REGULATORY COMPLIANCE IN CORPORATE RESTRUCTURES

Speaker

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Session Objectives

- Connect state unemployment claims and tax management practices
- Obtain an understanding of the “pre-acquisition” phases of the Employee Movement/M&A process
- Understand the impact of transaction structure and timing on financial outcomes
- Identify and quantify opportunities and compliance risk
- Provide tools to assist your organization during your next Employee Movement/M&A event
Employment Tax Types

**SOCIAL SECURITY INSURANCE (FICA)**
- **Tax Rate:** 2017/2018 - 6.2%
- **Wage Base:**
  - 2017 – $127,200
  - 2018 – $128,400
- **Max Tax Cost:**
  - 2017 – $7,886
  - 2018 – $7,961

**FEDERAL UNEMPLOYMENT INSURANCE (FUTA)**
- **Tax Rate:** 2017 – 2.25%
- **Wage Base:**
  - 2017 – $17,993
  - 2018 – $18,103
- **Est. Avg. Tax Cost:**
  - 2017 – $405

**STATE UNEMPLOYMENT INSURANCE (SUI)**
1. Rate does not take into consideration the impact of FUTA credit reductions (CA and VI have a net FUTA tax rate of 2.4% for 2016).
2. Total SUI tax revenues for all taxing jurisdictions divided by total SUI taxable payroll, per the U.S. DOL.

Unemployment Tax Rates Are Impacted By Both Claims And Tax Management

State Unemployment Tax Cost Comparison

<table>
<thead>
<tr>
<th>Domestic Employment</th>
<th>Taxable Wages (1)</th>
<th>Taxable Payroll</th>
<th>Median Tax Rate (2)</th>
<th>Estimated Tax Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>50,000</td>
<td>$18,103</td>
<td>$905,150,000</td>
<td>2.25%</td>
<td>$20,365,875</td>
</tr>
<tr>
<td>10,000</td>
<td>$18,103</td>
<td>$1,013,000,000</td>
<td>2.25%</td>
<td>$4,073,175</td>
</tr>
<tr>
<td>1,000</td>
<td>$18,103</td>
<td>$18,103,000</td>
<td>2.25%</td>
<td>$407,318</td>
</tr>
<tr>
<td>500</td>
<td>$18,103</td>
<td>$9,051,500</td>
<td>2.25%</td>
<td>$203,659</td>
</tr>
<tr>
<td>100</td>
<td>$18,103</td>
<td>$1,810,500</td>
<td>2.25%</td>
<td>$40,732</td>
</tr>
</tbody>
</table>

2. Total state unemployment tax revenues for all states divided by total state unemployment tax taxable payroll for 2017, per the U.S. DOL.
### State of North Carolina Reference Chart

<table>
<thead>
<tr>
<th>Rate Calculation</th>
<th>Reserve State</th>
<th>Maximum Tax Rate</th>
<th>5.76%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage Base</td>
<td>$23,500</td>
<td>Penalty Tax Rate</td>
<td>N/A</td>
</tr>
<tr>
<td>Rate Issue Date</td>
<td>11/15</td>
<td>Average Weekly Benefit: Amount x Average Duration (weeks)</td>
<td>$256.53 x 92 = $23,500</td>
</tr>
<tr>
<td>Joint Accounting</td>
<td>No</td>
<td>Maximum Weekly Benefit: Amount x Maximum Duration (weeks)</td>
<td>$390 x 12 = $4,680</td>
</tr>
<tr>
<td>Voluntary Contributions</td>
<td>Yes (12/15)</td>
<td>State Response Deadline</td>
<td>10 Days</td>
</tr>
<tr>
<td>Non Business Rate</td>
<td>1.00%</td>
<td>1st Level Appeal (Deadline)</td>
<td>15 Days</td>
</tr>
<tr>
<td>NBR (Duration)</td>
<td>2 Years</td>
<td>Worksite State</td>
<td>No</td>
</tr>
<tr>
<td>Minimum Tax Rate</td>
<td>0.06%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### State of North Carolina M&A/Reorg Chart

- **Total/Partial Common Ownership Reorg**: Successor rate for the remainder of the year; commingled rate for subsequent years.
- **Total Non Common Ownership Reorg**: Mandatory transfer with successor rate for the remainder of the year; commingled rate for subsequent years.
- **Partial Non Common Ownership Reorg**: Optional transfer with successor rate for the remainder of the year; commingled rate for subsequent years.
- **Reorg into New Company**: Commingled rate of all of the predecessors immediately.

### Phases Of The Strategic Plan for Employee Movement

1. Work Plan
2. Due Diligence
3. Planning and Design
4. Implementation & Compliance
5. Post Implementation
Hypothetical Case Study: Buyer And Seller

Southern Foods, Inc. (“Buyer”) is a manufacturer:
- Operates 2 subsidiaries
  - SF Manufacturing, Inc.
  - SF Maintenance, Inc.
- Employs 20,000 in 10 states (incl. Florida)

Sunshine Foods, Inc. (“Seller” or “Target”) is a competitor in the manufacturing market:
- No subsidiaries
- Employs 425 in Florida

Planning & Design: Current Structure In Florida

<table>
<thead>
<tr>
<th>Subsidiary</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Southern Foods, Inc. (Mgmt)</td>
<td>0.10%</td>
</tr>
<tr>
<td>SF Manufacturing, Inc. (Op)</td>
<td>1.34%</td>
</tr>
<tr>
<td>SF Maintenance, Inc. (Mnt)</td>
<td>2.64%</td>
</tr>
<tr>
<td>Sunshine Foods</td>
<td>5.40%</td>
</tr>
</tbody>
</table>

Due Diligence: Sunshine Risk Assessment

<table>
<thead>
<tr>
<th>Taxable Payroll ($)</th>
<th>Sun Risk (SUI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-500,000</td>
<td>0.00%</td>
</tr>
<tr>
<td>500,000-1,000,000</td>
<td>1.00%</td>
</tr>
<tr>
<td>1,000,000-1,500,000</td>
<td>2.00%</td>
</tr>
<tr>
<td>1,500,000-2,000,000</td>
<td>3.00%</td>
</tr>
<tr>
<td>2,000,000-2,500,000</td>
<td>4.00%</td>
</tr>
<tr>
<td>2,500,000-3,000,000</td>
<td>5.00%</td>
</tr>
<tr>
<td>3,000,000+</td>
<td>6.00%</td>
</tr>
</tbody>
</table>
Planning & Design: Factors Impacting TOE*

- Type of transaction
- Common Ownership, Management, or Control ("COMC")
- Partial vs. total transfers of workforce
- Mandatory vs. optional TOE*
- Newly liable vs. currently liable employers
- Rating methodology (e.g., benefit ratio vs. reserve ratio)
- Specific employee identification method vs. percentage method
- Timing of transaction
- Timing of rate revision

* TOE Transfer of Experience

Planning & Design: Stock Acquisition or Merger Into NewCo

<table>
<thead>
<tr>
<th>Legal Entity</th>
<th>Old Rate</th>
<th>New Rate</th>
<th>Wages</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sunshine</td>
<td>5.40%</td>
<td>2.70%</td>
<td>$3,000,000</td>
<td>$81,000</td>
</tr>
</tbody>
</table>

Planning & Design: Asset Acquisition (Single Co)

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>TOE?</th>
<th>Successor/Surviving Entity</th>
<th>Effective SUI Rate Before (%)</th>
<th>Effective SUI Rate After (%)</th>
<th>Annual Payroll ($)</th>
<th>Variation ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Acquisition</td>
<td>Yes</td>
<td>Southern Foods, Inc. (parent)</td>
<td>2.186</td>
<td>2.275</td>
<td>16,000,000</td>
<td>(14,200)</td>
</tr>
<tr>
<td>Asset Acquisition</td>
<td>No</td>
<td>Southern Foods, Inc. (parent)</td>
<td>2.186</td>
<td>1.183</td>
<td>16,000,000</td>
<td>150,000</td>
</tr>
</tbody>
</table>
Wage Base Carryovers

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>TOE?</th>
<th># of EE’s Impacted</th>
<th>Taxable Wages Duplicated from 07/01 to 12/31 ($)</th>
<th>Tax Rate(%)</th>
<th>Potential Overpayment ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FUTA</td>
<td>7,000</td>
<td>215</td>
<td>1,500,000</td>
<td>0.600</td>
<td>9,000</td>
</tr>
<tr>
<td>FICA</td>
<td>118,500</td>
<td>25</td>
<td>787,500</td>
<td>6.200</td>
<td>48,825</td>
</tr>
<tr>
<td>SUI</td>
<td>7,000</td>
<td>215</td>
<td>1,500,000</td>
<td>0.100</td>
<td>1,500</td>
</tr>
</tbody>
</table>

|             |      |                   |                                              |             | Overpayment $59,325       |

Typically, wages paid by a predecessor can be used by a successor for purposes of the annual wage limitation. Can your payroll/HR system handle?

Implementation And Compliance

What if Southern and Sunshine didn’t properly file compliance documents to execute on the “tax-efficient” strategy?
- Forego $173,200 in rate reduction savings
- Forego $59,325 in wage base carryover savings

What if Southern and Sunshine were related by COMC?
- If required compliance documents were not filed, and Southern’s .10% rate was used to pay tax:
  - $173,200 tax assessment
  - Interest and penalties
  - $210,000 potential SUTA dumping penalty
  - SUTA dumping is a 3rd degree felony in Florida.

Audit

- AUDIT – Claims, Tax Rate, Returns
  - 54 Different Statutory Dates & Deadlines
Audit Analysis & Recovery

A company was issued a penalty 2018 tax rate of 10.9010% in Pennsylvania. The penalty was issued due to a state miscalculation. Once all the necessary documentation was presented to the state the protest was upheld and a revised rate was issued.

<table>
<thead>
<tr>
<th>Estimated Taxable Payoff</th>
<th>Penalty Tax Rate</th>
<th>Revised Tax Rate</th>
<th>Estimated 2018 Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>$37,000,000</td>
<td>10.9010%</td>
<td>7.7270%</td>
<td>$1,174,380</td>
</tr>
</tbody>
</table>

Voluntary Contributions

- 26 States / Deadlines
- Size Matters (Variance)
- Negative to Positive
  - KY, MA, MO, NJ, NY
- Multiple Rate Groups / Growth
- Benefit States May Save Multiple Years

Voluntary Contribution: Anticipated Growth

A company with 30 employees is opening up a new plant in 2018 (increasing to 1,100 employees)

<table>
<thead>
<tr>
<th>30 Employees VC 1 Rate Group</th>
<th>1,100 Employees VC 1 Rate Group</th>
<th>1,100 employees VC to MIN Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Payroll</td>
<td>$300,000</td>
<td>$14,300,000</td>
</tr>
<tr>
<td>2017 Tax Rate</td>
<td>3.20%</td>
<td>3.20%</td>
</tr>
<tr>
<td>Voluntary Contribution</td>
<td>$1,000</td>
<td>$12,000</td>
</tr>
<tr>
<td>2017 Voluntary Tax Rate</td>
<td>3.07%</td>
<td>0.00%</td>
</tr>
<tr>
<td>2017 Savings</td>
<td>($493)</td>
<td>$457,600</td>
</tr>
</tbody>
</table>
Joint Accounting

11 STATES – RULES VARY
Ohio – Transcripts
BE POSITIVE
Your FOOTPRINT Matters
NJ: Must Project Rates
Common Ownership??
Life Sentence

Joint Accounting Example
NJ based Pharmaceutical Company: By sharing unemployment tax reserves between commonly owned subsidiaries the following actual savings was secured:

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Estimated Payroll</th>
<th>Individual Tax Rate</th>
<th>Joint Tax Rate</th>
<th>Reserve Balance</th>
<th>Actual Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company A</td>
<td>$62,764,560</td>
<td>6.10%</td>
<td>1.20%</td>
<td>($3,240,356)</td>
<td>$3,075,463</td>
</tr>
<tr>
<td>Company B</td>
<td>$49,023,381</td>
<td>2.60%</td>
<td>1.20%</td>
<td>$2,563,365</td>
<td>686,327</td>
</tr>
<tr>
<td>Company C</td>
<td>$27,405,313</td>
<td>2.50%</td>
<td>1.20%</td>
<td>$2,164,587</td>
<td>322,118</td>
</tr>
<tr>
<td>Company D</td>
<td>$52,650,000</td>
<td>1.60%</td>
<td>1.20%</td>
<td>$6,858,593</td>
<td>211,227</td>
</tr>
<tr>
<td>Company E</td>
<td>$12,207,000</td>
<td>1.60%</td>
<td>1.20%</td>
<td>$1,295,358</td>
<td>49,432</td>
</tr>
<tr>
<td>Company F</td>
<td>0</td>
<td>1.60%</td>
<td>1.20%</td>
<td>$1,531,886</td>
<td>0</td>
</tr>
<tr>
<td>Company G</td>
<td>$20,000,173</td>
<td>1.20%</td>
<td>1.20%</td>
<td>$6,082,589</td>
<td>0</td>
</tr>
<tr>
<td>Company H</td>
<td>$28,500,000</td>
<td>1.20%</td>
<td>1.20%</td>
<td>$5,325,672</td>
<td>0</td>
</tr>
<tr>
<td>Company I</td>
<td>$43,490,002</td>
<td>1.20%</td>
<td>1.20%</td>
<td>$10,996,033</td>
<td>0</td>
</tr>
<tr>
<td>Company J</td>
<td>0</td>
<td>3.70%</td>
<td>1.20%</td>
<td>$8,890</td>
<td>0</td>
</tr>
</tbody>
</table>

Joint Account Savings: $299,496,874 1.20% $23,304,004 $4,324,568

Large Bread Company Case Study:
Planning & Design: Current Structure in AZ

Sample Bread Company ("Buyer") is a national bakery-café concept with multiple FEINs:
- Operates under Sample, LLC
- Employs over 55,000 in 45 states (incl. Arizona)
- Processes over 90,000 W2's
- Approx. 950 company-owned location

AquireMe Bakery Café ("Seller") is a competitor fast-casual bakery-café:
- Operates under AquireMe, Inc.
- Employs over 2,200 in 5 states (incl. Arizona)
- Processed over 4,000 W2's
- Approx. 45 locations
Sample Bread: Learning from Experience

1. Track your rates: ensure Rate Notices are received
   - Example: QA rate, employer must track down online
2. Put together a schedule: important Details of Each State
3. Compare rates / time received to determine payroll tax accruals
4. Note Voluntary Contribution states to ensure timely payment
5. Update payroll tax system and/or vendor timely
6. Ensure unemployment partner has received all details
7. AUDIT your quarterly tax returns for the proper rates
8. Educate your operations how the process works

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Sample Bread Case Study:
Internal Reorganization in Arizona

**BEFORE**

- Sample, LLC
- AquireMe, Inc.

**AFTER**

- Sample, LLC
- AquireMe, Inc.

By securing $1,066,195 in positive UI tax reserves and a lower tax rate from AquireMe, Sample is expected to save $346,800 in taxes and another $88,100 by not restarting the wage bases.
Sample Case Study:
Unemployment Tax Rates Are Impacted By Both Claims And Tax Management

<table>
<thead>
<tr>
<th>Sample Bread</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall unemployment effective tax rate</td>
<td>1.625%</td>
</tr>
<tr>
<td>Overall national SUTA tax cost</td>
<td>$7,220,500</td>
</tr>
<tr>
<td>Annual savings from claim wins (1,880 claims)</td>
<td>$2,169,684</td>
</tr>
<tr>
<td>Savings from tax planning (Arizona only)</td>
<td>$434,900</td>
</tr>
</tbody>
</table>

Summary: Pre-Acquisition Questions

- Who are the parties involved?
- What is the transaction type?
- When is the transaction taking place?
- Where is the transaction taking place?
- What is the most tax-efficient structure?
- How do I stay compliant?

Unemployment Tax Reorg Due Diligence Checklist

- Name and FEIN of successor legal entity(ies)
- Expected date of contemplated transaction
- Name of predecessor legal entity(ies)
- FEIN and SUI account numbers of predecessor(s)
- Number of employees, by state, by legal entity
- Taxable payroll by state, by legal entity for the current and prior two years
- State unemployment quarterly contribution and wage reports of predecessor for the current and prior two years
- State unemployment tax rate notices of predecessor for current and prior two years
- State unemployment tax rate notices for current and prior two years
- Name and FEIN of successor legal entity(ies)
- Legal entity organizational chart
- Forms 940 and 941 for each legal entity for the current and prior two years
- Employment tax transcripts for current and prior two years
- Employment tax notices and assessments for current and prior years
- Copy of significant payroll policies and procedures for high-exposure issues
- Employment tax rate notices for current and prior two years
- Current state unemployment clearing notices from all state workforce agencies
- Detail of acquisitions or transferred employees to the current and prior three years

Confidential and Proprietary
Questions?

Thank you for your participation in today's presentation.