The following views are individual views of the members of the Section of Taxation of the American Bar Association who prepared them and do not represent the positions of the American Bar Association or of the Section of Taxation.

The comments were prepared by individual members of the Committee on Employee Benefits of the Section of Taxation. Principal responsibility was exercised by Greta E. Cowart. Substantial contributions were made by Thomas R. Hoecker, Greta E. Cowart, Phyllis Borzi, and Henry Smith. The comments were reviewed by James R. Raborn and T. David Cowart of the Section's Committee on Government Submissions and by Elaine K. Church, Council Director for the Committee on Employee Benefits.

Although members of the Section of Taxation who participated in the preparation of these comments necessarily have clients affected by federal taxation, including the federal tax rules applicable to the subject area addressed by these comments, no such member (or the firm of such member) has been engaged by a client with respect to the specific subject matter of these comments.

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The purpose of these comments is to raise and discuss issues presented by the proposed Treasury Regulations issued on February 3, 1999 regarding the continuation coverage requirements for group health plans (the “Proposed Treasury Regulations” or “Proposed Regulations”). The Proposed Treasury Regulations modify Treasury Regulation sections 54.4980B-1 through 7 and add new sections 54.4980B-9 and 10.

The Committee commends Treasury's efforts to address the difficult issues addressed in the Proposed Regulations and appreciates and recognizes Treasury's consideration of the Committee's prior comments which were submitted on November 14, 1995 and November 30, 1998.

I. Business Reorganizations

A. Background and General Comments

A number of issues are raised by the Proposed Treasury Regulations with respect to “Stock Sales” and “Asset Sales”.

In general, the Proposed Treasury Regulations require that COBRA coverage be extended to qualified beneficiaries who lose their job and certain medical coverage as the result of either a Stock Sale or an Asset Sale. In addition, the Proposed Treasury Regulations impose an obligation on the purchaser to offer COBRA coverage to individuals who were qualified beneficiaries before the transaction whose last employment was with respect to the assets or equity sold and with whom the purchaser otherwise has no, and will not have any, contact or relationship. This obligation is beyond the scope of the statute and provides the described class of qualified beneficiaries with greater protection than that provided to other participants or qualified beneficiaries in the same plan. This expansion of required COBRA coverage also fails to recognize the economic realities of business transactions, the terms negotiated by the parties thereto and, most importantly, the fact that the purchaser in many Asset Sales or Stock Sales will not have access to the records necessary for it to defend itself against any improper requests for COBRA coverage.

B. Specific Issues

Issue 1:

A. Springing Liability in an Asset Sale. Under the Proposed Treasury Regulations, an asset purchaser would not succeed to COBRA liabilities of the selling entity unless it expressly assumed them or unless it is deemed to be a successor employer. The deemed successor employer provision permits the shifting of the COBRA liabilities at any point throughout the entire duration of the maximum coverage period, resulting in springing liability for the buyer to extend COBRA coverage to individuals for which it may have no access to records.
The successor employer liability approach dictated by the Proposed Treasury Regulations with respect to Asset Sales generally follows a similar proposal contained in the 1998 Proposed Treasury Regulations Preamble, 63 F.R. 708-712. However, the Proposed Treasury Regulations expand the position taken in the Preamble to the 1998 Proposed Treasury Regulations further than one might reasonably have anticipated. The Preamble to the 1998 Proposed Treasury Regulations provided for a springing obligation to provide COBRA coverage for only six months following the transaction. Under the new proposal, the successor liability could occur at any time within 18 months following the transaction. In all cases, our position remains that there is no statutory basis for successor liability in COBRA.

B. Recommendation. The shifting of the obligation to provide COBRA coverage in an Asset Sale should be limited to a reasonable period (such as no more than 60 days after closing) so that the purchaser is not placed in the position of guaranteeing the seller’s continued health plan operations for an extended period.

Issue 2:

A. Definition of an Asset Sale. Proposed Treasury Regulation section 54.4980B-9 Q/A1 defines an Asset Sale to be a sale of substantially all of the assets of a trade or business or of a plant or division. It is unclear what constitutes the sale of “substantially all” assets.

B. Recommendation. Final regulations should clarify that this provision is not intended to apply in the event of outsourcing of a department or division. Final regulations also should provide definitive guidance on what constitutes substantially all of the assets.

Issue 3:

A. Definition of M&A Qualified Beneficiary. Proposed Treasury Regulation section 54.4980B-9 Q/A4(a) and (b) define an M&A qualified beneficiary for both an Asset Sale and Stock Sale. The broad definition of M&A qualified beneficiaries includes not only those who lose coverage as the result of the sale, but also those who lost coverage prior to the sale and whose last employment was in connection with the assets or business being sold. This approach expands the group for whom a purchaser might reasonably expect to have some liability so as to include those who lost coverage prior to any transaction with the purchaser and with whom the purchaser otherwise has no contact, employment relationship or connection and for whom the purchaser has no records.

B. Recommendation. The purchaser should not have any COBRA obligations or liabilities with respect to employees of the seller (and related qualified beneficiaries) who became qualified beneficiaries prior to the sale. The definition of M&A qualified beneficiary in this context should be limited to individuals whose qualifying event occurred in connection with the sale. Extending the COBRA obligation to individuals whose qualifying event occurred prior to the sale is simply inappropriate, since it exposes the purchaser to liability for claims by M&A qualified beneficiaries who may have lost coverage for many reasons other than the sale.
The Proposed Treasury Regulations elevate the rights of these M&A qualified beneficiaries to higher levels than that afforded to other qualified beneficiaries and persons covered by the health plan and provides them with better protection than individuals who worked with other portions of the parent organization who previously had qualifying events, but whose employing entity was not sold. Thus, the regulations potentially elevate some qualified beneficiaries' rights over those of other qualified beneficiaries merely as the result of the qualified beneficiaries having been employed at some point in relation to assets that were subsequently sold or with respect to an entity that was subsequently sold. There is no statutory basis for this approach.

In addition, we emphasize that in many instances the purchaser will not have any records regarding individuals who became qualified beneficiaries prior to the sale. In an Asset Sale, sellers are generally not willing to transfer employment records and information regarding employees and their health care coverage unless the employees are being transferred to the purchaser. While records are more likely to be transferred in a Stock Sale than in an Asset Sale, they are not always transferred and may be retained by the seller. Imposing this exposure with respect to transactions that have already closed places a purchaser in an awkward position.

If the final regulations nonetheless continue the approach taken in the Proposed Treasury Regulations, the effective date of the final regulations should provide that they will only apply to a transaction closing at least 24 months following the issuance of the final regulations in order to give employers the opportunity to plan for obtaining the records necessary to administer COBRA following any stock or asset acquisition.

**Issue 4:**

A. **Definition of Stock Sales.** The definition of Stock Sales in Proposed Treasury Regulation section 54.4980B-9 Q/A1 refers to the transfer of stock in a corporation which causes the corporation to become a different employer or a member of a different controlled group. This definition assumes that all stock sales result in a sale of a controlling interest. In some sales, a controlling interest may not be transferred. The corporation may cease to be a member of the prior controlled group, but may not become a part of a new controlled group. Instead, it will be a separate employer. There is no statutory basis for shifting liabilities to a stock purchaser unless the purchaser and the employer become part of the same controlled group.

B. **Recommendation.** Final regulations should clarify that a purchaser of an interest in an entity which results in the entity ceasing to be a member of the seller's controlled group, but which does not shift the entity to the controlled group of the purchaser, is not covered by the regulation.
Issue 5:

A. COBRA Obligations for Non-Stock Entities. The Preamble to the Proposed Treasury Regulations does not directly invite comments on whether the obligation to make COBRA continuation coverage available is affected by the transfer of control in a non-stock entity that causes the entity to no longer be a member of a group of trades or businesses under common control. For example, such a situation might occur upon the transfer of membership or a change in the constitution of the board of directors of a not-for-profit organization. Nevertheless, the Preamble does solicit comments for other rules that should be considered.

Code sections 4980B(e)(1) and 414(t) only extend COBRA liability for excise taxes to members of the controlled group and ERISA section 607(4) only extends the concept of employer liability for providing COBRA coverage to members of the controlled group. Little guidance outside of GCM 39616 and a few private letter rulings exists to provide any guidance with respect to whether a non-stock corporation is part of a controlled group. Tax exempt entities are the most common type of non-stock entities.

B. Recommendation. COBRA successor liability provisions should not be extended to non-profit and non-stock entities in the absence of clear guidance regarding the determination of which entities are part of the controlled group.

Issue 6:

A. Effect of Continuation of Identical Plan by Purchaser. The Preamble to the Proposed Treasury Regulations requested comments regarding whether a qualifying event should be deemed to not occur in the event of a sale of substantially all of the assets of a trade or business, parent or division where the purchaser maintains a plan identical to the plan of the seller and credits the participants with all amounts incurred during the year to date toward satisfaction of preexisting condition exclusions, deductibles, and out-of-pocket maximums.

The Preamble to the Proposed Treasury Regulations indicated that one possible approach would be that a loss of coverage would be considered not to have occurred as long as the buyer in an Asset Sale continues to maintain the same group health plan coverage the seller maintained before the sale without charging the employees any greater percentage of the total cost of coverage than the seller had charged before the sale and without changing the coverage. The coverage would be treated as remaining unchanged in the event there was no obligation to provide a summary of material modifications within 60 days after the change due to a material reduction in covered services or benefits under ERISA. If both of these conditions were satisfied for the maximum coverage period that would otherwise apply as the result of the seller's termination of the employees' employment (generally 18 months from the date of the sale), then those terminations of employment would never be considered qualifying events. If, however, the conditions were not satisfied for the full maximum coverage period, then on the date that
those conditions cease to be satisfied, the seller would be obligated to make continuation coverage available for the balance of the maximum coverage period.

**B. Recommendation.** If the buyer in an Asset Sale continues to maintain the same, or a substantially similar, group health plan and the percentage cost to the employees is not increased, a COBRA qualifying event should not be deemed to have occurred. With the approach suggested in the Preamble to the Proposed Treasury Regulations, a COBRA qualifying event is deemed not to occur only if the buyer continues the group health plan unchanged for the maximum coverage period. The seller's COBRA obligations should not be dependent on the buyer's maintenance of the same, or a substantially similar, program at the same or less percentage cost for the duration of the maximum coverage period. In a typical commercial merger and acquisition transaction, sellers typically do not maintain contact with buyers after the transaction is closed and sellers would have no reason to know when or whether a buyer changes or eliminates health coverage for its employees. Under the approach in the Preamble, the seller's liability for COBRA might arise as long as 18 months after the sale occurred (and likely without the seller's knowledge). Accordingly, we recommend that after a reasonable period of time (such as six months), the buyer should be able to modify the program without triggering the seller's COBRA obligations. If, however, the 18 month approach suggested in the Preamble is adopted, we recommend that the regulation state clearly that 18 months is the maximum period for which a seller remains liable.

**II. Interaction of FMLA and COBRA (Proposed Treasury Regulation Section 54.4980B-10)**

**A. Background**

The Proposed Treasury Regulations also provide guidance on the interaction of the Family and Medical Leave Act of 1993 (29 U.S.C. section 2601 - 2619) and COBRA's continuation coverage requirements. Generally, this portion of the Proposed Treasury Regulations follows the guidance previously set forth on this subject in IRS Notice 94-103, 1994-2 C.B. 569.

Proposed Treasury Regulation section 54.4980B-10 Q/A 1(a) provides that the taking of a FMLA leave is not itself a COBRA qualifying event. Instead, a COBRA qualifying event (for the employee and any covered spouse and dependents) occurs when an employee covered by a group health plan on the first day prior to FMLA leave (or who becomes covered by the plan during FMLA leave) does not return to employment with the employer at the end of the FMLA leave and would, but for COBRA, lose plan coverage.

Proposed Treasury Regulation section 54.4980B-10 Q/A 1(b) also provides that a loss of plan coverage at the end of a FMLA leave is not a COBRA qualifying event if, prior to the employee's return from FMLA leave, the employer has eliminated plan coverage for the class of employees to which the employee would have belonged had he or she not taken FMLA leave.
Proposed Treasury Regulation section 54.4980B-10 Q/A 2 provides that the qualifying event occurs on the last day of the FMLA leave, and the COBRA continuation period generally begins on that day. However, if coverage is not lost until a date after the last day of the FMLA leave and the plan provides for the optional extension of the required COBRA continuation periods under Code section 4980B(f)(8), then the maximum continuation coverage period is measured from the date when coverage actually is lost.

Proposed Treasury Regulation section 54.4980B-10 Q/A 3 provides that any lapse of plan coverage during the FMLA leave, whether for failure to pay required premiums or because of an affirmative decision not to continue coverage during the FMLA leave, is disregarded when determining whether the employee has a COBRA qualifying event on the last day of the FMLA leave.

Similarly, Proposed Treasury Regulation section 54.4980B-10 Q/A 4 provides that any State or local law requiring plan coverage for a period longer than FMLA is disregarded when determining whether the employee has a COBRA qualifying event on the last day of the FMLA leave.

Proposed Treasury Regulation section 54.4980B-10 Q/A 5 provides that an employer may not condition COBRA coverage on the employee's reimbursement of any premiums paid by the employer to maintain the employee's plan coverage during his or her FMLA leave, even in those cases in which, under Department of Labor Regulations 29 CFR 825.213, the employer may seek to recover premiums from the employee.

B. Specific Issues

Issue 1:

A. How Does an Employer Determine the Date on Which an Employee Does Not Return to Employment with the Employer at the End of the FMLA Leave for Purposes of COBRA? The Proposed Regulations do not provide explicit guidance concerning how an employer determines the date on which an employee does not return to employment with the employer at the end of a FMLA leave for purposes of COBRA. Instead, example 2 to Proposed Treasury Regulation section 54.4980B-10 Q/A2 refers to the FMLA regulations at 29 CFR Part 825 (sections 825.100-800) for determination of when the last day of a FMLA leave occurs.

The absence of explicit guidance on this point could be interpreted to suggest that an employee is not deemed to not return to employment with the employer at the end of a FMLA leave until the day after the last day of the employee's available FMLA leave period.

For example, if an employee with a full 12 weeks of available FMLA leave takes a FMLA leave on January 1, 1999, it could be argued that the date on which the employee does not return to employment with the employer at the end of the FMLA leave is March 25, 1999,
even if the employee announces to the employer, on January 31, 1999, that the employee does not intend to return to employment with the employer.

B. Recommendation. The Proposed Regulations should be amended to include explicit guidance concerning how an employer determines the date on which an employee does not return to employment with the employer at the end of a FMLA leave for purposes of COBRA.

This guidance should provide that the date on which an employee does not return to employment with the employer at the end of a FMLA leave is the day after the last day of an employee's FMLA leave. The guidance should incorporate the guidance issued in IRS Notice 94-103, 1994 IRB 1994-5 and FMLA regulations at 29 CFR Part 825 (sections 825.100-800), which provided that in the event an employee notifies the employer that he/she will not return to work prior to the end of the FMLA leave that the FMLA leave ends and the COBRA qualifying event is deemed to occur on the day following the date on which the employer is notified that the employee will not return to work. This would specifically state the principle shown in Proposed Treasury Regulation section 54.4980B-10 Q/A2 and Ex.2 and would be consistent with the FMLA regulations at 29 CFR Part 825 (Sections 825.100 - 825.800).

Issue 2:

A. How Does the Employer Determine the Last Day of an Employee's FMLA Leave for Purposes of COBRA? The Proposed Regulations do not provide explicit guidance concerning how an employer determines the last day of an employee's FMLA leave for purposes of COBRA. Instead, they rely on Proposed Treasury Regulation section 54.4980B-10 Q/A2, Ex.2's reference to having it determined under the FMLA regulations issued by the U.S. Department of Labor. The use of this cross reference for the determination of the termination of the FMLA leave should be incorporated directly in the final regulations rather than being merely referenced in an example.

This absence of clear guidance could be interpreted to suggest that the last day of an employee's FMLA leave does not occur until the last day of the employee's available FMLA leave period.

For example, if an employee with a full 12 weeks of available FMLA leave takes a FMLA leave on January 1, 1999, it could be argued that the last day of the employee's FMLA leave is March 25, 1999, even if the employee announces to the employer, on January 31, 1999, that the employee does not intend to return to employment with the employer.

B. Recommendation. The Proposed Treasury Regulations should be clarified to explicitly include guidance concerning how to determine the last day of an employee's FMLA leave.
This guidance should explicitly adopt and cross reference the position taken in section 825.209(f) of the Department of Labor FMLA Regulations at 29 CFR Part 825 regarding the last day an FMLA leave terminates. This section provides that an employer's obligation to provide health benefits during a FMLA leave generally terminates on the earlier of: (1) when the employment relationship would have terminated if the employee had not taken FMLA leave (e.g., if the employee's position is eliminated during the FMLA leave, etc.); (2) when the employee informs the employer of his or her intent not to return from the leave (including before starting the leave, if applicable); or (3) when the employee fails to return from leave after exhausting his or her available FMLA leave period.

III. Proposed Treasury Regulation section 54.4980B-9 Q/A and Multiemployer Plans

A. Background

Proposed Treasury Regulation section 54.4980B-9 Q/A10 addresses the question of whether a multiemployer plan has a COBRA obligation to new or existing qualified beneficiaries who were covered under the multiemployer plan prior to the employer's cessation of contributions to the multiemployer plan and whose last covered employment under the plan was with the employer no longer contributing to the plan. The answer to Proposed Treasury Regulation section 54.4980B-9 Q/A10 suggests that only if the employer establishes a new group health plan (or starts contributing to another multiemployer plan) covering the employer's employees formerly covered under the multiemployer plan, can the multiemployer plan shift the COBRA obligations to the employer.

B. Specific Issue

Issue 1:

A. Multiemployer Provision Should Not be Limited to New Plans or Contributions to New Multiemployer Plans. The Proposed Treasury Regulations only address a shift in the COBRA obligation in the event the employer either commences contributions to another multiemployer plan or "establishes one or more group health plans" but fails to address whether any shift of the COBRA obligation should occur in the event the employer already maintains another group health plan.

B. Recommendation. Proposed Treasury Regulation section 54.4980B-9 Q/A10 suggests that the COBRA obligation may only be shifted to the employer in the event that the employer ceasing to contribute to the multiemployer plan either "establishes one or more group health plans" or "starts contributing to a new multiemployer plan." The final regulations should clarify that a multiemployer plan is permitted to shift the COBRA obligation to the employer as soon as the employer covers a substantial number of employees formerly covered under the multiemployer plan, under another group health plan or a multiemployer plan, regardless of whether it is a new or preexisting plan.