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Road Rules Provide Street Smarts For FSAs and COBRA

By Juli Hanshaw

While last month's article removed the training wheels and found the balance with COBRA and health flexible spending arrangements (FSAs), this month we are going to buckle up and learn how to get behind the wheel and learn more about the rules of the road.

We will cover four additional areas where COBRA and FSAs intersect:

- calculating the correct FSA COBRA premium;
- determining FSA account balances for spouses/dependents;
- pre-tax payment of COBRA premiums; and
- FSAs in asset sales.

The FSA COBRA Premium

What premium do you charge for an FSA under COBRA? Let's check the rear view mirror to determine the amount. (It may be helpful to review last month's article on when an FSA should be offered under COBRA.) Recall that under the law the applicable premium is "the cost to the plan for such period of the coverage for similarly situated beneficiaries" plus two percent. Determining the true cost to the plan could become a technical nightmare when comparing claims paid with forfeitures and administrative fees at year end. Fortunately, the IRS endorsed a "reasonable estimate" approach in its regulations, stating that it is reasonable to base the COBRA premium on the annual FSA election amount.

The premium is the annual election amount divided by 12. Easy enough, right? Well, as we drive along the highway, there could be some curves in the road.

Let's review a couple of examples before hitting the road for a test drive. An employee elects \$1,200, and the qualifying event is Sept. 30. The monthly COBRA premium would be the \$1,200 divided by 12 plus a two-percent administrative fee, or \$102.

But how do you determine the rate if a company has the election amount taken out of 26 pays rather than 12 months? The premium is figured slightly different in this situation. Let's stop at the light and review an election of \$780 where the qualifying event is Sept. 30 and 19 FSA deductions have been taken out. The monthly COBRA premium would be figured by calculating the unpaid portion of the annual election ($7 \times \$30 = \210), then dividing by the number of months remaining at the time of the event ($\$210 \div 3 = \70). The monthly COBRA premium, including the two-percent administrative fee, would be \$71.40.

What if the qualifying event were one where the employee will continue active coverage after a qualifying event for a covered spouse or dependent (for example, divorce/legal separation or loss of dependent status)? There are two views. One view is that the spouse/dependent would simply pay the monthly election amount, plus the two-percent administrative fee.

Example. A divorce that was final on Sept. 30 with a \$2,400 FSA election would result in a monthly COBRA premium of \$204 for the divorcing spouse ($\$2,400 \times 1/12 \times 102$ percent).

The other view is that you would simply divide the remaining months by the available balance, adding the 2-percent administrative fee. Under the above example, assuming a full balance, the monthly COBRA premium would be \$816 ($\$2,400 \div 3 \times 102\%$).

While the regulations do not specify which view is correct, IRS has informally indicated it favors the first view.

FSA Account Balances for Spouses/Dependents

Sounds like it's time to take off the parking brake and go for a spin. However, a traffic

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jam can cause delays just like some unusual situations that employers come up against with FSAs and COBRA. For example, what happens when the person receiving the COBRA FSA benefit is a dependent child (who ceased to be a dependent) or a divorced spouse? Should the spouse/dependent have the full election amount available, the remaining unpaid claim portion or a fraction thereof? Sounds about as difficult as parallel parking but with practice it becomes easier.

The spouse or dependent(s) would be eligible to elect the full amount minus any claims incurred for that individual. If the family election was \$2,000, the spouse/dependent(s) would be allowed to continue the maximum annual reimbursement amount reduced by the expenses incurred by the spouse/dependent(s) before the qualifying event.

Pre-tax Payment of COBRA Premiums

Ever find the blind spot that caused an accident on the road? Some employers haven't looked before changing lanes or made their own rules for COBRA and FSAs. Employers do not want to lose any money with employees leaving who have used their whole election amount. Some have asked employees to sign an agreement that states if a qualifying event occurs before the end of the plan year, the remaining monthly premiums will be taken from the employee's final paycheck on a pre-tax basis. Then, employers erroneously believe FSA coverage is not lost and COBRA is not offered. This type of

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Medicare Entitlement as a COBRA Qualifying Event

I am sure someone can figure out circumstances under which Medicare entitlement can be an initial qualifying event. (See ¶1251.) But it happens so infrequently that most administrators probably overlook the cases where it does happen. Perhaps the government agencies could issue a definitive ruling or notice or regulation dealing solely with Medicare entitlement issues and explain for everyone the circumstances under which Medicare entitlement is: (1) an initial qualifying event; (2) a multiple qualifying event; and (3) an event that terminates COBRA coverage. I'm sure that guidance will be well-received.

Drop Us a Line About Your COBRA Dislikes

That's my list. What would you change? Let us know by dropping us a line at healpub@thompson.com. We'll keep track and try to provide some helpful pointers on issues that really bother people about COBRA administration. 🏠

arrangement violates both the cafeteria plan rules governing an FSA and federal COBRA regulations.

Under the cafeteria plan rules, the pre-tax option is available for coverage of employees, their covered spouses and covered dependents. Under the above scheme, the coverage period would occur when the employee is technically a former employee. That is not permissible.

FSAs and COBRA can be as hard as learning to maneuver through traffic.

COBRA requirements state that a loss of coverage includes any increase in payments. The fact that the payment terms would change — pre-tax versus post-tax — would create a loss of coverage, and COBRA would have to be offered anyway. In addition, a qualified beneficiary must be allowed to make payments on a monthly basis. Therefore, forcing an employee into a one time lump-sum payment upon termination violates COBRA.

On the other hand, a qualifying event involving a reduction in hours could involve pre-tax payment of COBRA premiums as long as the employee continued to be employed.

FSAs in Asset Sales

There's a stop signal ahead. An employee has an FSA plan, but finds out the employer is now in an asset sale. What happens to the FSA plan when the light turns green? Typically a buyer will want to minimize any disruption to the benefits of the acquired employees. IRS Revenue Ruling 2002-32 presented two options in these situations.

The first option is for the seller to continue to cover the buyer's new employees under the seller's plan for a period of time (for example, through the end of the plan year). There will be no loss of coverage and no qualifying event, unless the health FSA does not qualify for limited COBRA application. In such a case, the seller would need to offer COBRA on the first day of the next plan year for the balance of 18 months after the sale date.

The second choice simply involves the buyer continuing the participants' coverage, rolling over balances and amending plan documents to cover the new employees as of the first day of the seller's plan year.

Conclusion

FSAs and COBRA can be as hard as learning to maneuver through traffic. But with practice and patience and no bad advice from back seat drivers, employers can learn how to accelerate through the issues to the final destination — compliance. 🏠