

# **EMPLOYEE BENEFITS IN MERGERS & ACQUISITIONS**

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# M&A EMPLOYEE BENEFITS ISSUES PRESENTATION AGENDA

- Structure of Transaction (stock vs. asset acquisition)
- Typical (and not so typical) Benefit Liabilities
- Post-Closing Benefits Options and Issues
- Purchase/Sale Agreement: Issues and Options

# STRUCTURE OF TRANSACTION

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## ■ **Stock Acquisition**

- Target's benefit plans transfer by operation of law
  - Parties can negotiate different result
  - Target employees may participate in plans of parent or other affiliate
- Buyer acquires compliance risks

## ■ **Asset Acquisition**

- Less typical for benefit plans to transfer to buyer
- Buyer needs to offer alternative benefits
- Parties can negotiate transfer of particular plans, or portions of plans

# **BENEFIT LIABILITIES**

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# CHECKLIST OF BENEFIT LIABILITIES

- Sample checklist items:
  - Employee census information:
    - Name/SSN/DOB/DOH
    - Comp and benefits details
  - Employment contracts, written or otherwise
  - Plan documents and all amendments
  - Summary Plan Descriptions and Summaries of Material Modification
  - Insurance and group annuity contracts
  - Most recent IRS Determination or Exemption Letters
  - Trust documents and trust statements
  - Collective bargaining agreements
  - Funding and other financial information, including but not limited to valuation reports, withdrawal liability for any applicable plans
  - Details of all EPCRS and other corrective actions for operational or form defects

# CHECKLIST OF BENEFIT LIABILITIES (CONT.)

- Sample Checklist Items (continued)
  - Forms 5500, with all schedules, audits and actuarial reports
  - Vendor contracts
    - HIPAA business associate agreements
  - All claims and appeals files
  - Enrollment materials: communications and sample forms
  - COBRA, HIPAA and all other legally required notices and certificates
  - Detailed records of COBRA qualified beneficiaries and status
  - Other employee communications
  - Employee manual or handbook
  - All policies for vacation/PTO/leave
  - Severance pay plans, policies, individual agreements and unwritten practices
  - Committee minutes, 408(b)(2) efforts, other governance matters

# BENEFIT LIABILITIES FOR TAX QUALIFIED RETIREMENT PLANS

- Defined Benefit Plans
  - Underfunded? Liability for plans of other members of target's controlled group?
  - Union multiemployer plan withdrawal liability
  - PBGC premium and reporting obligations
- Plan document timely updates



# TAX QUALIFIED RETIREMENT PLANS (CONT. OF BENEFIT LIABILITIES )

- Plan Operations
  - Follow plan terms
  - For 401(k) plans: Timeliness of remittance of employee contributions
  - Testing
  - Compliance with legal operational requirements – e.g. loans or distributions
  - Self-audit and EPCRS activity v. IRS audits or CAP penalties
- Governance and fiduciary performance
  - Prohibited transactions or fiduciary breaches
  - Plan fees
  - Reporting and disclosure obligations

# BENEFIT LIABILITIES FOR HEALTH, WELFARE AND FRINGE PLANS

- Plan Operations
  - ERISA claims and other requirements and compliance with plan terms
  - Health care reform requirements
  - Required notices and communications
- Nondiscrimination Testing
  - Medical, cafeteria, group life, dependent care FSAs and adoption assistance plans
- 4980H Rules
- Retiree Medical Plans
  - Ability to amend or terminate
- PTO/Vacation/Sick Leave Policies
  - Financial liabilities
  - Paid out or transferred to Seller
- Severance Plans, Individual Agreements and Other Commitments
  - Will transaction trigger liabilities? For Buyer and/or Seller?

# OTHER BENEFIT LIABILITIES ISSUES

- For All Plans: identify liabilities created by planned acquisition
  - Change of control or like provisions:
    - Springing accruals/benefits
    - Automatic or accelerated vesting
    - Springing funding obligations
  - Employment agreement commitments

# BENEFIT LIABILITIES FOR NONQUALIFIED EQUITY & LIKE PLANS

- SERPs/Excess Plans/Individual Arrangements
- Compliance with 409A
  - IRS self-correction program/activity
  - Commitments to gross up participants?
- Top Hat Plans
  - Realistic case for top hat status?
  - One time top hat filing completed?
- Funding status – Rabbi Trusts? Insurance?

# TAX CONSIDERATIONS OF BENEFIT LIABILITIES

- Code Section 162(m)
  - Identifying covered employees
  - Exception for qualifying performance based pay
- Code Sections 280G & 4999
  - Shareholder approval exception
- FICA Restart
  - Successor employer rule
  - Statutory merger

# **POST-CLOSING: BENEFITS OPTIONS & ISSUES**

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# POST-CLOSE BENEFITS STRUCTURE: GENERALLY

- Buyer Needs to Consider
  - Whether to assume particular plans
  - How to deliver benefits to acquired employees if it doesn't assume plans
  - Big factors include
    - Costs/degree of funding
    - Compliance/taint
    - Whether plans fit into Buyer's existing benefits culture
    - Testing implications
  - Whether to require termination of plans pre-closing
  - Required transition efforts
- Seller needs to consider
  - Buyer's above requests
  - Seller requests to protect transferred employees
  - For plans that aren't transferred – terminate/amend?

# TAX-QUALIFIED RETIREMENT PLANS – POST-CLOSE BENEFITS STRUCTURE

- General Concerns
  - Funded status
  - Taint/compliance status
  - Testing status post-closing
  - 411(d)(6) protections



# TAX-QUALIFIED RETIREMENT PLANS – (CONT. OF POST-CLOSE EB STRUCTURE)

- Defined Contribution Plans (e.g. 401(k) Plan)
  - Seller retains plan
    - Rollover
    - Loans
  - Seller transfers plan or portion of plan
  - Seller terminates plan

# HEALTH, WELFARE AND FRINGE PLANS – POST-CLOSE BENEFITS STRUCTURE

- Stock acquisition
  - Target's plans typically continued for short term
  - Buyer can assimilate employees into Buyer's benefits culture over time
- Asset acquisition
  - Clone plans
    - Continuation of comparable or same benefits for employees
    - Significant stand up effort
    - Legally new plans of buyer based on terms of Seller's plans
  - Force employees into Buyer's plans
- FSAs
  - Short year
  - IRS sanctioned alternatives
- MEWAs

# POST-CLOSE COBRA OBLIGATIONS

- COBRA in Stock Acquisition: None
- COBRA in Asset Acquisition
  - Seller maintains any plan = Seller
  - Seller does not maintain plan = Buyer if successor employer
  - Parties can contract differently but liability if other fails to perform

# NONQUALIFIED PLANS – POST-CLOSE BENEFITS STRUCTURE

- Distributions Triggered?
  - Stock deal = no separation
  - Asset deal = separation unless parties agree otherwise
- Change in Control
  - = 50% stock (30% within 12 months), 40% of assets or majority of Board
  - If CiC, plan terms may require payout
  - If CiC but plan terms do not require payout, sponsor of plan post-close can terminate plan and payout benefits to affected employees
- Assign Plan
  - If plan survives closing, parties can assign responsibility to Buyer or Seller
  - If Seller retains plan, Seller needs Buyer to communicate future separations
- Release/Waiver of Seller by Employees

# **PURCHASE/SALE AGREEMENT: ISSUES AND OPTIONS**

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# TYPES OF BENEFITS PROVISIONS IN PURCHASE/SALE AGREEMENT

- Seller Representations
- Seller Pre-Closing Covenants
- Closing Covenants
- Transition Services Agreement

# SELLER REPRESENTATIONS

- Seller Reps
  - Employees
  - Plans
  - Documents, communications, filings, Etc.
  - Various compliance representations – ERISA, Code, PTs, Funding, Reporting, Etc.
  - Absence of audits, investigations, examinations, legal actions
- Negotiation Issues
  - Seller discloses all plans or only material plans?
  - Seller commits to comprehensive disclosure of everything or only requested items?
  - Material or absolute compliance?
  - Disclosure of all problems or only known problems?
  - Representations cover only Target plans or all Seller plans?
  - Catch-All representations/warranties

# SELLER PRE-CLOSING COVENANTS

- Seller Covenants re Period Prior to Closing
- Affirmative Acts
  - Spin-off or create new plans that can be assumed by Buyer
  - Separate vendor or insurance arrangements so that Buyer can assume contract
- Commitments to Refrain from Certain Acts
  - No change in plans, benefits, compensation
  - No creation of new benefit plans or compensation arrangements
  - No movement of employees from one plan to another
  - Carve outs?
    - Changes already contracted
    - Changes already announced
    - Changes required by law
    - Changes in accordance with ordinary course of business



# BUYER AND SELLER COVENANTS

- Buyer and Seller Closing Commitments
  - Specify which party takes which ongoing plans and liabilities
    - Plan by plan
  - Specify whether all of a plan's assets and liabilities move:
    - Who takes retirees and deferred vested former employees?
  - Specify who satisfies severance obligations
    - Seller covers severance costs triggered by sale?
    - Buyer assumes future severance obligations?

# BUYER AND SELLER COVENANTS (CONT.)

- **Special Circumstances**
  - Special FSA accommodations?
  - Commit that there won't be a separation from service for NQDC plan purposes?
- **Post-Close Buyer Commitments**
  - Commitment to maintain benefits for period of time
  - Commitment to give service credit for time with Seller

# TRANSITION SERVICES AGREEMENT

- Buyer needs Seller to expressly commit to provide all needed transition services
  - Payroll services
  - Administrative or recordkeeping services
  - Assign contracts or relationships or negotiate commitments from vendors
- Seller should avoid inadvertently stepping into benefits outsourcing business
  - Should expressly avoid any fiduciary role/function for Buyer's plan
  - Should cap liability and acquire indemnity protection from Buyer
  - Obtain termination right if Buyer fails to maintain plans as clones of Seller's plans

# Q & A





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