



# Compliance Insights

*COBRA's Application to Expatriates, Inpatriates & Third-Country Nationals on U.S. & Foreign Health Plans*

---

October 2022

## AUTHORS



**Mark Holloway**

JD, CEBS  
Senior Vice President  
Director of Compliance Consulting  
816.960.9567  
mholloway@lockton.com



**Nick Dobelbower**

Director, Global People Solution  
202.414.2495  
ndobelbower@lockton.com

**THE INTERNAL REVENUE SERVICE (IRS) AND THE U.S. DEPARTMENT OF LABOR (DOL)**, the two federal agencies with primary jurisdiction over COBRA issues, have not issued any meaningful guidance on how COBRA applies to expatriates, inpatriates and third-country nationals (TCNs) on U.S. and foreign health plans. The scant guidance leaves many questions unanswered. Here's what we do know. For COBRA to apply, two conditions must be satisfied:

- The health insurance program must be subject to COBRA.
- The individual losing coverage must meet the definition of a COBRA qualified beneficiary.

Unfortunately, as reflected in the table below, the U.S. tax code and ERISA do not provide consistent answers on when COBRA should apply to expats, inpats and TCNs. In addition, the industry practice is that carriers offering expatriate medical insurance may not provide COBRA for an insurance contract issued outside the U.S.

	ERISA	Tax Code
Exemption from COBRA for foreign health plans?	Yes	No
Exemption from qualified beneficiary status for nonresident aliens with no U.S. source income?	No	Yes



## Some common terminology

- **COBRA QUALIFIED BENEFICIARY (QB):** An employee (or the employee’s spouse or child) who loses coverage under an employer group health plan due to a COBRA qualifying event, such as termination of employment.
  - Note that carriers have started using the terminology “continuation” to reference COBRA coverage for TCN and KLN (see definitions below).
- **EXPATRIATE (EXPAT):** A citizen of one country who is temporarily or permanently residing in another country. For example, a U.S. citizen who works in China is an expat.
- **INPATRIATE (INPAT):** From a U.S. perspective, a citizen of a foreign country (i.e., a noncitizen) who is transferred to the U.S. to work on a temporary or permanent basis. For example, a Chinese citizen temporarily working in the U.S. is an inpat.
- **THIRD-COUNTRY NATIONAL (TCN):** A TCN is a citizen of a foreign country working in another foreign country on international assignment, for a company headquartered in yet a third country. For example, a French citizen who works in Brazil for a U.S. company is a TCN.
- **FOREIGN NATIONAL:** From a U.S. perspective, an individual who is a citizen of any country other than the United States.
- **KEY LOCAL NATIONAL (KLN):** A high-level employee working in their own country for a foreign company.
- **NONRESIDENT ALIEN:** Generally, a citizen of a foreign country who does not reside in the U.S. for more than a brief period (e.g., no more than 30 days during the year). A nonresident alien with no source of U.S. income refers to such a person with no earned income from sources in the U.S. These individuals are not considered COBRA qualified beneficiaries under the U.S. tax code.
- **U.S. HEALTH PLAN:** A health plan that is either 1) established or maintained in the U.S., or 2) is not primarily for the benefit of people, substantially all of whom are nonresident aliens, even if the plan is established and maintained outside the U.S. These plans are covered by ERISA. In other words, a plan established and maintained outside the U.S. may be considered a “U.S. health plan” if a substantial number of members are U.S. citizens. See Exhibit 1 for details.
- **FOREIGN HEALTH PLAN:** An employer-provided group health plan established and maintained outside the United States primarily for the benefit of persons, substantially all of whom are nonresident aliens. These plans are exempt from ERISA.

## The problem: COBRA provisions in the tax law & ERISA are incongruent

### WHEN DOES COBRA APPLY?

	U.S. expat	TCN /KLN	Inpat
Covered by U.S. health plan	Yes	Arguably yes	Yes
Covered by foreign health plan	Maybe*	No	Maybe*

\*Plan would be exempt under ERISA, although the individual would meet the definition of qualified beneficiary under tax code.

### ERISA

Generally, ERISA (and therefore COBRA) applies to health plans maintained by ERISA-covered employers. However, the ERISA rules contain an exemption for plans maintained outside the United States primarily for the benefit of persons, substantially all of whom are nonresident aliens (we refer to this as a “foreign health plan,” in contrast to a “U.S. health plan,” as defined above). The parameters of this exemption from ERISA are discussed in Exhibit 1.

If the plan is a U.S. health plan, then any covered employee under the plan, regardless of citizenship or place of work, would have COBRA rights under the ERISA rules. Stated differently, an inpat or TCN covered under a U.S. health plan for expats would have COBRA rights.

If a person asserts they were improperly denied COBRA, all of the following can apply under ERISA:

- Lawsuits seeking coverage and payment of medical expenses by the health plan.
- Payment of the attorney’s fees if the lawsuit is successful.
- Penalties of up to \$110 per day for failing to provide a COBRA notice on a timely basis.

### TAX CODE

Unlike ERISA, there is no COBRA exclusion in the tax code for plans that are maintained outside the U.S. However, the tax code excludes from the definition of qualified beneficiary a covered employee, as well as the employee’s spouse and dependent children, if the employee is a nonresident alien with no earned income in the U.S.

The tax code’s COBRA rules are enforced by a \$100 per day excise tax levied by the IRS. The excise tax can apply not only to the plan sponsor, but also the plan’s insurer.

The IRS could try to enforce the COBRA requirements with respect to any employee covered under a foreign plan, subject to the exception for nonresident aliens with no source of U.S. income. To the best of our knowledge, the IRS has not pursued the excise tax with respect to foreign plans.

## How the carriers view the issues

In a perfect world, carriers would agree to extend COBRA strictly in accordance with the rules in ERISA and the tax code. Most carriers do provide COBRA for expats under U.S. plans and would be legally obligated to offer COBRA for a TCN covered under a U.S. health plan.

With respect to foreign health plans, the industry practice is that expat carriers will not provide COBRA under such plans, even if the individual is a U.S. expat, and even if the plan does not qualify for the ERISA exception for foreign health plans (e.g., when the plan covers a substantial number of U.S. expats).

### Examples: How COBRA applies

#### EXAMPLE 1:

A U.S.-based multinational firm provides an insured health plan for its expats and TCNs. Coverage is purchased from Megaworld Insurance Company and the contract is issued in Delaware. COBRA applies to the health plan, and the employees covered under the health plan will be considered COBRA qualified beneficiaries.

#### EXAMPLE 2:

Same as above, except the Megaworld insurance contract is issued in Bermuda. If the program is a foreign health plan, ERISA's COBRA rules would not apply to the plan. The tax code's rules might apply, subject to the exception for nonresident aliens with no U.S. source of income. But if ERISA applies, there's no question that the plan's enrollees would have COBRA rights. Unfortunately, the industry practice is that the insurer might not offer COBRA, even if the plan is covered by ERISA.

#### EXAMPLE 3:

Same as Example 2, except the plan covers only TCNs (no U.S. expats). The program would be exempt from COBRA.

---

*U.S. employer  
settles COBRA  
dispute with  
Indian nationals  
for \$1M*

---

A U.S. employer settled a class action lawsuit for not offering COBRA to Indian nationals who transferred from its U.S. operations to its operations in India. The plaintiffs argued they effectively terminated employment in the U.S. and were rehired by the parent company's Indian operation. Rather than litigate the issues, the parties agreed to a settlement of \$1 million for failing to offer COBRA. The employer in question asserted that consistent with IRS guidance, a transfer between sister companies in the same controlled group did not result in a termination of employment.

## What are the risks if COBRA is not offered?

The ERISA rules are a much greater concern than the tax code rules because of the risk of private lawsuits. Because the ERISA rules do not apply to foreign health plans, there seems to be little risk in denying COBRA to any person covered under a foreign health plan, including a U.S. expat.

If the employer wants to extend COBRA but the carrier will not cooperate, one alternative may be to transfer the U.S. expat to U.S. payroll prior to termination of employment and move the individual to a health plan that covers U.S. employees. Of course, if an employer wants to use this approach, the insurer (or where the plan is self-insured, the stop loss carrier) must agree to provide the requisite coverage.

However, this approach won't be a practical option for TCNs covered under foreign plans.

## *Exhibit 1*

### Plan must be established & maintained outside the United States

To be exempt from ERISA, the plan must be both established and maintained outside the U.S. The DOL has not precisely defined how it interprets "maintained and established," but the following factors are considered:

- The employer/plan sponsor must be located outside the U.S.
- Any plan assets must be maintained outside the U.S. (This is rarely an issue for welfare plans because most do not hold assets in trust.)
- For insured plans, the insurance contract should be issued by an insurer domiciled outside the U.S. An insurer domiciled outside the U.S. may include a foreign subsidiary of a U.S.-based insurance company, such as a Bermuda subsidiary of a U.S. insurer.

A plan is subject to ERISA even if it covers only foreign nationals but is established and maintained in the U.S. For example, a welfare plan maintained in the U.S. by a Taiwanese governmental entity for its Taiwanese employees in the U.S. (in-patriates to the U.S.) is covered by ERISA.

Keep in mind that employer plans maintained in U.S. territories are deemed to be maintained in the U.S. and therefore are subject to ERISA.

### **Plan must be primarily for the benefit of people, substantially all of whom are nonresident aliens.**

The DOL has issued a handful of rulings that address what is considered “primarily for the benefit of persons, substantially all of whom are nonresident aliens.”

Many of the rulings are from the 1980s and earlier and are inconsistent. Sometimes the result is obvious. For example, a plan that is maintained in France and covers only French citizens is not subject to ERISA. The analysis is more complicated in other instances, such as where plans maintained overseas cover a mix of noncitizens and U.S. citizens.

Based on prior DOL rulings, plans that are maintained outside the U.S., where fewer than 7% of the plan participants are U.S. citizens or residents, should qualify for the exception. The issue becomes murkier in plans where 7% or more of the participants are U.S. citizens.

Rulings in which a plan was not covered by ERISA (parenthetical references are to the DOL Advisory Opinion number):

- A pension plan maintained in Bermuda that covers no U.S. citizens (80-61A)
- A pension plan maintained in Canada that covers no U.S. citizens (81-58A)
- A pension plan maintained in England that covers a few British employees who travel to the U.S. on a temporary basis but no U.S. citizens (83-27A)
- A pension plan maintained in England that covers 154 U.S. citizens or residents out of a total of 1,564 participants (9.8%) (82-38A)
- A pension plan maintained in Norway that covers nine employees in the U.S. out of a total of 1,330 participants (0.6%) (77-68A)

Rulings in which a plan was covered by ERISA:

- A profit-sharing plan maintained in France that covers 60 U.S. employees who work in France out of a total of 110 people (54%) (78-26A)
- A business travel accident plan maintained in Canada that covers 1,900 U.S. citizens who are employed in the U.S. out of a total of 25,277 employees (7.5%) (80-05A)



**LOCKTON<sup>®</sup>**

**UNCOMMONLY INDEPENDENT**