Section 4980B.—Failure to Satisfy Continuation Coverage Requirements of Group Health Plans

26 CFR 54.4980B–2: Plans that must comply. (Also section 7805; § 54.4980B–9.)

Small employer plan exception to the COBRA continuation coverage requirements in mergers and acquisitions. Guidance is provided on when a group health plan maintained by an employer that grows to have more than 20 employees through a stock or asset acquisition is required to begin complying with the COBRA continuation coverage requirements.

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ISSUES

1. If, as a result of a transfer of stock, two previously separate employers are treated as a single employer for purposes of the COBRA continuation coverage requirements, how is the number of employees who were employed by the combined entity during the preceding calendar year determined for purposes of applying to the combined entity the exception from the

COBRA continuation coverage requirements for group health plans maintained by employers that normally employed fewer than 20 employees during the preceding calendar year (the small employer plan exception)?

2. If one employer acquires substantial assets (such as a plant or division or substantially all the assets of a trade or business) of another employer, when are the employees associated with the acquired assets taken into account for purposes of applying the small employer plan exception to the acquiring employer?

FACTS

Situation 1. Company *P* maintains a group health plan. *P* normally employed fewer than 20 employees during the previous calendar year. Under section 414(t) of the Internal Revenue Code, no other entity is treated as a single employer with *P*. During the current calendar year, stock in Corporation *O* is transferred so that after the transfer *P* and *O* are considered to be part of a single employer. The combined number of employees normally employed by *P* and *O* during the previous calendar year was at least 20.

Situation 2. Company *R* maintains a group health plan. *R* normally employed fewer than 20 employees during the previous calendar year. No other entity is considered to be part of a single employer with *R*. During the current calendar year, *R* acquires substantially all the assets of a business and continues the business operations associated with those assets without interruption or substantial change. The combined number of employees normally employed by *R* and the acquired business during the previous calendar year was at least 20.

LAW AND ANALYSIS

Section 4980B of the Code requires certain group health plans to make continuation coverage available to certain individuals who would otherwise lose their coverage under the plan as a result of certain occurrences (the "COBRA continuation coverage requirements"). Section 4980B imposes an excise tax if a plan subject to the COBRA continuation coverage requirements fails to comply with those requirements. Section 414(t) provides that all employees who are treated as employed by a single employer under section 414(b), (c), or (m) are treated as employed by a single employer for purposes of section 4980B and that the provisions of section 414(o) apply with respect to the requirements of section 4980B.

Section 4980B(d) of the Code and Q&A–4 of § 54.4980B–2 of the Miscellaneous Excise Tax Regulations provide that small-employer plans are excepted from COBRA. Q&A–5(a) of § 54.4980B–2 provides that, except in the case of a multiemployer plan, a small-employer plan is a plan maintained by an employer that normally employed fewer than 20 employees during the preceding calendar year. Under Q&A–5(b) of § 54.4980B–2, an employer is considered to have normally employed fewer than 20 employees during a particular calendar year if, and only if, it had fewer than 20 employees on at least 50 percent of its typical business days during that year. Under Q&A–4(c) of § 54.4980B–2, a small-employer plan otherwise excepted from COBRA is nonetheless subject to COBRA with respect to qualified beneficiaries who experience a qualifying event during a period when the plan is not a small-employer plan.

Q&A–1 of § 54.4980B–9 defines stock sale for purposes of § 54.4980B–9 as a transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different employer. Under Q&A–2 of § 54.4980B–2, an employer is defined to include any person who is a member of a group described in section 414(b), (c), (m), or (o) that includes a person for whom services are performed.

Q&A–1 of § 54.4980B–9 defines asset sale for purposes of § 54.4980B–9 as a transfer of substantial assets, such as a plant or division or substantially all the assets of a trade or business. Q&A–2 of § 54.4980B–2 provides that the term employer includes a successor to a person for whom services are performed and cross-references the rules in Q&A–8(c) of § 54.4980B–9 for determining when a purchaser of assets is a successor employer to the employer selling the assets. Under Q&A–8(c) of § 54.4980B–9, a buyer of substantial assets is not considered a successor employer to the seller of the assets unless the buyer continues the business operations associated with the purchased assets without interruption or substantial change and the seller ceases to provide any group health plan to any employee in connection with the sale.

In *Situation 1*, as a result of the stock transfer, *P* and *O* are treated as a single employer for purposes of section 4980B. Accordingly, in applying the small employer plan exception of section 4980B(d) to a group health plan maintained by the combined entity following the stock transfer, employees of both *P* and *O* during the previous calendar year must be taken into account. Since *P* and *O* combined normally employed at least 20 employees during the previous calendar year, a group health plan maintained by the combined entity becomes subject to COBRA as of the date of the stock transfer.

In *Situation 2*, Company *R* acquires substantially all the assets of a business and continues the business operations associated with those assets without interruption or substantial change. *R* alone normally employed fewer than 20 employees during the previous calendar year, but together *R* and the acquired business normally employed at least 20 employees during the previous calendar year. However, the acquisition of assets by *R* does not cause *R* to be considered a single employer with any part of the seller of the assets. Thus, the group health plan maintained by *R* continues to be excepted from COBRA until, with the normal application of the rules for determining whether a plan is a small-employer plan, the January 1 following a year in which *R* normally employed at least 20 employees. If, however, under the rules of Q&A–8(c) in § 54.4980B–9, *R* is a successor employer to the seller of the assets, then the group health plan of *R* will have the obligation to make COBRA continuation coverage available to any M&A qualified beneficiaries of the seller in accordance with the rules of Q&A–4(c) in § 54.4980B–2, even though *R* is otherwise excepted from COBRA.

HOLDING

In *Situation 1*, a group health plan maintained by the combined entity ceases to be excepted from COBRA as a small-employer plan as of the date of the stock transfer. In *Situation 2*, a group health plan maintained by the acquiring company continues to be excepted from COBRA as a small-employer plan for at least the remainder of the year of the asset acquisition.

EFFECTIVE DATE

For purposes of the excise tax of section 4980B of the Code, this ruling is effective for stock sales and asset sales that take effect on or after July 7, 2003.

DRAFTING INFORMATION

The principal author of this revenue ruling is Russ Weinheimer of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Mr. Weinheimer at (202) 622–6080 (not a toll-free number).