

# COBRA Tips™

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## HRAs: Are They Subject to COBRA?

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A Health Reimbursement Arrangement (HRA) is an employer funded health plan that typically reimburses participants for certain expenses not otherwise covered beneath the deductible of another health plan. These plans generally include a specified annual dollar benefit and the unused balance rolls over into the following plan year. For example, if the annual benefit amount is \$1,000 and the employee has \$200 in claims paid by the plan during the year, the remaining \$800 will be added to the following year's benefit amount. In this example, the unused \$800 benefit is added to the next year's \$1,000 benefit amount, for a total benefit of \$1,800. If the HRA meets the safe harbor requirements established by the IRS in its 2002 guidelines, the money in the account rolls over on a tax-free basis.

### HRAs and COBRA Premiums

Because an HRA is an employer sponsored health plan, it is subject to COBRA. COBRA premiums must be based on the cost to the plan of providing coverage to similarly situated beneficiaries who have not experienced a COBRA qualifying event. That premium must be determined for a 12 month period in advance.

Employers are not permitted to simply divide the maximum benefit by 12 months as the monthly premium due for COBRA. When health plans are self-funded by the employer, the premium must be actuarially determined, or alternatively, it must be calculated using a "past-cost" method. In addition to the applicable COBRA premium, the plan is also allowed to charge an administrative fee of up to 102% (150% during disability extension). For new HRA plans with no past claims experience, the actuarially determined premium will probably be the only option available.

Although the account balance available in the HRA may differ for each participant based on their length of time on the plan and claims incurred, employers cannot charge beneficiaries different COBRA premiums for the HRA according to the remaining benefit available. The IRS gives some guidance in this area and provides plans with a safe harbor as long as the COBRA applicable premium is the same for all HRA qualified beneficiaries in similar categories and individual account balances are not taken into consideration. The IRS has provided no additional guidance as to how HRA premiums should be calculated.

### HRA Account Accruals

According to the IRS safe harbor guidelines, an HRA complies with COBRA "by increasing the maximum reimbursement amount at the same time and by the same increment that it is increased for similarly situated non-COBRA beneficiaries (and by

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decreasing it for claims reimbursed)." So, if an HRA allocated \$1,000 to a single employee's account at the beginning of each year, a COBRA qualified beneficiary electing coverage is entitled to the same benefit.

## **Allocating HRA Account Balances**

The unique nature of the HRA plan design creates some interesting COBRA issues, especially when a spouse or dependent child is enrolled.

When only a single employee is enrolled, it is clear how to allocate the remaining HRA account balance. If the employee has been on the plan for two years and \$1,000 is placed into the account at the beginning of each year, the account balance will be \$2,000 minus any claims paid. The employee will accumulate an additional \$1,000 in each subsequent year.

If the employee enrolls with a spouse and the HRA allocates \$2,000 each year for families, after two years their account balance would be \$4,000 minus any claims paid. If the couple were to divorce, how much would be in each individual's HRA account?

Using the HRA example of \$1,000 allocated to single employees and \$2,000 allocated to employees with family coverage, either of the following options could be used in determining the account balance after a divorce (or after a child loses eligibility and elects continuation coverage under COBRA). Although either method is a reasonable method of calculation, it is worth noting that Option 2 is the informal interpretation that the IRS has adopted.

**OPTION 1** – Unused account balances are undivided and allocated evenly between parties following a COBRA election.

For example, if the HRA allocated \$4,000 to the family over the past two years and the total benefit used from the account was \$1,800 (\$500 in year one and \$1,300 in year two) the account balance would be \$2,200. In the event of a divorce, each person would maintain an undivided balance remaining in the account of \$2,200, and each would be entitled to an additional \$1,000 per year. The result is that the employer is responsible for providing an HRA benefit of \$4,400 to the family (\$2,200 to the employee and \$2,200 to the former spouse), which is double the account balance prior to the divorce.

**OPTION 2** – Unused account balances are allocated based on the remaining funds in the account minus claims incurred by each party in the plan year COBRA begins.

For example, if \$4,000 had been allocated to the account over the past two years and \$500 in claims had been paid in year one, then the family's account balance at the beginning of year two would be \$3,500. During the second year, the employee and spouse divorce. Assume the claims paid from the account for the employee during year two (prior to the divorce) totaled \$300, while claims paid for the spouse during the same period came to \$1,000. Thus, the amount to be allocated to the employee is \$3,200 (\$3,500 - \$300) and the amount to be allocated to the former spouse is \$2,500 (\$3,500 - \$1,000). The result is that the employer is responsible for allocating a total of \$5,700 between them, which is more than double the account balance prior to the divorce.

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## **Conclusion**

As a general rule, employers subject to COBRA must offer continuation coverage to qualified beneficiaries for any health plan that is considered employer sponsored. Thankfully, the DOL quickly resolved the issue for Health Savings Accounts, determining that they are not employer sponsored health plans subject to COBRA, as long as participation is voluntary. HRAs, on the other hand, are considered employer sponsored health plans and are therefore subject to all federal regulations that apply to ERISA plans, including COBRA.

More guidance from the IRS is expected on HRAs regarding the calculation of COBRA premiums, as well as allocating account balances. Until that time employers should use caution in their approach to administrating COBRA for HRA health plans.