

Targeted Compliance COBRA



COBRA, Health Flexible Spending Accounts, and Health Reimbursement Arrangements

Generally, health flexible spending accounts (health FSAs) and health reimbursement arrangements (HRAs) are health plans subject to COBRA continuation unless they are sponsored by an organization that is exempt from COBRA. Unfortunately, employers often overlook these benefits in the COBRA continuation process. To help your organization meet its COBRA obligations related to health FSAs and HRAs, consider the targeted action steps below.

- **Include your health FSA or HRA with COBRA election options.** A health FSA is a benefit providing reimbursement for specified medical expenses incurred by employees (and their spouses and dependents) and thus is a health plan for COBRA continuation purposes. An HRA is an employer-funded arrangement that reimburses employees for certain medical care expenses incurred by employees, their spouses, and their dependent children who are under age 27 as of the end of the employee's tax year. Although HRAs are generally "notional" accounts only, they are nonetheless considered to be health plans for purposes of COBRA. Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs) are not considered to be group health plans for purposes of the Internal Revenue Code, ERISA, or the Public Health Service Act and are thus not subject to COBRA. However, Individual Coverage HRAs (ICHRAs) and Excepted Benefit HRAs (EBHRAs) are considered to be group health plans and are subject to COBRA.
- **Identify COBRA qualified beneficiaries.** Generally, under a health FSA or HRA, only the employee is considered to be "enrolled" or "participating," even though expenses incurred by a spouse and dependents are also reimbursable. However, the IRS takes the view that the employee, the employee's spouse, and any dependent children can independently be COBRA qualified beneficiaries so long as their medical expenses are reimbursable under the health FSA or HRA. For example, in informal comments, the IRS has stated that a spouse may elect continuation coverage for a health FSA in connection with an employee's termination of employment, even if the spouse does not elect to continue coverage under the health FSA.
- **Determine the applicable premium.** Under the general rules for calculating COBRA premiums, the maximum COBRA premium is the "applicable premium" plus 2%. Essentially, this amount is the "cost to the plan" for coverage provided to similarly situated beneficiaries who have not experienced a qualifying event plus 2%. For health FSAs, the cost to the plan equals the claims paid to participants plus administrative expenses. Under IRS guidance, health FSA carryovers are not counted for purposes of determining the COBRA premium. Instead, the applicable premium is based on the employee's salary reduction election for the year and any nonelective employer contributions. As a self-insured health benefit, the applicable premium for an HRA must either be determined on an actuarial basis or based on the past-cost method. While employers may be tempted to use the full value of an HRA for a coverage period, not all plan participants use the full value of their HRAs during a given period, so the plan must either calculate the value using actuarial methods or the past-cost method.
- **Determine the appropriate maximum coverage period.** A special coverage period limitation exists for COBRA continuation coverage associated with health FSAs that meet three specific conditions. The first condition is that the maximum benefit payable under the health FSA to any participant for a year cannot exceed twice the participant's salary reduction election under the health FSA for the year (or, if greater, the amount of the employee's salary reduction election for the health FSA for the year, plus \$500). Second, other group health plan

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coverage, not limited to excepted benefits (e.g., limited-scope dental coverage), must be made available for the year to the participants by reason of their employment. Third, the maximum annual COBRA premium charged for the health FSA COBRA coverage must equal or exceed the maximum annual health FSA election amount. If these three conditions are met, a special COBRA rule applies that limits an employer's obligation to offer COBRA coverage. Under the special rule, COBRA coverage need not be offered to qualified beneficiaries who have "overspent" their accounts as of the date of the qualifying event. For those with underspent accounts, COBRA coverage must be offered, but may be terminated at the end of the year in which the qualifying event occurs. The maximum coverage period for an HRA is not subject to the same special limitation unless the HRA also qualifies as a health FSA (which very few do). Thus, HRAs are generally subject to the same maximum coverage periods as other health benefits.

- **Include your health FSA and/or HRA in your COBRA notices.** Because health FSAs and HRAs are subject to COBRA continuation, they are also subject to the COBRA notice requirements, including the General Notice, the Election Notice, and the Notice of Unavailability, and employers should include them in their notice processes.

The intent of this analysis is to provide you with general information. It does not necessarily fully address all your organization's specific issues. It should not be construed as, nor is it intended to provide, legal advice. Questions regarding specific issues should be addressed by your organization's general counsel or an attorney who specializes in this practice area.