he is no longer eligible to receive the subsidy, then the school district will have an additional payroll tax liability as well as exposure for penalties

based on its underpayment of payroll tax. Failure by the AEI to provide notice of noneligibility for the subsidy could subject the AEI to a "penalty tax."

Question: What constitutes an involuntary termination of employment?

Answer: The factual circumstances which constitute "an involuntary termination of employment" must be reviewed on a case by case basis. Certainly, a reduction in force would constitute an involuntary termination of employment. Other facts and circumstances which might not completely terminate the employment of an employee could nevertheless constitute a involuntary termination of employment. For example, if an employee resigns under the threat of termination of employment, this set of facts could constitute an involuntary termination of employment. A situation in which an employee's duties are materially and adversely diminished and his hours are materially adversely diminished could constitute an involuntary termination of employment. However, a reduction of hours is not an involuntary termination of employment. Issues which require caution involve factual circumstances in which an employee resigns after he has been admonished or has been placed on a plan of improvement and does not satisfactorily comply with the plan, thereby raising the likelihood of a termination of employment. For the school district, the determination of whether an employee's employment has been involuntarily terminated is critical because an employee has a right to immediately appeal a determination that his employment was not involuntarily terminated.

Question: What are the appeal rights of an employee who perceives that his employment has been involuntarily terminated during the period commencing September 1, 2008 and ending December 31, 2009, without getting the opportunity to utilize the subsidy of 65% of the COBRA premium payment?

Answer: The employee has an immediate right to appeal the decision to the U.S. Department of Health and Human Services. The Department of Health and Human Services must make a determination within 15 business days after it receives a complete application for appeal. It appears that school districts will have the opportunity to participate in the appeals process. Due to the potential cost to the school district in participating in the appeals process, it is important that the school district's administrators make the correct decision as to whether an employee's employment has been involuntarily terminated.

Question: Is an employee whose employment has been involuntarily terminated due to gross misconduct entitled to the COBRA premium subsidy?

Answer: No. Under these circumstances, the employee would not be entitled to elect COBRA continuation coverage, therefore, he is not entitled to receive a subsidy. However, caution must be taken to conclude that an employee's employment was involuntarily terminated due to the employee's gross misconduct. This analysis is reviewed on a case by case basis, looking at all relevant facts and circumstances.

Question: Are AEIs entitled to written notice advising them of their rights to receive a COBRA continuation coverage premium subsidy?

Answer: Yes, and in most cases the obligation to provide the notice to the AEI is imposed on the school district which formerly employed the AEI.

Question: What must be specified in the notice?

Answer: Rather than itemize the information which must be specified in the notice, the Department of Labor has published four different forms of notice. Only one form of a notice must be given to an

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“. . . certain individuals known as Assistance Eligible Individuals . . . are entitled to a limited federal subsidy for a limited duration with respect to the premiums paid . . .”

THE NEW COBRA SUBSIDY PROVISIONS (CONTINUED FROM PAGE 2)

AEI. The correct form must be provided to the AEI. The determination of the specific form which must be given to an AEI under a specific set of circumstances is complex and is beyond the scope of this article. **Because the period of the COBRA continuation premium subsidy does not commence until appropriate notice is given to an AEI, it is imperative that the correct notice be issued.** The involuntary termination of employment of each employee, the date of the involuntary termination of employment and the AEI's election to continue to be an insured participant under COBRA are factors which must be considered in determining the appropriate written notice to issue to the AEI. The forms can be obtained at the Department of Labor's website: www.dol.gov/COBRA.

Information which should be specified on the notice includes but is not necessarily limited to:

- a form or questionnaire to establish eligibility for the premium subsidy,
- contact information for the plan administrator,
- a general notice which requires the AEI to notify the plan when the AEI becomes eligible for coverage under another group plan or Medicare, and the penalty to the AEI for failing to disclose that information to the plan administrator,
- a general summary of the COBRA premium reduction and the conditions which would enable an AEI to obtain a premium reduction,
- a description of the election periods, which under certain circumstances could include a "second chance" for AEIs who have previously determined not to elect COBRA continuation coverage, and
- if the school district offers a different plan, then a description of the option, if any, to enroll in the other plan.

Question: When must the notices be issued?

Answer: Generally, the notice must be issued within 60 days after a participant suffers any event which would entitle the participant to COBRA continuation coverage. The requirement to issue the notice is not limited to individuals who have suffered a qualifying event which is the involuntary termination of employment; it must be issued to all participants who suffer any event which would qualify them for COBRA continuation coverage. For plan participants who are AEIs and whose employment was terminated on or prior to February 17, 2009, the deadline for issuing the notice is April 18, 2009.

Question: Once the notice is issued by the school district, how much time does the recipient have in which to elect continuation coverage?

Answer: The recipient of the notice has 60 days after the date of the notice in which to elect continuation coverage. However, even if the recipient elects COBRA continuation coverage, he is not required to pay the applicable premium until 45 days after his election. Therefore, it is possible that the school district will not receive the continuation premium from the participant until 165 days after the participant has suffered a qualifying event entitling that participant to COBRA continuation.

Question: ARRA did not become effective until February 17, 2009, but the COBRA continuation coverage applies to qualified beneficiaries attributable to an involuntary termination as early as September 1, 2008. How are these differences reconciled?

Answer: Each AEI whose employment was involuntarily terminated from September 1, 2008 through February 16, 2009, and who did not elect COBRA or who did elect COBRA but subsequently dropped it, is entitled to a "second chance" to

elect COBRA continuation coverage. The second chance will not extend the duration of continuation coverage beyond the original maximum period. If the AEI elects COBRA as a result of the second chance, generally the election will be effective as of March 1, 2009. There are exceptions to the general rule. A review of the facts of each involuntary termination from September 1, 2008 must

be made to determine whether the qualified beneficiaries affected by the involuntary termination must receive the "second chance" to elect COBRA continuation coverage.

Question: If the AEI is only required to pay 35% of the premium, who pays the remaining 65%?

Answer: The school district must initially make the payment, but it will be reimbursed by the United States government.

Question: If the school district must pay 65% of the employee's continuation coverage for a period of up to nine months, that will be financially devastating to the school district. How does it obtain financial relief?

Answer: If the school district properly advises an AEI of his rights, actually receives the COBRA continuation premium of 35% from the AEI, and actually pays the remaining 65% of the premium, then the school district is entitled to take a credit for the amount of its payment.

Question: How is the credit claimed?

Answer: The credit is a credit against the school district's employ-



"The credit is a credit against the school district's employment tax liability."

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THE NEW COBRA SUBSIDY PROVISIONS (CONTINUED FROM PAGE 3)

ment tax liability. The employment tax could consist of one or more of the following three taxes:

1. The employer's share of FICA tax.
2. The employee's share of FICA tax that the employer is required to withhold.
3. The income tax which the employer is required to withhold.

The subsidy does not have any impact on FUTA. The school district may not claim a credit against its FUTA liability. Regardless of whether the involuntary termination accrued prior to February 17, 2009, the earliest date that the credit can be claimed is February 17, 2009, and for the substantial majority of health plans the earliest date will be March 1, 2009. The school district obtains reimbursement of the subsidy by claiming the amount of the subsidy as a credit on its payroll tax return (Form 941). The Department of Treasury has already revised Form 941 to provide that the premiums of 65% paid by the school district are credited against its payroll tax liability. The credited amount will be treated as having been deposited on the first day of the quarter, and it will be applied against the school district's deposit requirements. Thus, the school district will be deemed to have deposited on the first day of the quarter the amount of the subsidy to which it is entitled. In lieu of the credit, the school district can request a refund. The school district may claim the credit for the quarter during which it provides the COBRA subsidy or it may claim the credit on Form 941 for a later quarter in the same calendar year.

Question: May the school district claim the credit if it pays the 35% of the COBRA continuation premium required to be paid

by the AEI?

Answer: No.

Question: Is the COBRA premium subsidy taxable income to the AEI?

Answer: Generally, the subsidy will not be included in the individual's federal income. However, the subsidy phases out for "high income" individuals. For individuals who file single returns and whose modified adjusted gross income exceeds \$125,000 (\$250,000 for joint returns) no subsidy is allowed. Those individuals who receive the subsidy will be required to report the full amount of the subsidy and repay it as an additional tax.

Question: What should school districts do now?

Answer: Due to the requirement that employers must issue notice by April 18, 2009 to certain AEIs, school districts at this time must immediately:

- compile an employee census concerning all employees whose employment was terminated from September 1, 2008 through February 17, 2009,
- determine whether those employees elected COBRA continuation coverage,
- determine whether those employees suffered an involuntary termination of employment,
- compile the data necessary to comply with the IRS guidelines concerning data retention,
- provide the appropriate notice to qualified beneficiaries, and
- the school district's HR department should coordinate with its health insur-



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ance carrier to be assured that the carrier is coordinated with the school district.

Due to the April 18 deadline, Rosenstein, Fist & Ringold has made Jerry Zimmerman available virtually on an "emergency basis" to assist with respect to this matter.

IRS Circular 230 Notice. The advice contained in this communication is not intended or written by us to be used and may not be used or relied on for the purpose of avoiding penalties under the Internal Revenue Code. Any advice in this communication is not confidential; rather, it is intended to support the promotion of the transactions addressed herein, and each taxpayer should seek advice based on its particular circumstances.

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