

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 (Note: this isn't an exhaustive list):

- an employee who leaves employment
- an individual recently divorced from an employee who covered them on employer-sponsored insurance
- an adult child who ages off the group plan at age 26

In this paper, we help you navigate 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.

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

Yes. You can make tax-free distributions from your HSA to pay medical premiums when you continue coverage through COBRA or are collecting unemployment benefits.

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 by COBRA. Employers aren't required to continue to contribute to former employees' accounts. Most employers stop contributing to former employees' HSAs to avoid potential compliance issues. Check with your former employer.

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 and meet other HSA eligibility requirements, you fund your account with tax-deductible contributions.

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 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.

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 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).

If I continue coverage through COBRA, can I still make tax-free distributions for eligible 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 withdrawals for eligible expenses from your account. Once you've funded your account, you can make tax-free distributions for eligible expenses for the rest of your life, whether you remain HSA-eligible or lose your eligibility to make additional contributions.

Disclaimer: This information is accurate as of January 20, 2021. 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.