Overview

In 2008, the Dow Jones Industrial Average had fallen nearly 50%, fueling a widespread economic recession that led to a significant decrease in capital expenditures, corporate lending, and mergers and acquisitions (“M+A”). However, as the economic climate continues to rebound, and credit becomes more readily available, a steady increase in the volume of M+A activity is expected across the U.S. as the cycle of corporate growth turns positive (Figure 1).

Just as the recent history of reductions in workforce added volatility to state unemployment insurance (“SUI”) tax rates, so will future increases in workforce associated with economic improvement and increased M+A activity. Moving forward, both acquiring employers and selling employers must be mindful of how M+A activities might impact their SUI tax rates.

Figure 1: M+A Activity Trend (U.S.)
While many elements are routinely analyzed in contemplation of an M+A transaction, there are unemployment tax issues (which are often overlooked) that should also be considered during the following phased approach to M+A transaction management:

- Due Diligence
- Planning + Design
- Implementation + Compliance
- Post-Implementation

Although the form an M+A transaction takes can impact how SUI tax costs are managed, it is the movement of workforce from one legal entity to another that should be of principal interest to employers. Just as “follow the money” was coined in reference to tracking the financial substance of a series of interdependent transactions, “follow the workforce” is a phrase that can be used to reinforce the importance of employee movement in an M+A transaction and how that movement might impact SUI tax costs moving forward.

While unemployment taxes do not often drive decisions relating to the structure of an M+A transaction, pre-transaction management can result in significant tax cost-savings. This can come in many forms, but may only require a minor change in the contemplated structure making certain not to disrupt other organizational objectives. Changes that may initially appear insignificant can often result in material cost-savings.
The Unemployment System

Because the joint federal-state unemployment system more closely resembles a social insurance program than a tax, it is one of the only employer taxes where the underlying rate can be altered by actions taken by an employer. These actions come in the form of effective unemployment claims management and proactive SUI tax management. This White Paper addresses only one aspect of tax management, the impact of M+A transactions on SUI tax costs. The ability for employers to manage and impact SUI tax rates is no more prevalent than when employers engage in M+A transactions, especially those involving unaffiliated employers.

The average annual SUI tax cost per employee has increased over 70% during the last five years to approximately $535 per employee. Adding to this cost are surcharges, interest assessments, federal unemployment taxes ("FUTA") and related credit reductions, and emerging penalties for non-compliance with “SUI integrity laws.” This necessitates heightened awareness and action on the part of employers, both from a claims management and tax management perspective, as employers play a key role in the unemployment program.

Overview of Federal-State UI System

Each state has its own Unemployment Trust Fund account generally funded by involuntary state unemployment taxes and voluntary contributions. Unemployment benefits are paid from these funds. When the inflow of state taxes is diminished and/or when benefit payments rise, reserve levels are depleted. When reserves are fully depleted, states may borrow from the Federal Unemployment Account in the form of Title XII loans.
A Phased Approach

When undertaking M+A activities, a phased approach can assist in ensuring that all compliance and tax rate risks are assessed and mitigated. Comprehensive unemployment tax management should, at a minimum, follow steps similar to those outlined in Figure 2. Risk management begins immediately upon identification of a potential acquisition target and continues until proper SUI tax rates are assigned and applied to taxable payroll.

Figure 2: The M+A Planning Process

Due Diligence
- Information and data gathering
  - Forms 940 and 941
  - Federal and state tax notices
  - UI tax rates and returns
  - Payroll policies and procedures
  - Past mergers and acquisitions
- Opportunity and risk assessment
  - High SUI tax rates
  - Unpaid employment taxes
  - “Payrolling”

Planning and Design
- Financial modeling and analysis
  - UI tax analysis
  - Successor wage base treatment: social security, FUTA, and SUI
  - Transfers of SUI experience: optional or mandatory
- Organizational and legal structuring

Implementation and Compliance
- Payroll integration
- Compliance filings
  - Accounts registered and closed
  - Status changes
  - Account reconciliations
  - Benefit charge details
  - Payroll detail
  - Transfers of experience
  - Wage base transfers

Post-Implementation
- Realization of desired outcomes
  - Ensures timely processing of compliance filings
  - Coordination with state agencies to address inquiries
  - Confirm accuracy of successor tax rate calculations
  - Protest tax rate discrepancies
  - Verify tax accounts have been closed
  - Avoids the inefficient use of future resources
  - Shortens the time needed for accruing/budgeting revised tax rates
Due Diligence sets the stage for all of the phases that follow. By gathering appropriate data from a selling employer, an acquiring employer will be better suited to assess unemployment tax opportunities, mitigate unemployment tax rate risk, and ease the payroll integration process.

**Information and Data Gathering**

An acquiring employer has a responsibility to request and obtain sufficient data from a selling employer to assess SUI tax rates, organizational structure and current and past payroll practices.

Should concerns materialize, additional information should be obtained to become comfortable with the level of exposure. In addition, data gathered can be used to assess successor liability for any delinquent unemployment taxes for which the acquiring employer may be liable.

**Assessment of Opportunities and Risks**

Once data is gathered, it must be analyzed to further assess unemployment tax rate risks and opportunities that might include:

- Benefit of utilizing a selling employer’s lower SUI tax rates (i.e., positive SUI experience)
- Rejecting the selling employer’s higher SUI tax rates (i.e., negative SUI experience)
- Use of wages paid by a selling employer to meet annual wage base limits (i.e., social security, FUTA and SUI) of an acquiring employer
- Recovery of employment taxes associated with annual wage base limits that have been restarted
PLANNING + DESIGN: THE STRATEGY DEVELOPMENT PHASE

Once Due Diligence is completed, planning and design of the most advantageous legal structure for the transaction can begin. The Planning + Design phase must be undertaken with all organizational objectives in mind, not just SUI tax impacts.

Financial Modeling and Analysis

Conducting a SUI tax analysis will allow an acquiring employer to determine if there is a requirement to incorporate the experience of a selling employer into post-transaction rating calculations. Such an analysis also allows the acquiring employer to quantify the financial impact such a transfer of experience might have on future SUI tax costs. For M+A transactions that may have significant financial impacts or are more complicated or unique, this may require obtaining guidance from state workforce agencies via a “pre-clearance” letter. The analysis permits the acquiring employer to assess:

- Post-transaction SUI tax rates
- Available transfer of experience options
- Timing of post-transaction SUI experience transfers based on the effective date of the transaction
- Method used to transfer SUI experience (wage detail vs. pro rata)
- Use of voluntary contributions to reduce SUI tax rates
- Impact on joint accounts

Organizational and Legal Structuring

An optimally structured transaction can result in significant SUI tax cost-savings while preventing potentially negative consequences. The language used in the acquisition agreement can also have significant financial implications to the parties. Provisions may influence:

- Acquiring employer’s ability to access selling employer’s payroll records (e.g., for taxable wage base continuation)
- Selling employer’s acquiescence to the transfer of experience, if desired by acquiring employer
- Identification of payroll integration responsibilities of each party (including transition services agreements)
- Protection against becoming responsible for the payment of undisclosed, contingent, or delinquent SUI tax liabilities of the selling employer
Strategic Deep Dive: Transfers of Experience

When an M+A transaction occurs, whether through a stock acquisition, asset acquisition, statutory merger/consolidation, divestiture, or internal realignment of workforce, the employers involved must notify the applicable state workforce agencies of the transaction. This allows the state workforce agencies to apply the proper “transfer of experience” provisions to the transaction. A “transfer of experience” is the assignment of all, or a portion of, SUI tax rating factors from one employer to another. These rating factors include: historic payroll, benefit charges, contributions paid, reserve account balances, and/or any other factor used in the determination of an employer’s SUI tax rate.

Each state has its own specific requirements and the burden is on employers to have an understanding of all compliance filing requirements and their respective due dates. State workforce agencies have the ability to assess meaningful penalties for non-compliance with these requirements. Penalties can come in many forms, including the assignment of the state’s maximum SUI tax rate, a minimum 2% increase in the assigned SUI tax rate, civil monetary penalties, and/or criminal charges.

Transfers of SUI Experience

Depending on the specific facts and circumstances of each M+A transaction, and the SUI tax provisions of the states involved, states may either require, prohibit, or allow a transfer of unemployment experience (Figure 3). Keep in mind, however, that all states require a transfer of SUI experience in cases where there is substantially common ownership, management, or control (“COMC”) between the employers involved.

M+A REPORTING REQUIREMENTS

The SUTA Dumping Prevention Act of 2004 (the “Act”), P.L. 108-295, requires each taxing jurisdiction to mandate the transfer of SUI experience between two affiliated employers [i.e., those having COMC]. To assist in administering the federal mandate, all state workforce agencies require employers to report movements of workforce from one employer to another when a trade or business (or portion thereof) is transferred, including internal realignments.
For general reference and guidance. Many factors must be considered before a transfer determination can be made.

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In states in which a transfer of experience is optional (i.e., allowed), the acquiring employer may have an opportunity to reduce SUI tax costs. To realize these cost-savings, employers must determine whether or not it is beneficial to transfer experience, taking into consideration immediate and future impacts. If the acquiring employer is not currently liable or will become liable as a result of the transaction, it must also determine whether the post-transaction rate is lower than the new employer rate.

Many states, however, will not allow a transfer of experience if the sole or primary purpose for the transaction is to achieve a reduced unemployment tax rate. As long as adherence to the SUI tax provisions of each state are respected (e.g., compliance documents are filed), and there is a legitimate business purpose for engaging in the transaction, the management of SUI tax rates should be accepted by state workforce agencies.

Transfers of experience can generally be placed into one of two categories, “total” transfers and “partial” transfers, each of which can have distinct impacts on SUI tax rates.

**Total Transfers of Experience**

A total transfer of experience may occur when one employer acquires all, or substantially all, of the trade or business (including workforce) of another employer. If the acquiring employer is a liable employer in the state at the time of the transaction, the unemployment experience of the selling employer is combined with the acquiring employer’s experience (assuming the transfer of experience is elected or required). The state then determines the acquiring employer’s unemployment tax rate based on that combined experience. The effective date of the revised tax rate will depend on the state(s) involved, which may be impacted by the effective date of the M+A transaction.

If the acquiring employer is not liable in the state, the selling employer’s experience will typically be assigned to the acquiring employer’s SUI tax account. The state determines the acquiring employer’s tax rate based solely on the selling employer’s experience (i.e., the selling employer’s rate becomes the acquiring employer’s rate). However, there are exceptions to this general rule.

States vary in their determination of a “total transfer of a trade or business.” Some states use a set percentage of total business being acquired or transferred (e.g., 75%), while others make the determination based on all the facts and circumstance of the transaction.

An acquiring employer should determine whether it is more beneficial to transfer the selling employer’s SUI experience into an existing legal entity with employment (i.e., a liable employer) or utilize a legal entity that is not currently liable, as the results can be materially different.
Partial Transfers of Experience

Some states allow or require a partial transfer of experience when an employer acquires only a portion of a selling employer’s trade or business. There are two methods typically utilized by state workforce agencies to determine the portion of the experience to be transferred:

- Wage Detail or Specific Identification Method (Figure 4)
  The state transfers to the acquiring employer the actual experience attributable solely to the portion of the trade or business unit(s) being acquired from the selling employer. Many states will default to the “pro rata method” below or some other method for determining SUI tax rates if there is no identifiable and segregable component of the selling employer’s business unit being acquired.

- Percent of Experience or Pro Rata Method
  The state transfers to the acquiring employer a pro rata share of the total experience of the selling employer, without regard to the underlying experience of the trade or business unit(s) being transferred. States vary as to the factors used to determine the pro rata share to be transferred (e.g., gross or taxable payroll immediately prior to the M+A transaction.)

Figure 4: Partial Transfer of Experience: “Wage Detail” States

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After a partial transfer, if elected or required, the acquiring employer’s SUI tax rate is calculated using the experience transferred and combined with the acquiring employer’s experience. The selling employer’s rate is then based only on the experience retained.

An acquiring employer can determine its potential cost-savings by forecasting future SUI tax rates utilizing the appropriate partial transfer method. The forecasted rate can then be applied to the anticipated future taxable payroll to obtain a forecasted SUI tax cost. This result can then be compared to the forecasted SUI tax cost assuming the transaction was not undertaken (i.e., a transfer of experience was not elected), again applying the same anticipated future taxable payroll.

A critical consideration in analyzing financial impacts of a mid-year M+A transaction, whether a total or partial acquisition, is the ability to carryover the annual taxable wage base. Opting out of a transfer of experience may preclude an acquiring employer from being able to use the wages paid by a selling employer to meet the annual taxable wage base limits for SUI tax purposes. This can significantly reduce any cost-savings that may otherwise be realized. However, not being able to use the selling employer’s taxable wages to avoid duplication of SUI tax will typically have no impact on the acquiring employer being able to use the selling employer’s wages to meet social security and FUTA annual taxable wage base limits.

**Figure 5: States Allowing SUI Wage Base Continuation without Experience Transfer**

For general reference and guidance. Many factors must be considered before wage base continuation can be determined.

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IMPLEMENTATION + COMPLIANCE: 
THE EXECUTION PHASE

Once the effective date of an M+A transaction has passed, employers must turn focus to executing the strategy developed during the Planning + Design phase. This allows employers to:

■ Take action on transfer of experience options
■ Implement joint account and voluntary contribution opportunities
■ File required compliance documents timely to avoid accusations of “SUTA dumping” and the potential assessment of penalties and/or penalty rates
■ Integrate year-to-date taxable wages paid by the selling employer so that annual taxable wage base limits may be carried over to the acquiring employer
■ Ensure the accurate payment of benefits to claimants
■ Ensure benefit payments are charged to the proper employer

Payroll Integration

Depending on the structure of a transaction, employers may be required to integrate disparate payroll systems. Key integration considerations might include adding employees timely to prevent disruptions in pay, aligning different pay cycles and employment tax deposit dates, and reviewing the ability to carryover year-to-date taxable wage information to prevent duplication of social security, FUTA, and SUI taxes.

Compliance Filings

In each state impacted by an M+A transaction, various compliance documents are required to be filed by both the selling employer and the acquiring employer. The number and type of documents vary based on the nature of the transaction and the state(s) involved. Examples of compliance filings might include account registrations and closures, status change notifications, and transfer of experience documents.

It is during this phase that voluntary contribution opportunities may be available to reduce SUI tax rates. The due dates for making voluntary contributions vary by state, so special attention must be given to assuring contributions are made timely. A voluntary contribution strategy might include a series of steps including:

1) Making a voluntary contribution to reduce an acquiring employer’s SUI tax rate, to the minimum if possible.

2) Opting not to transfer the experience of the selling employer.

3) Having the taxable payroll of the acquired employees applied to the lower SUI tax rate until such time as the acquiring employer’s rate is redetermined based solely on the experience of the acquiring employer.
POST-IMPLEMENTATION: THE FOLLOW-UP PHASE

The Post-Implementation phase is integral to the successful management of SUI tax costs in an M+A transaction and should not be discounted. It allows employers to:

■ Ensure the realization of strategies enacted in prior phases
■ Engage in future M+A transactions without concern for prior non-compliance
■ Update claims management systems for legal entity structure changes
■ Reduce the amount of resources necessary to address future inquiries from state workforce agencies

Compliance Follow-Up

Once state workforce agencies have received the required compliance filings, follow-up is necessary to make certain that desired outcomes are realized. This phase includes such actions as monitoring compliance filings to assure state workforce agencies process the forms properly and timely, addressing state inquiries, and providing additional information on the specific set of facts and circumstances associated with the M+A transaction.

Rate Verifications

Once state workforce agencies have assigned a revised tax rate (i.e., a rate redetermination), employers should confirm that they have been assigned the proper tax rate. This assurance is gained by making certain that the effective date of the newly assigned rate is proper, the appropriate factors from both the selling employer and acquiring employer have been incorporated into in the calculations, and any written protests are submitted timely to the appropriate department within the state workforce agency.
Summary

Each phase of the M+A planning process is key to assuring a successful outcome. There are numerous considerations within a short amount of time, as M+A transactions tend to move quickly, especially if the payroll tax and human resource departments are informed late in the process.

M+A transaction teams are typically made up of legal, tax, operational, and human resource experts. Included in this team should be a representative that understands how structural changes and elections can impact SUI tax rates and associated costs, not just near-term, but long-term as well. Understanding the opportunities and risks within each taxing jurisdiction can prevent unintended consequences and produce significant cost-savings. Each set of facts and circumstances is different, and must be specifically analyzed to produce the most advantageous results.

If annual taxable wage base limits are restarted, either inadvertently or due to data or system limitations, acquiring employers should seek retroactive refunds where statutes of limitations allow.

Employers can actively manage their SUI tax rates in a number of different ways. Although claims management is a continual process and impactful over time; and joint accounts and voluntary contributions can produce significant savings; M+A transactions often provide a mechanism for employers to produce significant cost-savings that can outweigh other SUI tax management strategies.

While this White Paper concentrates on unaffiliated employers, a sizeable portion of M+A transactions involve workforce realignments between affiliated employers (i.e., those with COMC). Although the cost-saving opportunities are not as prevalent with affiliated employers, there are similar compliance requirements, wage base carryover and tax management strategies available.
For more information, go to

www.equifaxworkforce.com
For more information, please contact:
moreinfo@equifax.com
800-888-8277
www.equifaxworkforce.com