10 Tips for Payroll when going through a Merger or Acquisition

Speaker Information

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Agenda

- Positioning Payroll
- Terms and Definitions
- Social Security and Medicare taxes
- Withholding and Reporting
- Federal Unemployment
- State Unemployment
- Wage Assignments
- Wage and Hour
- Common Pay Master or Agents

Positioning Payroll

- When your company is planning a merger, acquisition or divestiture, the payroll department should try to focus on its key responsibilities. Since payroll might not initially receive all the necessary information to make adequate preparation, take the initiative and ask management to include payroll in the initial discussions of the transaction. Let management know about the various responsibilities that fall under the direction of the payroll department and the potential liabilities and their tax ramifications depending on how management structures the merger, acquisition or divestiture. The same concepts governing mergers and acquisitions also apply when a company reorganizes its corporate structure or spins off from the parent company. The information you provide your senior management team may have a short-term or long-term impact on the pay-roll department and your company. Substantial savings may be generated through a complete analysis of state unemployment insurance implications.

Terms and Definitions

Acquisition - One entity gains possession or control of another commercial interest or entity.

Asset Purchase - A type of acquisition where only assets are purchased and the predecessor retains its Federal Employer Identification Number (FEIN).

Divestiture A transaction in which there is a transfer or disposal of commercial interests (such as stock in a corporation).

Successor An entity or corporation that takes on the burdens of a previous entity or corporation through merger, acquisition, or other means of succession.

Predecessor An entity or corporation that comes before another entity or corporation in time; something that has been succeeded by another. In an acquisition, the predecessor is the entity being acquired by the successor.

Predecessor Employer The predecessor employer is the organization that owned the assets of the previous employer before the transaction.

Reorganization The financial transaction in which there is a reconstruction of a business concern.

Spin off A transaction in which there is a distribution of particular assets and/or stock of another company by a business to its stockholders. It includes the new company created by such a distribution.

Terms and Definitions

Statutory Merger or Consolidation - A transaction in which there is a union of two or more commercial interests or corporations; a corporation is absorbed (called the acquired corporation) by another corporation (called the surviving corporation). The acquired corporation is dissolved and its FEIN becomes invalid. The Internal Revenue Service (IRS) has ruled that a statutory merger or consolidation will not result in a predecessor-successor relationship. Consider the surviving corporation as the same taxpayer and employer as the acquired corporation (Rev. Rul. 62-60, and Rev. Rul. 2004-53). Employees of Company A who become employees of Company B as part of the transaction will receive

inherits any outstanding tax liabilities associated with the predecessor. To complete the transaction, the predecessor must obtain approval for the transaction from each predecessor shareholder. The resulting structure after such a transaction will leave the successor holding the predecessor as a subsidiary. Since the predecessor remains intact as a subsidiary of the successor, the predecessor's FEIN remains the same. One significant drawback to a stock purchase is that, unlike a merger, the law does not provide a means of cashing out large numbers of dissenting shares under a stock purchase. Many companies are unwilling to have minority shareholders, which could occur if a predecessor's shareholder refused to agree to sell his or her shares to the successor on the offered terms. As a result, a stock

Private Equity - A source of investment capital from wealthy individuals and institutions for the purpose of investing and acquiring equity ownership in companies.

Social Security and Medicare taxes

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- A successor employer can typically credit the social security wages and taxes paid by the predecessor during the current calendar year when calculating its social security tax liability for employees who continue employment with the successor immediately after the acquisition. Thus, the social security employment tax liability is reduced in the year of the acquisition for the successor.
- A successor employer will use the Medicare wages paid by the predecessor during the current calendar year when calculating when the employee's Medicare wages exceed $200,000 to determine when the employee is subject to the additional Medicare tax.

Withholding Reporting

- When an employer ceases paying wages, IRS regulations require expedited reporting of Form W-2 to the SSA and the employees. For the quarter during which wages have ceased to be paid, the final Form 941 is due at the end of the month after the end of the quarter. The employee’s Forms W-2 are due to the employees no later than the due date for Form 941 and the forms must be filed with SSA one month later.

Withholding and Reporting

- When faced with a merger or acquisition, federal, state, and local income tax withholding and reporting can differ from typical situations, depending upon the type of merger or acquisition.
- Income Tax
- Federal Income Tax (FIT)Employers are typically required to withhold federal income tax from the wages they pay to employees. To determine the value of income tax to withhold from an employee's wages, the employer should have the employee complete Form W-4, Employee's Withholding Certificate. An employer failing to withhold federal income tax from its employees' wages may be subject to both civil and criminal penalties.
- State Income Tax (SIT)In addition to federal income tax, most employers are required to with-hold state income tax from their employees' wages.
- More than 40 states have a state income tax and require withholding from wages to collect it. While a few of those states still allow employers to use the employee's federal Form W-4 to calculate state income tax withholding, most now have separate state withholding allowance certificates that must be used. Pennsylvania does not have a state withholding allowance certificate nor does it permit any withholding exemptions as it has a flat tax rate. An employer failing to withhold state income tax from its employees may also be subject to both civil and criminal penalties.
- Local Income Tax (LIT)
- Many states have localities (cities, counties, school districts and other governmental units) that also require employers to withhold local taxes from their employees' wages or pay an employment tax on employees wages. The states with some form of local income tax withholding requirements include Alabama, Colorado, Delaware, Indiana, Kentucky, Maryland, Michigan, Missouri, New York, Ohio, Pennsylvania, and West Virginia

Withholding and Reporting

- Form W-2Each employee’s wages and taxes are reported annually to the employee and the Social Security Administration (SSA) on Form W-2, Wage and Tax Statement (Appendix P-31). The W-2 is provided to the employee no later than the last day of January for the prior calendar year. The information is sent to the SSA no later than the last day of February (when filing paper forms) or the last day of March (when filing electronically). Employers are required to file Forms W-2 by with SSA January 31. Most states have now moved up their filing dead-lines for Forms W-2 to January 31 to combat tax return fraud. Only Hawaii and New Jersey have deadlines in February (the 28th and 15th, respectively). A report with the W-2 totals must be produced and retained when the file of W-2 forms is created for electronic filing .If the filing date falls on a Saturday, Sunday, or holiday, the return is due on the next business day.
- Ceasing to pay wages
- When an employer ceases paying wages, IRS regulations require expedited reporting of Form W-2 to the SSA. For the quarter during which wages have ceased to be paid, the final Form 941 is due at the end of the month after the end of the quarter. The employees’ Forms W-2 are due to the employees no later than the due date for Form 941 and the forms must be filed with SSA one month later. An extension of the expedited date for filing Forms W-2 with SSA is automatic when the electronic filing specifications have not been released for the year.

Withholding and Reporting

- Asset Purchase - A predecessor-successor relationship must exist for the resulting entity (successor) to claim the social security tax and FUTA wage base credits from the predecessor. An employer that qualifies as a successor employer may take credit for wages paid in the same calendar year to any of its employees who were working for the predecessor immediately prior to the acquisition. This is true for social security and FUTA wages paid to predecessor employees who continue to work for the successor. Thus, employee and employer taxes are reduced for the successor in the year of the acquisition.
- Multiple successors - If multiple successors acquire separate business units from the predecessor, they may each take a credit for wages previously paid by the predecessor for employees who continue to work for the successor. A credit for wages may also be available for multiple successors in a situation where a single employee who previously worked for the predecessor continues employment with two separate successors
- Single successor - If a single successor acquires more than one predecessor and an employee worked for more than one of these unrelated entities (or predecessors) during the year of the acquisition, the successor may only take credit for wages paid by the predecessor who had employed the employee immediately prior to the acquisition.
- Asset Acquisition The IRS has provided two reporting alternatives for the completion of Forms W-2 and 941 in an Asset Acquisition:• Standard• Alternate Standard procedure
- Predecessor The predecessor reports on Form W-2 the wages and other compensation paid to its employees and any withheld employment taxes. If the predecessor continues in business, it must furnish Form W-2 to employees by January 31 of the year following the year wages were paid. On Form 941, the predecessor reports the wages and other compensation paid to its employees, withheld employment taxes and employer taxes

Federal Unemployment

- Most employers pay both a Federal and a state unemployment tax. FUTA is an employer tax and is not deducted from the employee's wages. The employer reports this tax on Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return.
- The FUTA tax rate is 6.0%. The federal tax applies to the first $7,000 of employee compensation during the year. State taxes may be based on higher wage bases and on higher or lower tax rates. Employers who pay their state unemployment taxes in full and on time can take a credit against their FUTA tax for amounts they paid into state unemployment accounts. This credit cannot be more than 5.4% of taxable wages even when the state rate exceeds 5.4%. If employers are entitled to the maximum 5.4% credit, the FUTA tax rate after the credit is 0.6%.

Federal Unemployment

- Options under a Statutory Merger or Consolidation
- File a consolidated Form 940 for the calendar year in which the merger occurred. Note the federal unemployment tax deposits made by the absorbed entity using its EIN on the consolidated return and inform the IRS of the EIN under which the deposits where made. In addition, take applicable state credits and report state contributions reported by the absorbed entity.
- Federal wage base credits - When a company in a statutory merger or consolidation absorbs a business, the resulting entity is considered the same continuing entity for FUTA purposes. Therefore, FUTA wage base credits are transferred from the absorbed entity to the resulting entity and the applicable maximum wage base is computed on the combined total wages. Liabilities for unpaid federal unemployment taxes are also transferred to the resulting entity.
- When the resulting entity completes its Form 940, it should credit any timely state unemployment tax payments deposited by the absorbed entity against the federal unemployment taxes for the resulting entity, up to the maximum credit allowed.
- Options under a Stock Purchase
- Since in a stock purchase the entity continues in the exact same for-mat under the new ownership as under the prior ownership, when completing Form 940, transfer the total of employees' wage and tax data into your payroll files. Include quarter-to-date and year-to-date FUTA wage and tax information for active and inactive employees.
- Options under an Asset Purchase
- In a asset purchase, a predecessor-successor relationship must exist for the resulting entity (successor) to claim federal wage base cred-its from the predecessor. An employer that qualifies as a successor employer may take credit for wages paid in the same calendar year to any of its employees who were working for the predecessor immediately prior to the acquisition. This is true for FUTA wages paid to the predecessor's employees who continue to work for the successor. Thus, employee and employer taxes are reduced for the successor in the year of the acquisition.

State Unemployment

- State laws determine the employer's State Unemployment Insurance (SUI) employer tax rates, employee wage bases, and benefit eligibility and amounts. Each state program must conform to certain federal requirements. For example, the Federal Unemployment Tax Act pro-vides the basis for state funding and coverage requirements. This dual federal-state system allows eligible employers in most states to reduce their FUTA tax liability by 5.4% to 0.6% of taxable FUTA wages.
- SUI Overview
- State unemployment insurance taxes are determined in a manner similar to that governing federal unemployment taxes. Employers apply a state assigned unemployment tax rate to the state taxable wages paid to the employee. Under the Federal Unemployment Tax Act, each state's taxable wage base must be at least equal to the $7,000 FUTA wage base for each employee.
- Although the federal unemployment program only requires the filing of an annual federal tax return, state unemployment regulations require quarterly reporting. Employers must also pay state contributions quarterly, and an employer's state unemployment tax rates may vary each quarter depending on unemployment cost factors and funding charges. Withholding unemployment contributions Alaska, New Jersey and Pennsylvania are the only states that require employers to withhold unemployment contributions from their employees' wages; however, the withholding rates are much lower than the employer's contribution rates in those states.

State Unemployment

- Dumping SUTA
- Dumping is the illegal practice of manipulating state UI rates in order to reduce payroll taxes. UI taxes are required to be paid by employers under each state's State Unemployment Tax Act (SUTA). In a typical SUTA dumping scheme:
- • An existing business with a high (poor) experience rating and a high SUTA tax rate forms a new company, • Transfers its employees to the new company, and
- • Then pays unemployment taxes under the new company's lower new employer tax rate (thereby "dumping" the original company's high tax rate). Or, in what is known as a "shell transaction," a newly formed company purchases an existing business with a low experience rating. The low experience rating is then transferred to the newly formed company producing a low SUTA tax rate.
- The SUTA Dumping Prevention Act of 2004 provides that "meaningful civil and criminal penalties" will be imposed on persons who knowingly violate or advise others to violate conforming SUTAs, but does not specify these penalties, leaving the penalties to the states. State UI laws provide the following
- :• Mandatory Transfers - Unemployment experience must be transferred whenever there is substantially common owner-ship, management or control of two employers, and one of these employers transfers its trade or business (including its workforce), or a portion thereof, to the other employer. This requirement applies to both total and partial transfers of business
- .• Prohibited Transfers - Unemployment experience may not be transferred, and a new employer rate (or the state's standard rate) will instead be assigned, when a person who is not an employer acquires the trade or business of an existing employer. This prohibition applies only if the state Unemployment Compensation (UC) agency finds that such person acquired the business solely or primarily for the purpose of obtaining a lower rate of contributions.
- • Penalties for SUTA Dumping - "Meaningful" civil and criminal penalties are imposed on persons "knowingly" violating or attempting to violate the two requirements discussed above.
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Wage Assignments

- Some states will note on the wage attachment form that the wage attachment will continue if a change in ownership occurs. Because of this, you should contact your legal department before continuing to make garnishment deductions not directed to the successor. It is a best practice to have the predecessor notify the court or agency of the employee’s termination by the predecessor and employment by the successor to reduce potential compliance issues. If necessary, ask the court or agency to fax a new order directed to the successor to your office

Wage Assignments

- Child Support

- An employee may go into arrears or default if you do not continue to withhold and pay the child support after an acquisition. Therefore, request a new income withholding order from the State Disbursement Unit. If you are advised by your legal counsel to stop withholding until receiving a new order, notify the employee to make payments directly to the State Disbursement Unit until the new order arrives.

- The federal Office of Child Support Enforcement (OCSE) feels that when one company acquires another, it acquires the legal responsibility to continue to honor the child support withholding orders previously in place. OCSE strongly recommends that you notify the state that issued the order about the acquisition and explain that you are honoring the withholding order for a particular employee. Some states will issue a new withholding order to the new entity if the company's name has changed. Other states will tell you to discontinue withholding. It depends on state law. OCSE strongly urges you to always notify the child support agency so that they'll be able to keep track of where the person is employed and where the withholding is coming from. Also, OCSE strongly recommends as a business practice (it's not a legal requirement), that you always keep your employees fully informed about what you're doing.

- OCSE guidelines state that when companies merge, the resulting employer (new company) takes on the responsibilities of the merging companies. That includes the responsibility to withhold child support from any employees who have an Income Withholding Order (IWO) in place. All child support withholding should continue. But the company should notify the issuing child support agency of the merger and its intent to continue the withholding. Once the issuing agency has been notified, the state child support office may send an amended IWO.

Wage Assignments

- Federal or State Tax Levy
- When a company acquires another company through an asset purchase, the continuation of a federal tax levy depends on how the sale is structured. Contact the applicable state tax agency and ask how they want you to handle the state tax levy. Typically, a new levy can be submitted very quickly. Contact your legal department for further direction
- .Creditor Garnishment
- The Department of Labor's Wage & Hour Division enforces the Consumer Credit Protection Act (CCPA) and ensures that employers don't deduct more for garnishments from their employees' wages than the statute permits. There's nothing in the CCPA that requires the successor in an asset purchase to contact the entity that issued the garnishment order in order to continue withholding. But the CCPA does impose liability for over withholding on the employer. It would be prudent to notify the garnishing authority of the transaction and charge of employer.

Wage and Hour

- If one or more employees are involuntarily transferred from one employer to another employer during the workweek because of a merger, acquisition, or reorganization, does this constitute joint employment so that all hours worked for both employers during the week must be added together to calculate overtime, or are the two employers considered completely disassociated so that each employer may disregard hours worked for the other? Does it matter if the two companies were related prior to the merger, acquisition or reorganization?
- Suppose that the employees of Company ABC are doing the work they normally do for Company ABC. Company DEF buys Company ABC or merges with Company ABC so that we now have Company ABC/DEF. The employees continue to do the work they normally do. If they work more than 40 hours in the workweek, they work overtime and have to be paid overtime. It's not a joint employment situation. There is only one employer. Whether these employers are two completely different companies or two companies that had some sort of relationship prior to the merger is immaterial. Suppose, on the other hand, that the employees are working for Company LMN. Company HJK buys Company LMN, but the employees are placed in a different work situation where they're doing completely different work. In that case we might have a separate enterprise. A particular employer may have, for example, a hotel and a gas station. These have different business purposes. Don't combine them even if someone goes from the gas station and works as a porter in the hotel. But let's say we have several super markets and the employer is purchased by a produce distributor. That would be considered a common business purpose. It would be considered that to be one enterprise. Take it a step further and say it was a farmer who bought these super-markets and he's providing the food. Again, there is a common business purpose.
- Another thing to consider are any existing union con-tracts (CBAs). Check with your legal counsel on this matter.

Common Pay Masters or Agents

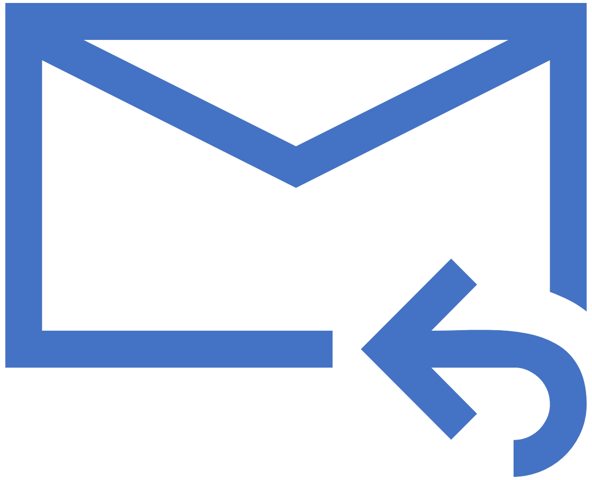
- Common Paymasters and Agents Importance - Despite the general rule requiring each employer to withhold and pay social security tax for employees who work for more than one employ-er, related corporations can reduce that burden considerably by using the common paymaster procedures. In addition, employers using the common paymaster procedures must combine the Medicare wages paid by all employers meeting the com-mon paymaster requirements when determining if the employee has reached the $200,000 threshold for the additional Medicare tax. The agent may reduce the reporting burden when a reporting agent combines employer burden.
- Note, the IRS no longer uses the term Common Pay Agent, agent is what is used now.

Common Pay Master

- Common Paymaster
- Where two or more related corporations concurrently employ one or more employees and pay them through one of the corporations as a common paymaster, the total FUTA, social security and Medicare wages and taxes that must be paid are determined as if the employees had one employer paying all their wages.
- Who is considered related? - To be considered related, corporations must meet one of the following tests at any time during a calendar quarter:
  - • They must be part of a “controlled group of corporations” under IRC §1563, which generally means one of the corporations must own at least 50% of the others’ stock or the same five or fewer persons own at least 50% of the stock of each corporation.
  - • Where a corporation does not issue stock, either 50% or more of the members of one corporation’s board of directors are on the other corporation’s board of directors or hold 50% or more of the voting power with respect to the other corporation
  - .• At least 50% of a corporation’s officers are concurrently officers of the other corporation.
  - • At least 30% of one corporation’s employees are concurrently employed by the other corporation.
- What is a common paymaster? - The common paymaster is a member of a group of related corporations (defined in the previous paragraph) that pays wages to employees working for two or more of the corporations. It is responsible for all payroll records, as well as withholding, depositing, and reporting, for the employees it pays. The common paymaster may pay the employees by cash or with one check or direct deposit or with separate checks drawn on each employer’s account (no other pay medium can be used). Each corporation must separately tax compensation in the form of property provided by the related corporations to an employee

SS and Med and Common Paymaster

- What is concurrent employment?
- To be concurrently employed, an employee must be employed by two or more related corporations at the same time and performing services for each one separately, not just as a group. So long as the employer-employee relationship exists, the fact an employee is working for only one employer at any one time does not destroy concurrent employment status
- Agents that have filed an approved Form 2678, Employer/Payer Appointment of Agent (Appendix P-66), are governed by special Form W-2 reporting rules. Generally the agent should enter its name as the employer in Box c and file one Form W-2 for each employee. However, the agent must file separate Forms W-2 showing the wages paid by each employer to the employee if the agent:• Is acting as an agent for 2 or more employers or is an employer itself and is acting as an agent for another employer. AND• Pays social security wages in excess of the social security wage base ($137,700 in 2020) to an employee. On each Form W-2, the agent should put its EIN in Box b. The employer's EIN should be shown in Box h of Form W-3. In Box c of each Form W-2, the agent should enter the following: • name of agent• agent for (name of employer)• address of agent These reporting procedures for agents do not apply in the common paymaster situation.
- The agent must treat the social security and Medicare wages paid to an employee from each employer separately, and not in conjunction with the wages paid to each employee on behalf of another employer for whom the agent acts. The combined wages paid by the agent are not used to determine if the employee's wages exceed the social security wage base ($137,700 in 2020) or the threshold for the additional Medicare tax ($200,000)



Thank you

- Please submit any questions via email to
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