

What Employers Need to Know About COBRA Coverage for Terminated Employees

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When the Affordable Care Act (ACA) was signed some nine years ago, many employers wondered what would become of COBRA (aka, the continuation coverage requirements of the Consolidated Omnibus Budget Reconciliation Act of 1985). The ACA's exchanges seemed poised to offer affordable, sometimes subsidized, health care options. Why would anyone continue to choose expensive COBRA continuation coverage? And yet, COBRA seems as strong as ever.

There are many reasons terminated employees are choosing COBRA over other insurance options. Some do not want the hassle of purchasing marketplace coverage, or see few appealing marketplace choices. Others simply prefer the devil they know – after all, why risk buying a new plan which may not cover needed services and preferred doctors, or might have terrible service? Moreover, some individuals are offered subsidized COBRA as part of a severance package, or are courted by a new employer who is willing to pay COBRA premiums for coverage under the former employer's plan.

Most employers are no strangers to the basic requirements of COBRA. In general, employees (and their spouses and dependents) who lose coverage under an employer's health plan due to termination of employment or reduction of hours are entitled to continue that coverage for up to 18 months. Although not the focus of this post, the 18-month period may be extended to 29 months in the event of a disability, and spouses and dependents have additional COBRA rights to elect up to 36 months of coverage due to certain other qualifying events including divorce or the employee's death.

Not surprisingly, however, the COBRA rules are complex, and we frequently field questions from employers who are facing employee terminations and just want to get things right. Here are some of the more common questions we receive from our employer clients.

1. Must I pay for a terminated employee's COBRA coverage?

No. An employer can require an electing employee to pay up to 102% of the cost of the medical coverage in order to continue coverage under COBRA. The 102% represents the total premium (employee's share plus the employer's share) plus a 2% administrative fee. Although many employers do subsidize COBRA, especially as part of a severance package, this is not required.

2. May I pay for a terminated employee's COBRA coverage (in full or in part)?

Generally yes, although employers who engage in this practice should proceed with caution. In particular, such an arrangement could be considered discriminatory under the Internal Revenue Code if the health plan is self-insured and the subsidy is not broadly offered. In addition, when the employer does agree to pay for all or part of the cost of COBRA coverage, they should be clear (such as in the former employee's severance agreement) that the obligation to pay is subject to the employee's timely election of, and eligibility for, COBRA coverage. The agreement should also state which plans will be subsidized and whether the subsidy will extend to employee-only or family coverage.

3. May I provide more than 18 months of COBRA coverage to a terminating employee?

If an employee terminates employment or has a reduction in hours, in either case resulting in a loss of health coverage, employers must offer 18 months of COBRA. The COBRA rules do not prohibit an employer from offering a longer period; however, offering more than the required 18 months could get an employer into hot water. For example, if an insurance or stop-loss carrier does not cover the extension period, and an employee with an extension has a catastrophic medical event after the 18th month, the employer may need to self-insure those expenses at a huge cost to the company.

4. A terminating employee is currently on our company's medical plan and is also over 65 and eligible for Medicare. Must I offer her COBRA coverage under our company's medical plan?

Yes, although the COBRA period may be limited depending on when Medicare "entitlement" occurs. For Medicare purposes, "entitled" means that an employee is not only eligible for Medicare, but is actually enrolled in Medicare coverage. If the employee became entitled to Medicare before the termination of employment, then the employee must be offered the full 18 months of COBRA. If however, the termination of employment occurred before Medicare entitlement, then the employer is permitted to terminate the COBRA period upon Medicare entitlement.

As an aside, keep in mind that the "Medicare Secondary Payer" (MSP) rules generally prohibit employers from offering Medicare beneficiaries incentives to decline enrollment or terminate coverage in an employer-sponsored plan. Employers must take care not to run afoul of these rules by discouraging Medicare-eligible employees from exercising their COBRA rights.

5. May an employee pay for his COBRA premiums pretax out of severance payments?

Maybe, if some requirements are satisfied:

- The employer's cafeteria plan must allow it. The "cafeteria plan" is the written plan that allows for payment of premiums on a pre-tax basis through payroll deductions.
- The employee should make an affirmative election to reduce the severance payments to pay for the COBRA coverage. This can be informal, but should be in writing.
- The pre-tax deduction generally should not continue beyond the end of the plan year in which the qualifying event occurred.
- If other employees are not allowed to partake in this practice, then it could be considered discriminatory under the Internal Revenue Code.

6. Must I offer COBRA coverage for a health care flexible spending account (FSA)?

COBRA is available for a health care FSA if the account is underspent as of the time of termination. The coverage in that case need only last for the duration of the year in which the termination occurs (i.e. not the full 18 months). For example, let's say an employee elects to contribute \$100/month to a calendar year health FSA. The employee terminates June 30 having submitted no medical expenses but having contributed \$600. This employee has an "underspent" account and has a right to elect COBRA for the rest of the year. If, however, that employee had submitted \$700 of expenses as of June 30, then the account is overspent and the employer need not offer COBRA for the FSA.

7. May an employee elect COBRA if he or she was not participating in our medical plan at the time of termination of employment?

No.

8. If we sell a division of our company, and some employees are terminated in connection with the sale, who is responsible for COBRA, buyer or seller?

COBRA contains a special set of rules that apply to business transactions. In general, the seller retains the responsibility to offer COBRA to employees terminated in connection with the sale. That said, these rules are complicated, and the answer may vary depending on a number of factors including: when and why the employees are terminated, the structure of the transaction, and whether the seller continues to maintain a health plan after the closing. The parties to the transaction should be sure to consult with counsel when structuring the transaction to make sure that all COBRA obligations are met.

9. How does COBRA coverage interact with marketplace exchange coverage?

Enrollment in marketplace coverage (i.e. "Obamacare") is limited to the open enrollment period (generally, November 1 to December 15) and to situations of special enrollment. Termination of employment creates a special enrollment right, as does the end of the full 18-month COBRA period. Terminating COBRA prior to the end of the 18-month period simply because an employee does not like the coverage or because an employer-provided COBRA subsidy has ended, however, does not create a special enrollment right.

10. We want to recruit an employee from another company, but we do not yet have a health plan of our own. Can we offer to pay for COBRA coverage under the prior company's plan?

While this practice is not legally prohibited, it raises many issues. For example, is it possible that these payments, in and of themselves, could create a health plan for which COBRA is required? Will other new hires demand a similar arrangement? If the employee changes his or her mind and wants to cancel COBRA, can the new employer allow the employee to enroll in the new employer's plans outside of open enrollment? Employers should proceed with caution.

Notes for the Road:

As noted above, the COBRA rules are complex! Each termination is different and severance arrangements vary; we encourage you to consult with counsel when handling COBRA matters in

employment termination situations.

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