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The sale of a business is increasingly commonplace in today’s marketplace. In the rush to dot all the “i’s” and cross all the “t’s,” COBRA compliance can be overlooked until the deal is almost done, if not later.

This does not need to be the case. Several years ago, IRS issued final regulations that provide ample guidance on the COBRA responsibilities of sellers and buyers. You can find these rules in Treas. Reg. §54.4980B-9.

**The Rule of Twos**

An easy way to remember COBRA guidance in this area is as the Rule of Twos:

- **Two types of sales.** A stock sale involves the transfer of stock that causes the corporation to become a different employer or part of a different employer. An asset sale involves the transfer of substantial assets (although what constitutes substantial is not defined).

- **Two types of M&A qualified beneficiaries.** Such individuals include those who were already on COBRA through the seller and were connected with the assets or entity being sold and those who have a qualifying event as a result of the sale.

- **Two requirements for a buyer to be considered a successor employer.** The two elements are: (1) because of the asset sale, the seller ceases to provide any group health plan coverage; and (2) the buyer continues business operations associated with the assets without interruption or substantial change.

- **Two major issues.** Who must offer COBRA, the buyer or the seller? To whom must COBRA be offered?

- **Two minor issues.** If both the buyer and seller qualified for the COBRA small employer exception before the sale, but the buyer has 20 or more employees after the sale, when is COBRA effective? In an asset sale, what are the buyer’s options for participants in the seller’s health flexible spending account (FSA)?

**Who Must Offer COBRA?**

The default position is that the seller must offer COBRA if it continues to maintain a group health plan after the sale. In a stock sale, if the seller no longer offers coverage, the buyer must offer COBRA, even if it was not subject to COBRA before the sale. In an asset sale, a buyer that qualifies as a successor employer has the COBRA obligation.

The buyer’s obligation to provide coverage to M&A qualified beneficiaries starts on the later of either:

- the date the seller ceases to provide coverage (sometimes referred to as “springing COBRA liability” because it can occur after the sale as the seller winds down its business); or
- the date of asset or stock sale.

Of course, the buyer and seller may allocate COBRA responsibility differently by the terms of the sales agreement.

**Who Must Be Offered COBRA?**

Any qualified beneficiary, who was already on COBRA before the sale, must be able to continue coverage whether it is an asset or stock sale. Also, COBRA must be offered to all employees of the seller who lose their job as a result of the sale and do not gain employment with the buyer immediately after the sale.

In a stock sale, those employees who move from the seller to the buyer do not experience a qualifying event and thus do not have to be offered COBRA, even if the buyer does not offer any group health plan coverage. On the other hand, in an asset sale where the buyer is not a successor employer, employees who are hired by the buyer do experience a qualifying event and must be offered COBRA, even if coverage is available.
Business Sales (continued from page 9)

through the buyer. The result is opposite if the buyer is a successor employer: There is no qualifying event and COBRA does not have to be offered.

The Small Employer Exception

Sometimes, a sale will involve a buyer that has never had to deal with COBRA because it qualified for COBRA’s small employer exception. After the sale, the buyer may now have 20 or more employees. When does COBRA apply? IRS provided the answer in Revenue Ruling 2003-70:

1) To the extent that the buyer is responsible for any of seller’s employees already on COBRA, that obligation begins right away.

2) For a stock sale, the buyer should add the employee totals for both companies for the prior calendar year. If the test for the small employer threshold is exceeded, COBRA applies as of the date of sale.

3) For an asset sale, the buyer should add employee totals for both companies as of the date of sale. If the test for the small employer threshold is exceeded in a given year, COBRA applies as of Jan. 1 of the following year.

Health FSAs in Asset Sales

A buyer typically will want to minimize any disruption to the benefits of the acquired employees. IRS provided buyers flexibility when it comes to health FSAs in Revenue Ruling 2002-32. There are two options:

1) The seller may continue to cover the buyer’s new employees under the seller’s plan for a period of time (for example, through end of plan year). There will be no loss of coverage and no qualifying event, unless the health FSA does not qualify for limited COBRA application. In such a case, the seller would need to offer COBRA on the first day of the next plan year for the balance of 18 months after the sale date.

2) This simply involves the buyer continuing participants’ coverage, rolling over balances and amending its plan documents to cover the new employees as of the first day of the seller’s plan year.

The above is a scaled-down summary of the major COBRA considerations when a business is sold. These rules apply to corporate entities. IRS has not issued guidance on how these rules would apply to non-corporate entities (for example, partnerships) although it has indicated that these rules “should apply in a similar fashion in analogous cases involving the transfer of ownership interests in noncorporate entities.” Other issues may occur, especially if either the buyer or seller is a part of a controlled group of companies.

Keeping with the theme described earlier, employers should do two things. First, don’t forget to address the COBRA issues well in advance of the sale’s close. Second, remember the Rule of Twos.

Cumulative Index, Volume 19

This cumulative index covers the Guide newsletter, Volume 19, Nos. 1-4. Entries are listed alphabetically, and provide either the headline of the news article or the name of the court case, followed by the volume, issue number and page number of the newsletter in which the entry appeared. For court cases, this index can be used in conjunction with the Table of Cases and Index of Cases found in Tab 1900 of the Guide.

Amin v. Flagstone Hospitality Management, L.L.C., 19:1/4
Are you USERRA-ready? What the final rules mean for your COBRA program, 19:2/6
Bush budget plan would tweak HCTC, 19:3/10
COBRA compliance – back to basics, 19:2/8
“Come together right now”: COBRA issues in the business sale context, 19/4:8
Franco v. Sitel Corp., 19/4:13
Giddens v. University Yacht Club, Inc., 19/4:10
How Medicare coverage and COBRA interact, 19/2/10
Is states’ renewed interest in health benefits extending to continuation coverage?, 19:3/3
Livingston v. South Dakota State Medical Holding Co., Inc., 19:3/2
Just joining the COBRA world? Here’s what you need to know, 19/4:3
Koopman v. Forest County Potawatomi Member Benefit Plan, 19/4:2
Krippendorf v. Mitchell, 19/3:8
Medicare Part D Prescription Drug Benefit: Tips on weighing the options and deciding how to proceed with this new subsidy for retired employees, 19:1/5
Treasor v. Metropolitan Transp. Authority, 19/2/12
Tufano v. Riegel Transportation, Inc., 19/4:5
Washicheck v. The Ultimate Ltd., 19/1/2