



## COBRA Continuation Coverage – Mergers and Acquisitions

Business reorganizations, such as mergers and acquisitions, often raise liability issues regarding COBRA continuation coverage. These liability issues typically involve two sets of individuals:

- Individuals who are receiving COBRA coverage under the seller's group health plan at the time of the reorganization; and
- Individuals whose employment status changes as a result of the reorganization.

Internal Revenue Service (IRS) regulations address the COBRA consequences of business reorganizations. As a general rule, if the selling entity maintains a group health plan after the transaction, it is responsible for providing the COBRA coverage. However, the specific rules that apply to a situation depend on a variety of factors, including whether the transaction is a stock sale or an asset purchase.

Also, the seller and buyer may contractually allocate COBRA liability as part of the transaction.

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## LINKS AND RESOURCES

- IRS COBRA [regulations](#) addressing business reorganizations
- Department of Labor's [Employer Guide to Group Health Plan Continuation Coverage Under COBRA](#)

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## General Rules for COBRA Liability

COBRA requires that covered employers provide qualified beneficiaries who would otherwise lose group health benefits with an opportunity to continue coverage for a limited period of time. Compliance with the COBRA rules can be difficult and mistakes can be costly.

Business reorganization, such as corporate mergers and acquisitions, raise additional complexities for COBRA compliance. The IRS has issued [regulations](#) that address how business reorganizations impact an employer's obligation to provide COBRA coverage. The COBRA regulations:

- Use specific terms—such as “buying group,” “selling group,” and “M&A qualified beneficiaries”—to describe the COBRA liability rules for business reorganizations;
- Allocate COBRA liability in two different types of business reorganizations (stock sales and asset sales); and
- Provide examples to help companies understand their COBRA obligations.

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## GENERAL RULES

According to the COBRA regulations, the party (the selling group or the buying group) that is responsible for making COBRA coverage available following a business reorganization is generally determined according to the following rules:

- **If the selling group maintains a group health plan after the sale**, a group health plan maintained by the selling group has the obligation to provide COBRA coverage to M&A qualified beneficiaries with respect to the sale.
- **If the selling group ceases to maintain any group health plan in connection with the sale**, the buying group has the obligation to provide COBRA coverage to M&A qualified beneficiaries with respect to the sale if:
  - The buying group maintains a group health plan, and
  - In the case of an asset sale, the buying group is a successor employer.

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Keep in mind that different COBRA liability rules may apply to a business reorganization, depending on specific facts and circumstances involved.

## Planning for COBRA Liability

Potential COBRA liability should be addressed when parties are negotiating a business transaction. The selling and buying groups should evaluate whether any individuals will qualify as M&A qualified beneficiaries, and, if so, what type of COBRA coverage will be offered and by which group health plan. The potential costs associated with providing COBRA coverage may be factored into the purchase price or otherwise addressed in the parties' agreement.

The COBRA regulations permit the selling and buying groups to **contractually agree** to allocate the responsibility for providing COBRA coverage. However, if the agreement fails, the party that has the COBRA obligation under the COBRA regulations remains responsible for making COBRA coverage available to M&A qualified beneficiaries.

Also, if the selling and buying groups agree to allocate COBRA liability in a way that is different from what the COBRA regulations would provide, the sponsor of the health plan assuming the liability should obtain assurances from its insurance carrier (or stop-loss insurer), before the transaction is complete, that the carrier will cover the M&A qualified beneficiaries.

## Important Concepts

### Business Reorganizations

The COBRA implications of a business reorganization largely depend on how the transaction is structured. The COBRA regulations divide business reorganizations into two types: (1) the ownership interest in a corporation is transferred by a sale of stock; or (2) the ownership of business assets is transferred by a sale of assets.

- **Stock sale**—A transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different employer. For example, a sale or distribution of stock in a corporation that causes the corporation to cease to be a member of one controlled group of corporations, whether or not it becomes a member of another controlled group of corporations, is a stock sale.
- **Asset sale**—A transfer of substantial assets, such as a plant or division of substantially all the assets of a trade or business.

The COBRA regulations do not address how COBRA liability is allocated when there is a transfer of ownership in a noncorporate entity. The [preamble](#) to the regulations suggests that the rules for transfers of ownership interests in corporate entities should apply in a similar way to situations involving the transfer of ownership interest in a noncorporate entity.

### Buying and Selling Group

The COBRA regulations use the terms “buying group” and “selling group” to describe the buyer and seller in a stock or asset sale. These terms are used because the COBRA implications of a business reorganization can impact the seller's or buyer's entire controlled group, not just the specific corporations or trades or businesses involved with the transaction.

In a stock sale:

- The **selling group** is the controlled group of corporations, or the group of trades or businesses under common control, which a corporation ceases to be a member of because of the stock sale.
- The **buying group** is the controlled group of corporations, or the group of trades or businesses under common control, which the acquired organization becomes a member of because of the stock sale.

In an asset sale:

- The **selling group** is the controlled group of corporations, or the group of trades or businesses under common control, that includes the corporation or other trade or business that is selling the assets.
- The **buying group** is the controlled group of corporations, or the group of trades or businesses under common control, that includes the corporation or other trade or business that is buying the assets.

A “controlled group of corporations” or a “group of trades or businesses under common control” refers to a group of companies that are related to each other through common ownership. The same rules that apply when determining which companies need to be aggregated for retirement plan nondiscrimination testing under the Internal Revenue Code apply to COBRA's business reorganization rules.

## Obligation to Offer COBRA Coverage

### Identifying M&A Qualified Beneficiaries

A business reorganization will raise COBRA liability issues with respect to M&A qualified beneficiaries. Thus, it is important for the buying and selling groups to identify potential M&A qualified beneficiaries when they are negotiating a business reorganization.

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The COBRA regulations define an “M&A qualified beneficiary” to mean a qualified beneficiary whose qualifying event occurred **prior to or in connection with** the sale. An M&A qualified beneficiary can be an employee, a spouse or a dependent child.

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In general, M&A qualified beneficiaries may include:

- Individuals who are already receiving COBRA coverage under the selling group’s health plan at the time of the sale; and
- Individuals who experience a qualifying event in connection with the sale.

### ***Qualifying Events Occurring Prior to Sale***

At the time of a business reorganization, the selling group will typically have individuals who are already receiving COBRA coverage due to a qualifying event (for example, an employee’s termination of employment, divorce from covered employee or a dependent’s ceasing to be a covered dependent). To be an M&A qualified beneficiary with respect to the business reorganization, a qualified beneficiary must be receiving COBRA as a result of employment associated with the assets being sold or the acquired organization.

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**Example:** Selling Group S consists of three corporations, A, B and C. Buying Group P consists of two corporations, D and E. Buying Group P enters into a contract to purchase all the stock of Corporation C from Selling Group S, effective July 1, 2020. Before the sale of Corporation C, Selling Group S maintains a single group health plan for the employees of Corporations A, B and C (and their families). Buying Group P maintains a single group health plan for the employees of Corporations D and E (and their families). Effective July 1, 2020, the employees of Corporation C (and their families) become covered under Buying Group P’s plan.

On June 30, 2020, there are 48 qualified beneficiaries receiving COBRA coverage under Selling Group S’s plan, 15 of whom are M&A qualified beneficiaries with respect to the sale of Corporation C. (The other 33 qualified beneficiaries had qualifying events in connection with a covered employee whose last employment before the qualifying event was with either Corporation A or B.)

Under these facts, Selling Group S’s plan continues to have the obligation to make COBRA continuation coverage available to the 15 M&A qualified beneficiaries under Selling Group S’s plan after the sale of Corporation C to Buying Group P.

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### ***Qualifying Event Occurring in Connection with the Sale***

An individual who experiences a qualifying event due to the reorganization is also an M&A qualified beneficiary. The COBRA regulations provide rules for determining when a qualifying event is deemed to occur in connection with a business reorganization. The rules vary based on whether the transaction is a stock sale or an asset sale.

- **Stock Sale—To experience a qualifying event with respect to a stock sale, an employee must lose his or her job.** The COBRA regulations provide that a covered employee who continues to be employed by the acquired organization after the sale does not experience a termination of employment as a result of the sale. Thus, if the employee remains employed with the acquired corporation, the sale is not a COBRA-qualifying event for the employee (or his or her spouse or dependent children), regardless of whether they are provided with group health plan coverage after the sale.
- **Asset Sale—To experience a qualifying event with respect to an asset sale, an employee does not need to lose his or her job.** An asset sale can be a qualifying event for a covered employee whose employment before the sale is associated with the purchased assets (and for his or her covered spouse and dependent children), regardless of whether he or she is employed by the buying group after the sale.

However, for the asset sale to be a qualifying event, **the covered employee (or the spouse or dependent child) must lose coverage under a group health plan of the selling group after the sale.**

There is an exception to this rule if the buying group qualifies as a successor employer. No qualifying event occurs if the buying group is a successor employer and the employee is employed by the buying group after the sale. A buying group is a successor employer if the selling group ceases to provide group health plan coverage in connection with the sale and the buying group continues the business operations associated with the purchased assets without interruption or substantial change.

## **Identifying the Responsible Health Plan**

As a general rule, if the selling group maintains any group health plan after the sale, then it is responsible for providing COBRA coverage to M&A qualified beneficiaries. However, there are different rules for when the selling group does not maintain a group health plan following the sale. These rules depend on whether the transaction is a stock or asset sale.

Also, the buying and selling groups can contractually agree to allocate COBRA liability in a different way, although, if the agreement fails, the party that has the COBRA obligation under the COBRA regulations remains responsible for making COBRA coverage available to M&A beneficiaries.

### ***Selling Group Does Not Maintain a Group Health Plan – Stock Sale***

If the selling group ceases to provide any group health plan to any employee in connection with a stock sale, a group health plan maintained by the buying group has the obligation to make COBRA coverage available to M&A beneficiaries.

### ***Selling Group Does Not Maintain a Group Health Plan – Asset Sale***

In an asset sale, a group health plan of the buying group is responsible for providing COBRA coverage to M&A qualified beneficiaries if:

- The selling group ceases to provide any group health plan to any employee in connection with the sale; and
- The buying group qualifies as a successor employer (in other words, the buying group continues the business operations associated with the assets purchased from the selling group without interruption or substantial change).

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## **RULES THAT APPLY TO BOTH STOCK AND ASSET SALES**

The buying group's COBRA obligation begins on the later of the two following dates and continues as long as the buying group continues to maintain a group health plan:

- The date that the selling group ceases to provide any group health plan to any employee; or
- The date of the stock or asset sale.

The determination of whether the selling group's cessation of providing any group health plan to any employee is "in connection with" the stock or asset sale is based on all of the relevant facts and circumstances.

The COBRA regulations confirm that a group health plan of the buying group does not, as a result of the stock or asset sale, have an obligation to make COBRA coverage available to those qualified beneficiaries of the selling group who are not M&A qualified beneficiaries with respect to that sale.

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## **IRS Examples – Stock Sale**

### **Example 1**

**FACTS:** Selling Group S consists of three corporations, A, B and C. Corporations A, B and C each maintain a group health plan for their employees (and their families). Buying Group P consists of two corporations, D and E. Buying Group P enters into a contract to purchase all of the stock of Corporation C from Selling Group S, effective July 1, 2020. As of June 30, 2020, there are 14 qualified beneficiaries receiving COBRA continuation coverage under Corporation C's plan. Corporation C continues to employ all of its employees and continues to maintain its group health plan after being acquired by Buying Group P on July 1, 2020.

**ANALYSIS:** Under these facts, Corporation C is an acquired organization and the 14 qualified beneficiaries under Corporation C's plan are M&A qualified beneficiaries. A group health plan of Selling Group S (that is, either the plan maintained by Corporation A or the plan maintained by Corporation B) has the obligation to make COBRA continuation coverage available to the 14 M&A qualified beneficiaries. Selling Group S and Buying Group P could negotiate to have Corporation C's plan continue to make COBRA continuation coverage available to the 14 M&A qualified beneficiaries. In such a case, neither Corporation A's plan nor Corporation B's plan would make COBRA continuation coverage available to the 14 M&A qualified beneficiaries unless Corporation C's plan failed to fulfill its contractual responsibility to make COBRA continuation coverage available to the M&A qualified beneficiaries.

Corporation C's employees (and their spouses and dependent children) do not experience a qualifying event in connection with Buying Group P's acquisition of Corporation C, and consequently no plan maintained by either Buying Group P or Selling Group S has any obligation to make COBRA continuation coverage available to Corporation C's employees (or their spouses or dependent children) in connection with the transfer of stock in Corporation C from Selling Group S to Buying Group P.

### **Example 2**

**FACTS:** Selling Group S consists of three corporations, A, B and C. Buying Group P consists of two corporations, D and E. Buying Group P enters into a contract to purchase all of the stock of Corporation C from Selling Group S, effective July 1, 2020. Before the sale of Corporation C, Selling Group S maintains a single group health plan for the employees of Corporations A, B and C (and their families). Buying Group P maintains a single group health plan for the employees of Corporations D and E (and their families). Effective July 1, 2020, the employees of Corporation C (and their families) become covered under Buying Group P's plan. On June 30, 2020, there are 25 qualified beneficiaries receiving COBRA continuation coverage under Selling Group S's plan, 20 of whom are M&A qualified beneficiaries with respect to the sale of Corporation C. (The other five qualified beneficiaries had qualifying events in connection with a covered employee whose last employment before the qualifying event was with either Corporation A or B.) Selling Group S terminates its group health plan, effective June 30, 2020, and begins to liquidate the assets of Corporations A and B and to lay off the employees of Corporations A and B.

**ANALYSIS:** Under these facts, Selling Group S ceases to provide a group health plan to any employee in connection with the sale of Corporation C to Buying Group P. Thus, beginning July 1, 2020, Buying Group P's plan has an obligation to make COBRA continuation coverage available to the 20 M&A qualified beneficiaries, but Buying Group P is not obligated to make COBRA continuation coverage available to the other five qualified beneficiaries with respect to Selling Group S's plan as of June 30, 2020, or to any of the employees of Corporations A or B whose employment is terminated by Selling Group S (or to any of those employees' spouses or dependent children).

## IRS Examples – Asset Sale

### Example 1

**FACTS:** Selling Group S provides group health plan coverage to employees at each of its operating divisions. Selling Group S sells the assets of one of its divisions to Buying Group P. Under the terms of the group health plan covering the employees at the division being sold, their coverage will end on the date of the sale. Buying Group P hires all but one of those employees, gives them the same positions that they had with Selling Group S before the sale, and provides them with coverage under a group health plan. Immediately before the sale, there are two qualified beneficiaries receiving COBRA continuation coverage under a group health plan of Selling Group S, whose qualifying events occurred in connection with a covered employee whose last employment prior to the qualifying event was associated with the assets sold to Buying Group P.

**ANALYSIS:** These two qualified beneficiaries are M&A qualified beneficiaries with respect to the asset sale to Buying Group P. Under these facts, a group health plan of Selling Group S retains the obligation to make COBRA continuation coverage available to these two M&A qualified beneficiaries. In addition, the one employee that Buying Group P does not hire, as well as all of the employees Buying Group P does hire (and the spouses and dependent children of these employees) who were covered under a group health plan of Selling Group S on the day before the sale, are M&A qualified beneficiaries with respect to the sale. A group health plan of Selling Group S also has the obligation to make COBRA continuation coverage available to these M&A qualified beneficiaries.

### Example 2

**FACTS:** Selling Group S provides group health plan coverage to employees at each of its operating divisions. Selling Group S sells substantially all of the assets of all of its divisions to Buying Group P, and Selling Group S ceases to provide any group health plan to any employee on the date of the sale. Buying Group P hires all but one of Selling Group S's employees on the date of the asset sale by Selling Group S, gives those employees the same positions that they had with Selling Group S before the sale, and continues the business operations of those divisions without substantial change or interruption. Buying Group P provides these employees with coverage under a group health plan. Immediately before the sale, there are 10 qualified beneficiaries receiving COBRA continuation coverage under a group health plan of Selling Group S whose qualifying events occurred in connection with a covered employee whose last employment prior to the qualifying event was associated with the assets sold to Buying Group P.

**ANALYSIS:** These 10 qualified beneficiaries are M&A qualified beneficiaries with respect to the asset sale to Buying Group P. Under these facts, Buying Group P is a successor employer. Thus, a group health plan of Buying Group P has the obligation to make COBRA continuation coverage available to these 10 M&A qualified beneficiaries. The one employee that Buying Group P does not hire and the family members of that employee are also M&A qualified beneficiaries with respect to the sale. A group health plan of Buying Group P also has the obligation to make COBRA continuation coverage available to these M&A qualified beneficiaries. The employees who continue in employment in connection with the asset sale (and their family members), and who were covered under a group health plan of Selling Group S on the day before the sale, are not M&A qualified beneficiaries because Buying Group P is a successor employer to Selling Group S in connection with the asset sale. Thus, no group health plan of Buying Group P has any obligation to make COBRA continuation coverage available to these continuing employees, with respect to the qualifying event that resulted from their losing coverage under Selling Group S's plan in connection with the asset sale.