



For those who have lost a job, a way to lower health insurance costs

Paying for COBRA benefits through a Health Savings Account can save money.

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The COVID-19 pandemic and social distancing forced many U.S. businesses to close, causing massive unemployment. As of the end of May, 1 in 4 American workers had filed for unemployment benefits^[1]. In addition to lost income, unemployment often means losing access to employer-provided health benefits.

Although COBRA (Consolidated Omnibus Budget Reconciliation Act) benefits are typically made available, coverage is often expensive, and with limited income, it may not be an option. Or is it? Funding a health savings account (HSA) may be a way to reduce the after-tax cost of health insurance and obtain relief provided by the IRS related to the COVID-19 outbreak^[2].

Here's how it works. Individuals who work in companies with 20 or more employees are able to temporarily continue their health insurance through COBRA coverage if they are laid off^[3].

Those who maintained a high-deductible health plan at work also typically have the option to establish and contribute to an HSA, which allows them to pay for certain medical expenses with pre-tax dollars. HSAs are portable, so you can take it with you when you leave an employer. You can also establish one individually. The annual HSA contribution limit in 2020 is \$3,550 for an individual and \$7,100 for a family. Those 55 and older can contribute an additional \$1,000. If you changed your type of health coverage during the year, your maximum contribution limit may be lower^[4].

Most health insurance premiums are not deemed a "qualified medical expense," meaning you can't pay them pre-tax from an HSA. One big exception is COBRA premiums^[5]. So if you fund an HSA, you can pay your COBRA premiums with pre-tax dollars.

And because of the pandemic, the IRS extended the HSA funding deadline for 2019 contributions to July 15, 2020, from April 15, so there's still time. And since COBRA costs for an individual or a family often exceed the HSA contribution maximum amounts, the flexibility to further fund a 2019 HSA until July 15 will allow some individuals and families to pay a larger percentage of 2020 and 2021 COBRA premiums using pre-tax dollars, as HSA funds can be rolled over from year to year.

Consider this example: Julia, age 52, had a high deductible health plan and HSA in 2019. She contributed \$1,000 to her HSA via payroll deduction in 2019 and reimbursed herself for assorted medical expenses totaling that amount throughout the year. Julia was laid off in April 2020 and received a severance package. She wishes to maintain her health insurance via COBRA coverage and the cost will be \$5,000 for the next year. Since the \$5,000 exceeds the 2020 HSA limit for individual coverage of \$3,500, she uses \$1,500 of her severance pay to further fund her HSA by July 15 with a 2019 tax year contribution. She then can fund her HSA for tax year 2020 to cover the remaining \$3,500 expected COBRA expense.

Another option for those who declined or are not eligible for COBRA but secured health insurance through another means, like the Health Insurance Marketplace, is to make premium payments through an HSA if they are receiving unemployment insurance^[6].

Finally, for those unable to fund their HSA by July 15, a one-time transfer is permitted from an IRA to an HSA. The maximum amount of this rollover is equal to the maximum annual contribution amount for the year (\$8,100 for those age 55 and older with a family health plan) minus any other contributions made to the HSA in the tax year. You can effectively turn what would have been taxable IRA withdrawal dollars into a non-taxable HSA withdrawal, if the withdrawal is used for health insurance premiums (for COBRA coverage and/or if you are receiving unemployment benefits).

Those who wish to proceed with either of these options should consult a tax advisor.

[1] The New York Times, May 28, 2020, https://www.nytimes.com/2020/05/28/business/unemployment-stock-market-coronavirus.html?campaign_id=60&emcedit_no_20700552&instance_id=0&nl=breaking-news&ref=nyt®_id=5966761&segment_id=20410&user_id=8156e-b954a976750a45117bd4aa06

[2] Internal Revenue Service, "Relief for Taxpayers Affected by Ongoing Coronavirus Disease 2019 Pandemic," Notice 2020-18, <https://www.irs.gov/pub/irs/cd/201818.pdf>

[3] COBRA also provides the right to continue benefits due to other life events such as death and divorce. U.S. Department of Labor, <https://www.dol.gov/general/topic/health-plans/cobra>

[4] Internal Revenue Service, 2019 Instructions for Form 8889, <https://www.irs.gov/pub/irs/cp-88890.pdf>

[5] Ibid.

[6] Ibid.