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Legend

The Retiree Committee =

The Employer =

The Buyer =

Dear .:

This is in reply to the ruling request dated September 26, 2003, which you submitted as authorized representative of the Retiree Committee. Based on the information submitted, we understand the relevant facts to be as follows.

The Employer provided group health plan coverage to eligible retired employees and their family members and surviving spouses. The Employer was delinquent in required contributions to its defined benefit pension plans. The defined benefit pension plans were terminated, the Employer filed voluntary petitions for bankruptcy, and the Pension Benefit Guaranty Corporation assumed responsibility for the Employer's defined benefit pension plans. The bankruptcy court approved the sale of substantially all of the Employer's assets to the Buyer, an unrelated third party. The asset purchase agreement provides that the Buyer does not have any obligation to provide continuation coverage benefits under section 4980B of the Internal Revenue Code (the Code) to qualified beneficiaries of the Employer. It is our understanding that the Employer continued to employ and make group health coverage available to approximately employees after the sale. These employees are winding down the Employer's remaining affairs. The Employer intends to be dissolved after winding down all its affairs.

The nonunion retirees of the Employer were represented in the bankruptcy action by the Retiree Committee. The Employer and the Retiree Committee negotiated an agreement relating to retiree health benefits, which was approved by order of the bankruptcy court. Pursuant to the agreement and order, the retiree health benefits were terminated. For a period of three months after the termination, the retirees were given the option to continue the same coverage but at their expense (Option 1). A separate health care coverage option was also made available to these retirees (Option 2). The coverage under Option 2 was not necessarily identical to the coverage in effect before the termination, to the coverage made available to the wind-down employees, or to coverage made available to employees of the Buyer.

Although the Employer was the original sponsor of Option 2 and established a trust to fund the benefits of Option 2, sponsorship of the trust providing Option 2 was transferred after the expiration of Option 1 to an association of retired employees who are beneficiaries under Option 2. The trust's sole purpose is to provide the benefits of Option 2 to eligible retirees and their family members or surviving spouses.

The Retiree Committee wishes to know whether Option 2 is qualified health insurance for purposes of the health coverage tax credit under section 35, whether Option 2 can still be qualified health insurance if the trust providing Option 2 is sponsored by a separate employee association, and whether the fact that a retiree may elect Option 2 outside of the applicable COBRA election period will affect whether it is qualified health insurance.

Section 35 provides a 65 percent tax credit for amounts paid by an eligible individual for qualified health insurance during eligible coverage months for coverage of the individual and qualifying family members. Eligible individuals include those who both have attained age 55 and are receiving benefits from the Pension Benefit Guaranty Corporation.

Section 35(e) defines ten categories of health coverage that are qualified health insurance, including coverage under a COBRA continuation provision (as defined in section 9832(d)).

Section 9832(d)(1) defines a COBRA continuation provision as section 4980B (other than subsection (f)(1) insofar as it relates to pediatric vaccines), part 6 of subtitle B of Title I of the Employee Retirement Income Security Act of 1974 (other than section 609), or Title XXII of the Public Health Service Act.

Section 4980B requires group health plans (with some exceptions) to make COBRA continuation coverage available to qualified beneficiaries in connection with the occurrence of qualifying events. A bankruptcy proceeding under Title 11 of the United States Code with respect to an employer that, but for the COBRA continuation coverage required under section 4980B, results in a loss of coverage is one of the qualifying

events. Retired employees and their spouses, dependent children, and surviving spouses can be qualified beneficiaries in connection with a qualifying event that is the bankruptcy of the employer.

Section 54.4980B-7 of the Miscellaneous Excise Tax Regulations sets forth the rules for how long a plan must make COBRA continuation coverage available. In connection with a qualifying event that is the bankruptcy of the employer, under Q&A-4(e) of §54.4980B-7 a plan may be obligated to make COBRA continuation coverage available to the retired employee until the retired employee's death, and, in the case of any other qualified beneficiary, until the earlier of the qualified beneficiary's death or the date that is 36 months after the retired employee's death. However, under Q&A-1 of §54.4980B-7, the obligation to make COBRA continuation coverage available can end on various earlier dates, including the date that the employer ceases to provide a group health plan to any employee.

Under Q&A-1 of §54.4980B-5 of the regulations, the coverage that must be made available to a qualified beneficiary is the same coverage that is made available to similarly situated nonCOBRA beneficiaries.

Section 54.4980B-9 of the regulations provides rules under which a buyer of assets can succeed to the obligation to make COBRA continuation coverage available to certain qualified beneficiaries of the seller. This obligation will not be imposed on the buyer earlier than the date the seller ceases to provide any group health plan to any employee.

Q&A-1 of §54.4980B-6 of the regulations requires a group health plan subject to COBRA to allow a qualified beneficiary to elect COBRA continuation coverage within an election period that cannot end earlier than 60 days after the later of (1) the date the qualified beneficiary loses coverage on account of a qualifying event or (2) the date the qualified beneficiary is notified of the right to elect COBRA continuation coverage.

Under Q&A-4 of §54.4980B-6, a qualified beneficiary may, until the end of the election period, revoke any waiver of COBRA continuation coverage made during the election period.

There is nothing in the facts to indicate that any of the exceptions to the COBRA continuation coverage requirements of section 4980B applies to any group health plan maintained by the Employer for any relevant period described in this ruling. The bankruptcy proceeding resulted in the termination of the group health coverage provided by the Employer to its nonunion retirees. Thus, the bankruptcy proceeding is a qualifying event giving retired employees, their spouses, surviving spouses, and dependent children covered under the retiree plan immediately before the termination of its benefits, the right to elect COBRA continuation coverage. The right can continue for the lifetime of the retiree and, for other qualified beneficiaries, until 36 months after the death of the retiree. Although the right could end earlier upon the date the Employer

ceases to provide a group health plan to any employee, the obligation could have been thereafter imposed on the Buyer.

The obligation of the Employer (and the potential obligation of the Buyer as successor employer) under section 4980B is to make available to the retired employees and other qualified beneficiaries the same coverage that is made available to similarly situated nonCOBRA beneficiaries. Option 2 clearly does not satisfy this standard. Coverage that does not satisfy the requirements of section 4980B can nevertheless be considered coverage provided pursuant to section 4980B if the coverage is made available solely to individuals to whom an obligation to make COBRA continuation coverage available exists or is made available as an alternative to COBRA continuation coverage or in settlement of an obligation to make COBRA continuation coverage available. Under the facts described, the Employer's making Option 2 available to retirees and their family members and surviving spouses was in settlement of the Employer's obligation (and of any potential obligation of the Buyer) to make COBRA continuation coverage available to them. In addition, the only individuals eligible to elect Option 2 are those to whom the Employer owed the obligation of making COBRA continuation coverage available.

In general, it is inconsistent with the policies reflected in the rules of section 4980B to allow an effective waiver of an individual's future rights as a potential qualified beneficiary before a qualifying event for that individual has occurred. If such a waiver could be effective, a plan could avoid any COBRA continuation coverage obligation merely by requiring all enrolling participants to waive all COBRA continuation coverage rights as a condition of enrollment. The regulations acknowledge the right of a qualified beneficiary to waive the right to COBRA continuation coverage once a qualifying event has occurred, and the right to revoke that waiver before the end of the election period. Although the regulations do not acknowledge the possibility of a waiver before the right to elect COBRA continuation coverage arises, we believe that in limited circumstances such a waiver can be effective. If a waiver is entered into shortly before and in anticipation of a qualifying event, with the waiving party being fully informed of the right to COBRA continuation coverage in connection with the anticipated qualifying event, then the waiver is not contrary to the policies reflected in section 4980B. In these limited circumstances in which an anticipatory waiver of COBRA continuation coverage is not contrary to public policy, the provisions in the regulations allowing revocation of the waiver until the end of the election period apply. Thus, although an individual may effectively waive some or all of the individual's COBRA continuation coverage rights shortly before the occurrence of the qualifying event that gives rise to those rights, under the Code provisions and regulations relating to COBRA continuation coverage the individual may revoke that waiver at any time before the end of the COBRA election period. However, the effect of other law (such as law under Title 11 of the United States Code) may affect the individual's right under the Code to revoke the waiver.

In the facts described, the Retiree Committee negotiated the termination of retiree health coverage and the terms of Options 1 and 2 after the bankruptcy

proceeding commenced but before it had resulted in a loss of health coverage for the retirees, and thus before a qualifying event had occurred. Neither the terms of Option 1 (because of its limited duration) nor the terms of Option 2 (because the coverage was not necessarily the same as that provided to similarly situated nonCOBRA beneficiaries) satisfies the requirements for COBRA continuation coverage. The agreement by the Retiree Committee to accept that coverage in lieu of the coverage required under section 4980B was an effective waiver of the retirees' COBRA continuation coverage rights. The Code and the regulations alone would not have prevented an individual subject to the agreement negotiated by the Retiree Committee from revoking that waiver at any time before the end of the COBRA election period. However, applicable law under Title 11 of the United States Code may have prevented such a revocation from taking effect.

The lack of continuing sponsorship by the Employer (or by the Buyer) of the trust providing Option 2 does not necessarily defeat the characterization of Option 2 as being provided pursuant to the requirements of section 4980B. Under these circumstances, the Employer intended to dissolve and wished to transfer assets to the Buyer free of any COBRA obligations. It was not unreasonable for the Retiree Committee to have negotiated a settlement of their rights to COBRA continuation coverage under which the source of the coverage would be a trust unrelated to the Buyer and under which sponsorship by the Employer would be transferred to a party unrelated to any employer that might conceivably have an obligation to make COBRA continuation coverage available to the retirees and other beneficiaries. Because there was a legitimate obligation to make COBRA continuation coverage available and Option 2 appears to be a legitimate means for settling that legitimate obligation, the lack of continuing sponsorship by an entity that has an obligation to make COBRA continuation coverage available does not defeat the characterization of Option 2 as coverage provided pursuant to the requirements of section 4980B.

Coverage provided pursuant to the requirements of section 4980B is coverage provided under a COBRA continuation provision within the meaning of section 9832(d) even if the coverage does not satisfy the requirements of section 4980B. Such coverage is also qualified health insurance within the meaning of section 35.

The regulations prescribe a minimum period for allowing an individual to elect COBRA continuation coverage. A plan is free to allow qualified beneficiaries a longer period to elect COBRA continuation coverage if it wishes to.

Accordingly, based on the information presented and representations made, we rule as follows:

1. Coverage under Option 2, while not satisfying the requirements of section 4980B, is qualified health insurance for purposes of section 35 with respect to those individuals to whom the Employer had the obligation to make COBRA continuation coverage available under section 4980B.

2. Coverage under Option 2 will not cease being qualified health insurance under section 35 merely because sponsorship of the trust providing Option 2 is transferred to an employee association so long as the sole purpose of the trust remains the provision of health benefits to the Employer's retired employees and their family members and surviving spouses.

3. Allowing retirees or surviving spouses to elect Option 2 beyond the end of the minimum period required under section 4980B for allowing qualified beneficiaries to elect COBRA continuation coverage will not affect whether Option 2 is qualified health insurance under section 35.

Except as specifically ruled, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. No opinion is expressed about how the Employee Retirement Income Security Act of 1974 applies to the facts described in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Harry Beker
Chief, Health and Welfare Branch
Office of Division Counsel/Associate Chief
Counsel
(Tax Exempt & Government Entities)

cc: