benefit strategies LLC

HSA GPS Fact Sheet Series

HSAs and COBRA

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) provides many people with the right to continue coverage on a group medical plan after they experience a qualifying event. Examples of qualifying events include an employee who leaves employment, an individual recently divorced from an employee who covered her on employer-sponsored insurance, and an adult child who ages off the group plan at age 26. (Note: This isn't an exhaustive list.) In this paper, we help you navigate at the intersection of Health Savings Accounts (HSAs) and COBRA so that you remain in compliance with HSA rules and maximize your HSA and medical coverage opportunities.

1. I recently left my job. What are my COBRA rights?

That depends on the size of your employer and circumstances of your departure – topics beyond the scope of this paper. If you're eligible to continue your medical coverage via COBRA, your employer must offer you the opportunity to continue your current plan. During the employer's subsequent open enrollment period, you can choose from the same medical plan options as active employees as long as you remain COBRA-eligible. If you're enrolled on an HSA-qualified medical plan and are eligible for COBRA continuation, you can remain covered on that plan. And as long as you remain HSA-eligible, you can continue to contribute to your HSA.

2. How much does COBRA coverage cost?

Your premium is the same as active employees' premiums on the same plan. Note that employers typically pay between 50% and 80% of active employees' premiums. You won't receive that employer contribution when you continue coverage through COBRA. Thus, if you pay only $150 (30%) of your $500 monthly premium when you're an active employee, your employer charges you the full $500 when you continue coverage as a former employee. In addition, federal law allows an employer to charge an additional 2% fee ($10 in our example) monthly fee to offset the cost of administering the program. Thus, in the example, you pay a $510 monthly premium to continue your medical coverage.

3. Can I pay my medical premiums tax-free from my HSA?

Yes. You can make tax-free distributions from your HSA for pre-Medicare medical insurance premiums only when you continue coverage through COBRA or are collecting unemployment benefits.

4. My employer contributes $50 per pay period to my HSA. Do I still receive those contributions when I continue my coverage through COBRA?

Probably not. Although you may have continuation rights to the medical plan, HSAs themselves are not a medical plan and thus not covered under COBRA. Employers don't have to continue to make contributions to former employees. Most employers stop contributing to former employees' HSAs to avoid potential compliance issues. Check with your former employer.

5. If I continue medical coverage through COBRA, can I continue to make HSA contributions?

Yes. HSA eligibility isn't tied to employment. If you're covered by an HSA-qualified medical plan (regardless of whether you're an active employee, a former employee continuing coverage through COBRA, or someone who purchases a medical plan in the nongroup market) and meet other HSA eligibility requirements, you can open and contribute to an HSA.

6. I made pre-tax payroll contributions to my HSA. Now I've left the company and can't make additional contributions through payroll, since I'm no longer on the payroll. Do I lose tax advantages?

You can make personal (after-tax) contributions to your HSA and deduct those contributions from your adjusted gross income when you file your personal income tax return. When you do so, your taxable income is reduced dollar-for-dollar. You aren't able to recapture FICA taxes paid when you received the income, however.

7. I'm young and can enroll in a nongroup plan that I buy through an ACA marketplace for a lower premium than COBRA. Can I enroll in a nongroup plan rather than continue through COBRA and pay my premiums tax-free from my HSA?

You can enroll in the nongroup plan, but you can't pay your premiums with tax-free HSA distributions unless you're covered on COBRA or collecting unemployment benefits. If you leave your job voluntarily, aren't eligible for unemployment benefits, and purchase coverage other than COBRA continuation, any distributions from your HSA to pay medical insurance premiums are included in your taxable income (and subject to an additional 20% tax if you're under age 65 and not disabled).

Depending on your premium through the public marketplace (including advance premium tax credits, commonly called premium subsidies), you may be better off financially purchasing insurance in the nongroup market and paying with after-tax dollars. Premiums in the nongroup market are adjusted for age, so older workers eligible to continue the group medical plan through COBRA generally find it advantageous to elect COBRA.

In contrast, a young, healthy person may save money by purchasing a plan with a lower premium based on her age and deductible higher than the group plan (which, if she's healthy, won't result in additional out-of-pocket costs).

8. If I continue coverage through COBRA, can I continue to make tax-free distributions for qualified expenses? If I don't elect COBRA continuation, can I make tax-free distributions for qualified expenses?

The answer to both questions is "yes." You must be HSA-eligible to open and contribute to an HSA. You don't need to be enrolled in an HSA-qualified plan or be HSA-eligible to make tax-free distributions for qualified expenses from your HSA. Once you've funded your account, you can make tax-free distributions for qualified expenses for the rest of your life, whether you remain HSA-eligible or lose your eligibility to make additional contributions.

This information is accurate as of Nov. 5, 2018. Please note that this discussion is for informational purposes only and is based on current regulations. It doesn't represent, and shouldn't be construed as, a substitute for professional advice. Please consult your personal legal, financial, or tax counsel to discuss your personal situation and refer to IRS Publication 969.

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