

Special COBRA Issues Exist With HRAs

By Rich Glass, JD

As open enrollment season approaches, employers may consider adopting a health reimbursement arrangement (HRA) or adapting their current one. HRAs have never been more popular. A July 30, 2007, *Wall Street Journal* article, "Employers Turn To Alternative For Insuring Staff," even discussed HRAs as a substitute for traditional employer-provided health coverage.

When considering HRAs, take care to understand the COBRA implications. One difficulty is that the IRS' final COBRA regulations were issued before HRAs came into existence, and Notice 2002-45, the decisive HRA resource, devotes only two paragraphs of its 14 pages to COBRA.

Five difficult HRA areas are:

- COBRA application to HRAs
- COBRA coverage levels for varying qualifying events
- Calculating the COBRA premium
- Spend-down options
- HRA-eligible expenses

COBRA Application

HRAs, like health FSAs, are ERISA plans governed by Sections 105 and 106 of the Internal Revenue Code. In theory, an employer might be able to take advantage of the limited duty to offer COBRA, which exists with health FSAs. In reality, this COBRA limitation is rarely available for two reasons:

1) *The maximum annual benefit cannot exceed two times the participant's salary reduction election under the arrangement for the year or, if greater, \$500.* Because HRAs are completely employer-funded and balances often increase above \$500 (especially if carryovers are allowed), most HRAs are subject to COBRA.

2) *Assume an HRA where the maximum benefit is \$500; the limited COBRA offering is*

available only if the COBRA premium equals or exceeds the maximum benefit available under the HRA. The COBRA premium, as explained further below, is based on the cost of coverage, which almost always will be less than the maximum benefit available.

Therefore, employers that offer HRAs to their employees usually must offer them when they experience a COBRA qualifying event. One way to minimize the COBRA bite is to bundle HRA and group health plan coverage. In other words, HRA eligibility requires participation in the employer's health plan.

Coverage Levels

For a qualifying event that is a termination of employment, each qualified beneficiary has the right to an individual election of HRA coverage. That means each family member would typically have the right to coverage in the amount of the HRA balance the day before the qualifying event. For an employee who has carried over funds from previous years, the multiplying effect can greatly increase the plan's HRA obligation.

In addition, the employer must continue to make contributions to COBRA qualified beneficiaries' HRAs on the same basis, frequency and amount as it does for active employees.

Example. Assume an annual \$1,200 HRA contribution, funded on a monthly basis. An employee has a covered spouse and three children. The account balance is \$1,500. Each of the five qualified beneficiaries would have the right to elect their own COBRA HRA with a balance of \$1,500 (for a total of \$7,500 in potential exposure). In addition, the employer would have to continue the \$100 per month funding for each qualified beneficiary who individually elects COBRA HRA coverage.



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What about the employee who continues HRA but has a covered spouse (via divorce) or covered dependent (via loss of dependent status) with a qualifying event? How much coverage should the spouse or dependent have? One option is to simply provide the amount of coverage available to the employee at the time of the qualifying event. The other option is to provide the amount of coverage available at the start of the plan year, reduced only by the spouse's or dependent's reimbursed expenses. The second option has been informally endorsed by IRS representatives.

Example. Assume again an annual \$1,200 HRA contribution, funded monthly, with a \$1,500 account balance at the start of the plan year. A divorce occurs on March 1. During the first two months, the employer has contributed \$200, and \$700 in expenses have been incurred, leaving a current balance of \$1,000. The spouse has incurred \$100 of the expenses, the employee the other \$600. Under the first option, the spouse's starting COBRA balance would be \$1,000; under the second option, it would be \$1,600.

Calculating the Premium

Under COBRA, the applicable premium is the total cost of coverage, including any related administrative fees. Notice 2002-45 makes it clear that an employer may not base the COBRA premium on an individual's current account balance. Because an HRA is self-insured, employers have two methods for calculating the applicable premium, either based on past costs or a reasonable actuarial estimate.

The past cost method involves looking at the total costs for the prior determination period, adjusted by the year-to-year change in the implicit price deflator of the gross national product as of the end of the sixth month of that period. This information can be found at: www.bea.gov/bea/dn/nipaweb/SelectTable.asp#S1.

Example. Assume a \$1,200 HRA with 100 participants and \$50,000 in total costs (claims and related fees). The increase in the implicit price deflator for June 2006 is 3.9 percent (116.347 - 112.446). Thus, the annual COBRA premium is \$529.89 (\$50,000/100 x 103.9% x 102%), and the monthly COBRA premium is \$44.16 (divide by 12).

The past cost method is not available for new HRAs, obviously, or when there is a significant plan design

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Court Decides Who's on First Before Medicare — COBRA or Dependent Coverage

Often, health plan participants will benefit from multiple health coverage sources. When that happens, plans need to consider which plan pays first. To do that, the insurance industry has developed so-called “coordination-of-benefits” (COB) rules. COB rules are so common that even self-insured plans tend to follow them. The trick is that the plan language needs to be clear and specific.

For example, the application of COB rules when there is COBRA coverage, dependent coverage and Medicare was explained in *Marquis v. Fairview Nursing Home, Inc.*, 2007 WL 2410368 (D.N.H., Aug. 22, 2007). In that

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change from the prior determination period. In those cases, the services of an actuary are required for making a reasonable estimate of the cost of HRA coverage.

Spend-down Option

HRAs may allow former employees to spend down their balances. This is often an attractive feature for retirees with several health benefit options besides those offered by the last employer. Employers that offer a spend-down feature often will package it as alternative coverage to COBRA. Thus, the former employee has an either-or proposition: either take the COBRA coverage and pay for it or waive COBRA coverage and spend down the remaining HRA balance at no additional cost.

HRA-eligible Expenses

As the *Wall Street Journal* article noted, HRAs may reimburse individual premiums, including COBRA premiums. Thus, an employee with a large HRA account balance could elect COBRA for both the group health plan and HRA and be reimbursed for the group health plan premiums out of the HRA. In addition, an HRA can reimburse individual premiums, although some states interpret HIPAA nondiscrimination laws as preventing such a practice because individual policies are individually underwritten. Premiums and eligibility are often based on health factors, and the HRA funding is said to convert the individual policy into a group health plan. Texas, for one, adopted this interpretation last year in Commissioner's Bulletin #B-0028-06.

One thing is clear: as HRAs become more popular, HRA COBRA compliance will become increasingly important. 🏠

case, the court concluded that based upon the Medicare statute and the plans' terms, the plan providing the dependent coverage should be the primary payer over the COBRA plan.

Facts of the Case

Chardon Rubber Co. had a group health plan insured by Anthem Blue Cross and Blue Shield. Leo Marquis, a former Chardon employee, had COBRA coverage under the plan due to a termination of employment. (See ¶1122 of the *Guide*.) He also was a covered dependent under his wife's health coverage from her employer, Fairview Nursing Home, Inc., and was covered under Medicare Part A (due to Social Security disability).

Between January and June 2004, Marquis incurred medical bills, for which Anthem, Fairview and Medicare all denied coverage. Based upon their respective COB provisions, Fairview argued that Anthem was primary, while Anthem contended that Fairview was primary and Anthem was also secondary to Medicare.

Medicare Definition: Current Employment Status

The Medicare statute defines “current employment status” as “the individual is an employee, is the employer, or is associated with the employer in a business relationship” (42 U.S.C. §1395y(b)(1)(E)(ii)).

Marquis sued Anthem and Fairview, seeking a declaratory judgment on which party should be the primary payer. To that end, Marquis agreed with Fairview that Anthem should be primary.

To resolve the issue, the court analyzed the COB language in the Anthem policy and Fairview plan.

Fairview's plan stated that its coverage would be secondary if the claimant is covered as a dependent and the claimant has coverage as the insured under another policy. The parties agreed that Marquis was a dependent under Fairview's plan and was insured under Anthem's policy.

The Anthem policy provided that:

[t]he plan which covers the patient as the insured is primary to the plan which covers the person as a dependent; except, if that person is also a Medicare beneficiary and as a result

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