

## COBRA Compliance and the Health Flexible Spending Account Carryover

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In Internal Revenue Service (“IRS”) Notice 2013-71, the IRS issued guidance allowing Health Flexible Spending Accounts (“Health FSAs”) to offer carryovers of unused balances of up to \$500 remaining at the end of a plan year to be used for qualified medical expenses in a subsequent plan year (See our [November 2013 Special Alert](#) for an overview of the Notice). Offering this Health FSA carryover is optional, but if an employer wants to add the feature, the employer must amend its Health FSA plan document on or before the last day of the plan year from which amounts may be carried over. While the Health FSA carryover feature may reduce potential Health FSA forfeitures, there are several COBRA administrative and compliance issues that an employer must consider before deciding whether to implement the Health FSA carryover feature.

### How COBRA Applies to Health FSAs

Health FSAs are group health plans that generally are subject to the COBRA rules. If a participant in a Health FSA providing excepted benefits experiences a COBRA qualifying event (e.g., termination of employment) and has an underspent account, the Health FSA must offer such participant COBRA continuation coverage up through the end of the plan year. Further, the Health FSA may charge the COBRA qualifying beneficiary up to 102% of total plan premiums for COBRA coverage. For example, assume Employee A elects \$2,400 in Health FSA coverage for the plan year and terminates employment on April 30th. The maximum COBRA premium that can be charged for the remaining eight months in the year is \$1,632 (i.e., \$1,600 (8 months x \$200) x 102%).

### How the Health FSA Carryover Feature Interacts with COBRA

If a Health FSA participant terminates employment, the participant forfeits any remaining Health FSA amounts (including any unused carryover amounts at the time of termination). However, if the Health FSA participant properly elects COBRA continuation coverage, the participant may take advantage of the Health FSA plan’s carryover feature and carry over up to \$500 in unused Health FSA amounts to the next plan year. Although the IRS has not provided formal guidance on this issue, IRS officials have informally commented that the COBRA qualifying beneficiary must be provided the Health FSA carryover option if the option is provided to active Health FSA plan participants — even if this would result in the COBRA qualifying beneficiary having coverage beyond the end of the plan year. However, the Health FSA carryover cannot last beyond the end of the applicable maximum COBRA coverage period (e.g., 18 months from the date of the COBRA qualifying event). This is a departure from the normal Health FSA COBRA rules, which provide that a Health FSA participant’s maximum COBRA continuation coverage period is exhausted at the end of the plan year in which the COBRA qualifying event occurs.

## **Carryover Amount is not Taken Into Account When Determining COBRA Premium**

An employer should disregard any Health FSA carryover amounts when calculating the Health FSA COBRA qualifying beneficiary's COBRA premium. An IRS official has informally explained that including these amounts would cause the Health FSA COBRA qualifying beneficiary to pay twice for the carryover amount. In other words, the Health FSA COBRA qualifying beneficiary would pay for the carryover amount once in the prior year when he or she made salary reductions to his or her Health FSA, and again in the carryover year.

## **Re-enrollment Rights Do Not Have to be Offered**

Although a COBRA qualifying beneficiary may continue to participate in the Health FSA as long as he or she has amounts to carry over (up to his or her maximum COBRA coverage period), the Health FSA is not required to provide the qualifying beneficiary with open enrollment rights. For example, the qualifying beneficiary does not have the right to re-enroll in the Health FSA plan (*i.e.*, increase his or her Health FSA election amounts) at open enrollment.

## **Carryover Impact on Health Savings Account Eligibility**

If a COBRA qualifying beneficiary's general purpose Health FSA amounts carry over to a subsequent year, this carryover will prevent such individual from making or receiving Health Savings Account ("HSA") contributions in that year. Under the Internal Revenue Code's HSA rules, an individual who is covered by a non-High Deductible Health Plan (*e.g.*, a general purpose Health FSA) is HSA-eligible. It is important to note that even an individual covered by a general purpose Health FSA solely as a result of Health FSA carryover amounts is HSA-eligible for the entire plan year — even for the months in the plan year that the individual's Health FSA no longer has any amounts available to pay or reimburse medical expenses. Accordingly, if an individual elects COBRA for his or her Health FSA, and any amounts carry over to a subsequent year, the individual will be HSA-eligible for that year. For example, the COBRA qualifying beneficiary will not be able to make or receive HSA contributions to an HSA offered through the individual's new employer for the year that any Health FSA amounts carry over. To avoid this result, an employer may amend its Health FSA plan to provide participants the opportunity to either (1) opt out of the Health FSA carryover feature, or (2) carry over any unused amounts from a general purpose Health FSA to an HSA-compatible Health FSA (*e.g.*, a limited purpose Health FSA) for the following year.

## **Action Items**

An employer wanting to permit Health FSA participants to carry over any unused Health FSA amounts from the 2014 plan year will need to amend its Health FSA plan by December 31, 2014 to include the carryover feature. Further, the employer will need to coordinate with its Health FSA third party administrator and/or COBRA administrator to ensure that these vendors can properly administer this new carryover feature. The employer also will need to carefully communicate the Health FSA carryover feature to its employees and COBRA qualifying beneficiaries (including how the Health FSA carryover will impact HSA eligibility). Ideally, the employer should explain the Health FSA carryover feature prior to the end of the election period for the plan year in which the Health FSA carryover will apply so that participants can account for this new feature when making their elections. Contact the author of this article or the attorney with whom you normally work for questions or assistance in amending your Health FSA plan.

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