

# Mergers & Acquisitions:

How to Turn  
Benefits M&A yhem  
Into M&A gnificent



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# Mergers & Acquisitions:

How to Turn Benefits M&A yhem Into M&A gnificent

- Co-hosts:

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## Your Presenter Today

Ilene H. Ferenczy, JD, APA, CPC



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## Agenda

- M&A Basics
- M&A Service Crediting Rules
  - Such as They Are
- Case Studies
- Key Takeaways
- Getting the Client to Notify You in Advance of the Transaction



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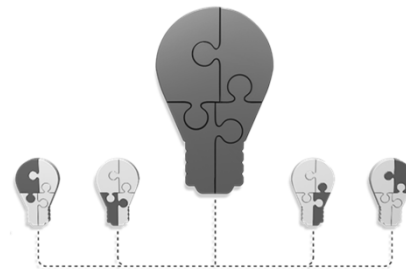
## M&A Basics



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## Understanding the Deal

- Three types of transactions:
  - Stock purchase
  - Asset purchase
  - Merger



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## Stock Acquisition

- Buyer purchases a majority of the shares of stock of the Target
  - If Buyer is a company, Target becomes a subsidiary
  - No change in employment for employees
  - Transaction does not change which benefit plans are sponsored by the Target (except to the extent that the Target participates in the Seller's plans)
    - To get rid of the Target's plans, generally must terminate the plans



## Stock Acquisition

- Concern for the Target (Seller):
  - Plan and employees now need to be aggregated with those of Buyer as controlled group for coverage, nondiscrimination
  - Plan terms may require coverage of other employees of the controlled group (as may the plan of the Buyer)
  - Plan design specifics may no longer work well



## Asset Acquisition

- Buyer purchases all or some of the Target's assets and assumes all or some of the Target's liabilities
  - Stock remains owned by the Sellers: if all assets are sold, company is a shell with just the "consideration" for the transaction
  - Seller/Target remains the sponsor of all plans unless Buyer affirmatively adopts them
  - Employees are terminated by Seller and hired by Buyer (to the extent desired)



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## Asset Acquisition

- Employees will generally be eligible for distributions from the Seller's plan
  - Concern for Seller: partial plan termination
    - Undefined in statute, but applies when a large enough percentage of participants' employment is terminated
    - Rule of thumb: 20% decrease
    - Result: full vesting
    - (Can apply in stock sale setting, too, if employees no longer participate in Seller's plan)



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## Company Merger

- Two companies combine and one of them – or a new company – survives the transaction
- The survivor owns and owes all of what either company owned or owed before the transaction – by operation of law
- The survivor sponsors all employee benefit plans sponsored by either company before the transaction – by operation of law
- Similar in most respects to stock acquisition

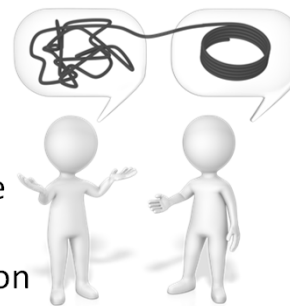


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## Company Merger

- Make sure to understand the transaction and to communicate it to the various service providers
  - Be sure that service contracts survive the transaction
  - Be sure that everyone knows the new structure so that they can help you with the post-transaction transitions



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## Service Crediting Rules in M&A ... Such as They Are



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## When Do the Acquired Employees Meet the Eligibility Requirements?

- Asset acquisition: unless the plan provides otherwise, all employees are new to the Buyer, and no prior service counts
  - Acquired employees must start from scratch to meet eligibility requirements in the Buyer's plan
  - If Buyer wants to include past service, it must amend its plan to do so



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## When Do the Acquired Employees Meet the Eligibility Requirements?

- Stock Acquisition: Not clear re prior service
  - Nothing specific in Code or regulations
  - Scenario #1: Target adopts into the Buyer's Plan
    - Under rules for eligibility service under IRC §410(a):
      - Service prior to the adoption of the plan may be excluded for vesting, but not for eligibility purposes
    - So, does all service count, and the Target employees enter at the next entry date?
    - Does "service" for §410(a) in Buyer's Plan include only service with the controlled group?



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## What Service Counts for Acquired Employees?

- Stock Acquisition: (cont'd)
  - Scenario #2: Target does not adopt the Buyer's plan:
    - Is it clearer that "date of hire" for the acquired employees for purposes of the Buyer's plan eligibility (and its §410(b) testing) is the date of acquisition?
    - Does it make sense that "service" of an employee is dependent on the plan, itself?
  - Many believe that, as there is no clear guidance, "reasonable interpretation" is that DOH is date of transaction in both scenarios



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## When Do the Acquired Employees Meet the Eligibility Requirements?

- Exclusion of pre-stock acquisition service:
  - Argument against:
    - Couldn't have done it if the acquired company adopted a new plan (why should the parent plan be able to do so?)
  - Argument for:
    - “service” means service with this employer, i.e., with the controlled group; service before becoming part of the controlled group doesn't count



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## When Do the Acquired Employees Meet the Eligibility Requirements?

- Merger: Even less clear
  - Nothing specific in Code or regulations
  - Everyone works for the survivor; isn't prior service something “owned and owed” by the merging companies?
    - It seems intellectually dishonest to say that prior service isn't counted
    - But, people make that argument (DOH for merged entity is the date of merge)
  - Is there any way to exclude prior service for former Company A employees of one entity if the only plan to survive the merger is the other entity's plan?

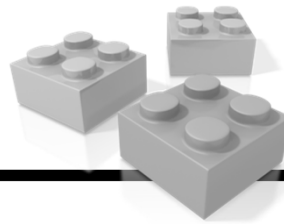


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# Case Study #1

## Simple Asset Acquisition



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## The Facts

- Buyer is buying the assets of Target, effective June 1, 2020
  - Buyer: Has regular 401(k) plan with quarterly entry – 12/31 plan year end
  - Target: Has regular 401(k) plan with monthly entry – 12/31 plan year end
- What will happen if transaction happens with no changes made to any plan?



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## The Answer



- Because this is an asset sale, all Target employees will:
  - Cease to be employed by Target
    - Experience a termination of employment for plan purposes, entitling them to a distribution from Target Plan
    - Possibly (probably?) a partial plan termination that will lead to 100% vesting in Target Plan



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## The Answer



- Because this is an asset sale, all Target employees will:
  - Become employees of Buyer
    - Will enter Buyer Plan on first day of calendar quarter following when they complete eligibility requirements
      - No service with Target counted
    - May roll over benefits from Target Plan to Buyer Plan if Buyer/plan permits



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## What If ...?

- Buyer wants former Target employees to participate in its plan immediately?
  - Amend plan to permit former Target employees to participate immediately (or on entry date following transaction); or
  - Amend plan to permit employees acquired through a company transaction as defined in IRC §410(b)(6)(C) to enter immediately (or on entry date following transaction); or
  - Amend plan to provide that past service with Target counts for eligibility; people will enter July 1 if eligible (for eligibility only or vesting, too?)

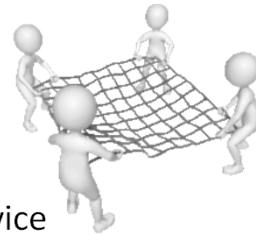


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## What if ...?

- Buyer Plan is a safe harbor 401(k) plan?
  - If acquired employees enter normally, no problem
  - If amending plan to grant past service or change eligibility, no problem: it's okay to amend a safe harbor plan mid-year to let in a new group of employees (be sure to provide notice)



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## What if ...?

- Target Plan was a safe harbor 401(k) plan?
  - Who cares? The employees terminated employment and are eligible for distribution from Target Plan
  - No need to terminate the plan or take other action to pay out employees who left as part of transaction



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## Big Takeaway

- From Seller's perspective: Asset sale is just a big termination of employment by a bunch of folks
  - Partial plan termination concerns
- From Buyer's perspective: We just hired a bunch of folks



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## Case Study #2

### Simple Stock Acquisition



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## The Facts



- Buyer is buying 100% of the stock of Target, effective June 1, 2020
  - Buyer: Has regular 401(k) plan with quarterly entry – 12/31 plan year end
  - Target: Has regular 401(k) plan with monthly entry – 12/31 plan year end
- What will happen if transaction happens with no changes made to any plan?



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## The Answer (?)

- Not enough facts ...
- What we do know:
  - Target becomes a Subsidiary of Buyer and part of its controlled group
- Buyer Plan
  - If it includes all employees of controlled/affiliated service group, Subsidiary employees will be eligible to enter ...
  - When? What service is included?



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## The Answer (?) – (cont'd)

- Not enough facts ... What do the plans say?
- Target (i.e., Subsidiary) Plan
  - If it includes all employees of controlled/affiliated service group, Buyer (i.e., the parent) employees will be eligible to enter ...
  - When? What service is included?
- Problem: if plans do not read correctly, all employees will be eligible to be in both plans!



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## So, the First Inquiry Is Always: What Do the Plans Say?

- You need to follow the terms of the plans, regardless of issues that arise when you do ...



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## You Get More Facts:

- Buyer Plan provides: employees acquired through company acquisition are excluded during §410(b)(6)(C) transition period. After that, they are eligible when they complete the six-month eligibility requirement, not including service with Target
- Target Plan provides: employees who become part of its controlled group through acquisition are excluded



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## Excluding People Raises §410(b) Concerns

- Issue: A group of employees is excluded
  - When a plan excludes an employee group, it must meet §410(b) (i.e., ratio percentage test, average benefit percentage test, QSLOB rules)
- When a plan is involved in a company transaction, the §410(b) problem can arise immediately after the transaction happens



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## What's With This §410(b)(6)(C) Thing?

- (“I never understood that, did you ....?”)
  - Here’s the set-up:
    - Buyer’s Plan excludes the acquired employees
    - When a plan excludes an employee group, it must meet the coverage rules of §410(b) (i.e., ratio percentage test, average benefit percentage test, QSLOB rules)
    - If the Buyer’s Plan cannot meet coverage rules, it’s disqualified as of the acquisition
  - That’s not practical!



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## What's With This §410(b)(6)(C) Thing?

- §410(b)(6)(C) gives Buyers' and Sellers' plans a break when there's a company transaction
- It says:
  - If the plan met §410(b) before the acquisition
  - You are deemed to meet §410(b) during a transition period that:
    - Begins on the day of the transaction
    - Ends on the last day of the plan year following the year of the transaction
  - Even if you would fail coverage if you did testing



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## What's With This §410(b)(6)(C) Thing?

- Does §410(b)(6)(C) always apply?
  - Yes, for asset purchases or sales, stock purchases or sales, mergers of companies
  - If §410(b) was met prior to the transaction
- But, there's a hitch:
  - Cannot have a significant amendment during the transition period, or the transition period ends
    - Applies on a plan-by-plan basis
    - What is a "significant amendment"? Not entirely clear.
    - Safest route: don't amend during transition period!



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## What's With This §410(b)(6)(C) Thing?

- WHY does this rule exist?
  - To give companies time to adjust to an acquisition
  - What's with the amendment thing?
    - If a company can get its act together enough to amend the plan, it should be able to deal with coverage
    - So, if it amends during the transition period, it must deal with coverage



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## What's With This §410(b)(6)(C) Thing?

- Back to our scenario:
  - Buyer's Plan excludes the acquired employees during the transition period
    - So, assuming no amendments are made to Buyer's Plan, and it met coverage when the transaction occurred, it can exclude the acquired employees through 12/31/21, even if this would normally cause the plan to fail coverage testing
    - Acquired employees will become eligible after the end of the transition period
      - Depending on interpretation of the Plan Administrator, will count all service or just service under the controlled group



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## What's With This §410(b)(6)(C) Thing?

- Timing of transaction can be critical:
  - If Buyer bought Subsidiary in November 2019, and the two companies' plans had calendar plan years, the transition period would run through December 31, 2020
  - Plans would need to be tested for coverage as of January 1, 2021 (transition period is about one year)
  - But if transaction delayed to January 1, 2020, transition period extends to December 31, 2021 (transition period is about two years)



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## What's With This §410(b)(6)(C) Thing?

- Back to our scenario:
  - Target (New Subsidiary) Plan excludes all employees who become part of the company through a transaction
    - Buyer's (parent) employees are excluded forever
    - During the transition period, no problem (assuming no amendment - §410(b) is deemed to be met)
    - After transition period, Subsidiary's Plan must meet coverage, treating parent employees as excluded



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## Suppose Instead ...

- Target's (New Subsidiary) Plan provides that it covers all employees of the controlled/affiliated service group as eligible employees
- Target's Plan has no eligibility requirements
- Result:
  - Must follow the terms of the plan, even during transition period
  - All Buyer employees became eligible to enter Target's Plan immediately after the acquisition

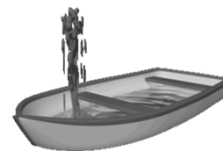


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## Oh No! Not Our Intent!

- We discover this problem the day after the acquisition
- Subsidiary takes immediate action to amend its plan to exclude the Buyer employees before they accrue anything
  - Amendments made during transition period end the transition period
  - Now, Target's Plan must meet coverage excluding the Buyer's employees
    - If it does, terrific
    - If it doesn't, we've got a problem
  - Note: Buyer's transition period is not affected by amendments to Target's Plan



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## Possible Solutions if Target's Plan Fails Coverage

- Amend Target's Plan to let in some of its otherwise excludible employees to meet coverage
- Freeze Subsidiary Plan
  - Of course, that means that none of the Target's employees will have a 401(k) plan after the acquisition
- Do some quick plan design, and amend both plans to do whatever it is you want to do post-transaction
  - Transition period lost at that point, but you've redesigned the plans anyway



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## One More Complication ...

- We discover the error eight months after acquisition...
- Options for the future are the same as before
- Options for the past:
  - Self-correction for Target Plan– Buyer's employees are the ones not enrolled in error – will have QNECs
  - VCP Target Plan and ask the IRS to treat eligibility for Buyer Plan as tantamount to eligibility in Subsidiary Plan
    - Consideration: what is the match in the two plans?



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## Big Takeaways

- Stock purchase creates a controlled group
- Make sure plans say what you want *before* the transaction
- The §410(b)(6)(C) Transition Rule is your friend ... embrace it



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## Case Study #3 Terminate Acquired Plan



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## Facts

- Buyer is poised to purchase all the stock of Target as of 7/1/20
- Each company sponsors a 401(k) plan
- Buyer does not want to continue the Target's Plan, but wants it terminated
- Buyer's HR Director marks it on her calendar to ensure that the termination of the Target's Plan occurs as soon as the acquisition is over



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## Problem

- After transaction, Buyer and Target are part of a controlled group, i.e., "one employer"
- IRC §401(k)(10) prohibits distributions of deferrals, safe harbor contributions, and QNECs/QMACs from terminating 401(k) plan if the company sponsors an "alternate" defined contribution plan
  - Alternate DC Plan: any plan except a SEP, SIMPLE IRA, 403(b), a 457 plan, or an ESOP



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## Result

- If the HR Director waits until after the transaction, there will be an alternate DC plan (i.e., Buyer Plan), so no distribution of deferrals, QNECs, QMACs, SHCs is permitted from Target Plan



## Solutions

- Terminate before transaction
  - The existence of an “alternate DC plan” is judged on date of termination, i.e., the date on which the termination documentation of the 401(k) plan is signed
  - If there is no alternate DC plan at that date, anything that happens later is irrelevant
  - So, if Subsidiary terminates its plan prior to the transaction, it can make full distributions when the termination is processed, even if that is after the acquisition



## Solutions

- Terminate before transaction
  - Question: Can we terminate on the date of the transaction?
    - Probably not. How do you determine whether the termination preceded the acquisition?
  - Question: Can we terminate before the transaction, contingent on the transaction taking place?
    - No one knows. Do you want to take that risk?
    - Safest course of action: terminate day before transaction (or earlier)
  - Question: What if we terminate the day before and the transaction falls through?
    - Re-adopt the plan; 100% vesting probably sticks, though (get over it)



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## Solutions

- Transaction already happened! Now what?
  - Option 1: terminate Target Plan, but merge 401(k)-type assets into Buyer Plan
  - Option 2: just merge the two plans (no 100% vesting)
  - Option 3: freeze Target Plan and keep separate until all current employees have left or are 100% vested
    - Probably 100% vesting occurs at freeze – after all, no future “substantial and recurring” contributions to Target Plan
  - Option 4: keep Buyer and Target Plans separate so long as permissible under IRC §410(b)



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## Big Takeaway

- If you want to terminate acquired 401(k) plan in stock acquisition or merger, you need to do it before the transaction closes.



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## Case Study #5 Selling a Subsidiary



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## Facts

- Seller sells stock of a Subsidiary
- Subsidiary participates in Seller's 401(k) Plan
- Seller wants to pay out Subsidiary employees from the plan after the sale
- Issue: Do we have a distributable event?
  - No, no termination of employment by Subsidiary employees ... they are still working for the Subsidiary



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## The Key

- A parent company may pay out employees of a sold subsidiary from its 401(k) plan only if:
  - Sale is to an unrelated Buyer;
  - Buyer is not adopting the Seller's Plan; and
  - Subsidiary will not participate in former Parent's Plan *at all* after the transaction



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## Cutting off Subsidiary Participation

- How:
  - Question: how did subsidiary participate?
    - Plan included employees of entire controlled group
      - If so, participation terminates automatically concurrent with sale; no participation after sale is possible
    - Subsidiary did separate participation agreement
      - Need to terminate participation agreement *before* the transaction



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## What Happens if You Don't Deal With This Before the Transaction:



- You cannot pay out the participants until they terminate employment with the former Subsidiary ... even though that entity is no longer related to the plan sponsor
- Solution (if the Buyer cooperates): spin off portion of plan covering Subsidiary and merge with Buyer's Plan



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## Big Takeaway

- If you are selling a Subsidiary that participates in the Parent's Plan, make sure participation is terminated before the transaction



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## Key Takeaways



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## What You Should (Can) Remember ...

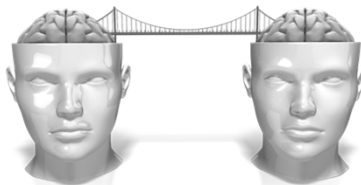
- Almost every M&A issue is best addressed before the transaction
- Document planning is key: what do you want the plans to say after the transaction, and what do they say now?
- If you can choose plan provisions before there is any transaction that leave you with the most flexibility, do that



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## How Do We Get the Client to Notify Us in Advance?



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## In Reality ...

- Although the key way to handle M&A issues is to know about them *in advance* ...
- ... clients commonly don't tell their advisors about this until after the fact ... often, way after



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## You Need To ...

- Get your client to communicate to help you help them ...
- Get your client to communicate so that problems don't happen for which they (fairly or unfairly) blame you

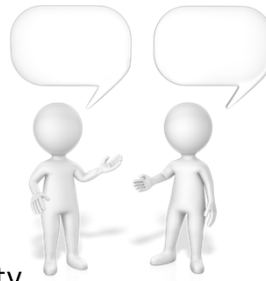


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## The Best Way

- If you want communication, you need to communicate
  - Tell your client often about the need to advise you of M&A in advance
    - Service Agreement
    - Every data request
    - Every communication opportunity



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## Questions?



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## Contact Information

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