

A Primer on COBRA Continuation Coverage for Health Care Flexible Spending Accounts

by Kimberly S. Couch on July 30, 2024

It is a common practice for employers to offer employees a health care flexible spending account (“Health FSA”) option under a cafeteria plan. However, employers (and their COBRA administrators) may not be aware that Health FSAs are subject to COBRA continuation coverage requirements and may inadvertently fail to provide COBRA notices and election packages to Health FSA participants when they experience a qualifying event. Noncompliance with COBRA requirements may result in costly penalties and excise taxes.

Health Care Flexible Spending Accounts

A Health FSA allows employees to set aside money on a pre-tax basis to pay for medical expenses that may not be covered under their employer’s health plan, such as deductibles and copays. Employees elect to contribute a set amount to a Health FSA before a plan year begins, subject to IRS limits.¹ Employee contributions to a Health FSA are not subject to payroll or income taxes. If disbursements from a Health FSA are used for qualified medical expenses,² the disbursements are not included in an employee’s income.

Under the “uniform coverage” rule, an employee must be reimbursed for all qualified expenses submitted for reimbursement under a Health FSA at any time during the plan year even if the employee has not yet made sufficient contributions to cover the reimbursement claims submitted. Health FSAs are also subject to a “use it or lose it” rule. If an employee does not use the full amount that they elect to set aside in a Health FSA for a plan year, the employee forfeits the unused amount. However, IRS guidance modifies the “use it or lose it” rule, allowing cafeteria plans to permit limited rollovers of small unused Health FSA balances (up to \$640 for 2024) into a subsequent plan year.³

¹ For 2024, the contribution limit to a Health FSA is \$3,200, and the limit may be adjusted each year.

² A list of IRS approved qualified medical expenses may be found [here](#).

³ See IRS Notice 2013-71 [here](#). The IRS also has issued a grace period rule under which an employee may use a Health FSA balance for the prior year to reimburse expenses incurred in the first 2-1/2 months of the succeeding plan year. See IRS Notice, 2005-42 [here](#). An employer may choose one or no modification to the use it or lose it rule, but not both, and the modification selected must be stated in the cafeteria plan document.

COBRA Requirements

A plan sponsor must offer COBRA continuation health coverage to any qualified beneficiary who loses coverage under a “group health plan” because of a qualifying event, such as termination of employment.⁴ For COBRA purposes, a group health plan is a plan maintained by an employer to provide health care to employees and former employees and their families through insured or self-insured arrangements. The IRS has confirmed that Health FSAs are group health plans that are subject to COBRA.⁵

If an employee elects to contribute to a Health FSA and terminates employment, the employee may be reimbursed for medical claims incurred before the employee’s termination date, provided they are submitted timely. However, the employee may not be reimbursed for claims incurred after the employment termination date unless the employee elects COBRA continuation coverage.

Special COBRA Rules for Health FSAs

Special COBRA continuation rules apply to FSAs that are excepted benefits.⁶

COBRA Continuation Period for Health FSAs. As a rule, COBRA continuation coverage under a group health plan must be offered for 18 months or 36 months, depending on the type of qualified beneficiary and the type of qualifying event. However, an employer must offer COBRA under a Health FSA only until the end of the plan year in which the qualifying event occurs. There is an exception to this rule if the employer’s cafeteria plan permits rollovers of small Health FSA balances as described above. In that event, a qualified beneficiary may roll over their unused balance (up to the applicable rollover limit) into the following plan year. A qualified beneficiary may continue to roll over their unused Health FSA balance in future plan years until the otherwise applicable COBRA continuation period ends (e.g., 18 months in the event of a termination of employment) or if earlier, the maximum rollover period specified in the employer’s cafeteria plan.⁷

Calculating COBRA Premiums for Health FSAs. The maximum amount that an employer may charge for COBRA continuation coverage is 102% of the applicable premium for the period of coverage. The “applicable premium” is the plan’s cost for providing coverage during the period for similarly situated plan members who are not COBRA qualified beneficiaries. For a Health FSA, the cost of coverage is the amount elected by the employee for the plan year plus any employer contributions.

⁴ IRC Sec. 4980B.

⁵ Treas. Reg. Sec. 54.4980B-2, Q&A-8.

⁶ A Health FSA is an excepted benefit if (i) the maximum benefit does not exceed two times the employee’s salary reduction election under the Health FSA for the plan year or, if greater, the sum of the employee’s salary reduction election for the plan year plus \$500 and (ii) the employer maintains another group health plan that provides essential health benefits. See IRS Technical Release No. 1997-01 [here](#).

⁷ See IRS Notice 2015-87, Part V [here](#).

The COBRA premium calculation does not include any unused amounts carried over from a prior plan year under a cafeteria plan that permits rollovers.⁸

Example 1: Assume employee X elects to contribute \$3,000 to a Health FSA for 2024 and has \$500 in unused contributions rolled over from 2023. Assume further that X terminates employment on April 30, 2024 after contributing \$1,000 and being reimbursed \$400 in qualified medical expenses. X's maximum monthly COBRA premium to continue X's Health FSA coverage is \$255 ($\$3,000/12 \times 1.02$). The \$500 carried over from 2023 is not taken into account in calculating X's monthly COBRA premium.

Example 2: Assume that X has \$400 in unused contributions at the end of 2024 and rolls over that amount into the Health FSA for 2025. X's maximum COBRA premium for 2025 will be \$0 ($\$0/12 \times 1.02$) because amounts rolled over are not included in the premium calculation. X may continue to submit qualified medical expenses for reimbursement through October of 2025, when the applicable COBRA continuation period ends (18 months for termination of employment).

When COBRA must be Offered. An employer is not always required to offer COBRA continuation coverage under a Health FSA. A qualified beneficiary must be offered COBRA only if the maximum reimbursement amount they would receive during the remainder of the plan year exceeds the premium amounts they would be required to pay for COBRA for the remainder of the plan year. The maximum reimbursement account includes any unused amounts carried over from a prior plan year under a cafeteria plan that permits rollovers, but the rollover amounts are not included in the premium calculation.⁹

Example 1: Assume employee X elects to contribute \$3,000 to a Health FSA for 2024 and has \$500 in unused contributions rolled over from 2023. Assume further X terminates employment on April 30, 2024 after contributing \$1,000 and being reimbursed \$400 in qualified expenses. The maximum remaining reimbursement amount that X may receive for 2024 is \$3,100 ($\$3,500 - \400). The maximum premium X would be required to pay for the remainder of 2024 is \$2,040 ($\$3,000 - \$1,000 \times 1.02$). X must be offered COBRA continuation coverage under the Health FSA.

Example 2: Assume the same facts as in *Example 1*, except X has been reimbursed \$2,000 in qualified expenses as of X's employment termination date. The maximum reimbursement amount that X may receive for the remainder of 2024 is \$1,500 ($\$3,500 - \$2,000$). The maximum premium X would be required to pay for the remainder of 2024 is \$2,040 ($\$3,000 - \$1,000 \times 1.02$). X's employer is not required to offer X COBRA continuation coverage under the Health FSA.

⁸ *Id.*

⁹ *Id.*

Penalties and Excise Taxes

An employer may be penalized up to \$110 per day for failing to provide a timely COBRA notice to a qualified beneficiary.¹⁰ In addition, the employer may have to permit retroactive COBRA elections and cover costs incurred from the retroactive COBRA election date.¹¹ Finally, an employer may be subject to an excise tax of \$100 per day (\$200 if more than one qualified beneficiary is affected) for the period beginning on the first day of the failure to comply with COBRA and ending on the date the failure is corrected.¹²

Practical Considerations

Health FSAs are funded with pre-tax dollars. COBRA continuation coverage is typically paid with after-tax dollars and may be subject to an additional 2% administrative fee. Accordingly, as a practical matter, few employees will elect COBRA coverage for their FSAs, except where they have meaningful account balances that would otherwise go unused. Employees may elect COBRA if they expect to incur medical expenses after their employment termination date and/or the employer's cafeteria plan permits rollovers of unused Health FSA contributions. However, employers are required by law to offer eligible qualified beneficiaries the option to elect COBRA continuation coverage for their Health FSAs. Failure to do so may result in costly penalties and excise taxes.

Please contact a member of our [Employee Benefits & Executive Compensation Group](#) if you have any questions regarding COBRA requirements for Health FSAs.



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¹⁰ ERISA Sec. 502(c)(1).

¹¹ See, e.g., *Buford v. General Motors, LLC*, 2022 WL 2584 (E.D. Mich. Jan. 26, 2022).

¹² IRC Sec. 4980B(c)(3).