ARTICLES

M&A Benefit Due Diligence: Look First or Pay Later

By Keith Fujishige

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2018 was another hectic year for mergers and acquisitions, with a record high of 3,774 deals recorded, globally. Recent survey data indicates this pace of M&A activity is set to continue. While the buying price drives the headlines and focus of these deals, benefit plans are typically largely lost in the shuffle and receive minimal scrutiny during the due diligence process. In fact, it's often the case that a Letter Of Intent (LOI) has already been signed before any detailed review of the employee benefits is undertaken or completed. This is a mistake. Given the potential liabilities involved, much greater focus should be placed on this area especially with the passage of the Affordable Care Act (ACA).

Generally there are two type of structures under which a Merger or Acquisition occurs; either a stock sale or an asset sale. Each has a different effect on the employee benefits plans of the entities involved. In a stock sale the buyer will essentially "own" all assets and liabilities of the seller. This ownership would include responsibility for all liabilities of company sponsored employee benefit plans - past and future. Conversely, in an asset sale the buyer is purchasing individual assets of the seller and decides what liabilities they will assume. In this type of sale, generally, employee benefits liabilities are not taken over.

In late 2017 Applicable Large Employers (ALE's) as defined by the Internal Revenue Service began receiving IRS Letter 226J for violations of the so-called Pay-or-Play violations section of the Affordable Care Act, which was passed into law in 2015. The letters specified penalties ranging from tens of thousands to millions of dollars. Employers were generally given 30 days to respond to the violation allegations in the letter before a demand of payment was made by the IRS.

There are a number of issues that arise from these ALE letters that could lead to significant liabilities in a stock purchase acquisition. Realistically, due diligence should insure that any ACA penalty amounts have been included in the sellers financial statements. Note however, that it took the IRS a full two years to notify companies of Pay-or-Play violations. Given these types of notification delays, the seller may not even be aware that they are subject to a penalty. Depending on the size of the company involved, an acquirer could unexpectedly face a million dollar fine! Also, imagine that you have 30 days to provide specific documentation to the IRS during the turmoil of an acquisition. Lastly, consideration should be made concerning ALE status itself. If the seller believes they do not qualify as an ALE, then additional diligence should be done to insure

control group rules do not apply and that the seller has properly accounted for both Full Time, Part Time, and Seasonal employees.

In a follow-up this article we'll review additional ACA compliance issues that could also result in fines, such as reporting and notices violations.

TAGS:
Employee Benefits