TAX BRIDGE ON THE ROAD: RETIREMENT PLAN AND EXECUTIVE COMPENSATION CONSIDERATIONS IN MERGERS AND ACQUISITIONS

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Panelists

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TAX BRIDGE TO PRACTICE: EMPLOYEE BENEFITS IN MERGERS AND ACQUISITIONS

PRELIMINARY CONSIDERATIONS
Retirement and Executive Compensation Considerations Relating to the Structure of the Deal

• Type of Deal
  – Joint Venture
  – Merger of Equals
  – Stock Deal
    – Entire entity
    – Acquisition of subsidiary of larger ongoing entity
  – Asset Deal
    – Business deal with respect to employees and benefits

• Public or Private Company

• Types of Employees and Location of Employees
Categories of Plans

• Types of Plans
  – **Tax-qualified Retirement Plans**
    – Defined Benefit Plans
    – Defined Contribution Plans (401(k) and 403(b) Plans)
  – **Executive Compensation**
    – Non-qualified Plans
    – Equity Compensation Plans and Award Agreements
  – Multiemployer Pension Plans
  – Health and Welfare Plans
    – Self-funded / Fully-insured
    – Retiree Medical
  – Employment Agreements/Severance Agreements
  – Change-in-Control Arrangements
Categories of Documents

- Plan Document & Plan Amendments
  - Board/Committee Resolutions Relating to Plans
- Trust Agreement / Funding Mechanism
- Summary Plan Description / Summary Material Modifications
- Third-Party Agreements
- IRS/DOL Audit Letters, Compliance Statements
- Actuarial Reports, if applicable
- Collective Bargaining Agreements for Unionized Work Forces
- Employee Manuals/Handbooks
- Any Special Documents Required to be Filed or Maintained
Diligence Issues for Tax-qualified Retirement Plans

• Documentary Compliance
  – Timely Adoption of Documents and Amendments
  – Correct Party Adopting Amendments

• Operational Compliance
  – Coverage Issues
  – Contribution Issues
  – Consistency with Plan Document (and Summary Plan Description)
  – Plan Loans

• Funding Issues (for DB Plans)
• Review of any Outstanding Filings
  – Determination Letters
  – Annual Report on IRS Form 5500
  – Governmental Correction Programs
Recent Developments Impacting Diligence of Tax-qualified Retirement Plans

• Determination Letter Program (Notice 2018-24)
  – Limited to Individually Designed Plans

• Tax Cuts and Jobs Act
  – Extended Rollover Deadline for Certain Plan Loan Distributions
  – Hardship Withdrawals (Proposed Regulations Published 11/14/18)

• Increased Audits of Defined Benefit Plans by the Dept. of Labor

• 401(k) and 403(b) Litigation
## Diligence Issues for Executive Compensation Arrangements
### Common Types of Executive Compensation (Equity)

<table>
<thead>
<tr>
<th></th>
<th>Restricted Stock</th>
<th>Restricted Stock Units (RSUs)</th>
<th>Non-qualified Stock Options (NQSO)</th>
<th>Incentive Stock Options (ISO)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
<td>A promise to award shares of stock in the future, subject to pre-defined vesting requirements</td>
<td>A promise to distribute shares of stock (or in some instances, a cash equivalent) in the future, subject to pre-defined vesting requirements</td>
<td>A right to purchase shares of employer stock at a pre-determined fixed price</td>
<td>Same as a NQSO, but with beneficial tax treatment if certain conditions are met (See Code Sections 421 and 422 for conditions)</td>
</tr>
<tr>
<td><strong>General Timing of Income Tax for Employees (U.S.)</strong></td>
<td>Vesting (at grant if an 83(b) election is made)</td>
<td>At settlement</td>
<td>At exercise</td>
<td>At sale of shares underlying option (long-term capital gains if certain conditions are met; regular tax rates if such conditions are not met)</td>
</tr>
<tr>
<td><strong>General Timing of Employer Deduction (U.S.)</strong></td>
<td>Vesting</td>
<td>At settlement</td>
<td>At exercise</td>
<td>No deduction unless certain conditions are not satisfied</td>
</tr>
<tr>
<td><strong>Taxable Amount</strong></td>
<td>Fair market value of award at vesting (or fair market value of award at grant if 83(b) election is made) over amount paid</td>
<td>Fair market value at settlement</td>
<td>Fair market value of sales proceeds at exercise, less the exercise price</td>
<td>Fair market value of sales proceeds at exercise, less the exercise price</td>
</tr>
</tbody>
</table>
Diligence Issues for Executive Compensation Arrangements
Common Types of Executive Compensation (Non-Equity)

• Cash Incentive Plans
  – Annual and Long-term Incentive Plans

• Non-qualified Deferred Compensation Plans
  – Unfunded
  – Contributions May Exceed Contribution Limits to Qualified Retirement Plans

• Severance Arrangements
  – Triggers
  – Installment or Lump Sum Payments

• Change of Control Arrangements
  – Balances the Interests of the Executive and the Employer
  – Possible Retention Issues Following a Transaction

• Amending or Adopting Employment Agreements

• Perquisites
  – Car Allowance; Club Dues; Tax Planning; Gross-ups
Diligence Issues for Executive Compensation Arrangements
General Overview of Section 409A

• Section 409A imposes strict rules with respect to the deferral and distribution of non-qualified deferred compensation
  – Start with whether there is a legally binding right to taxable compensation in a future year
  – Exclusions from 409A: Qualified retirement plans; bona fide vacation, sick and compensatory time arrangements; disability and death benefit plans
  – Exceptions to 409A: Short-term deferral is the most common

• Deferral elections must generally be irrevocable and be made in the tax year before services are performed

• Permitted Distributions: Fixed Date; Death or Disability; Separation from Service; Change of Control; Unforeseeable emergency

• Noncompliance triggers income inclusion of all amounts deferred under plans of the same type; included amounts are subject to a 20% excise tax, plus an additional interest tax
Diligence Issues for Executive Compensation Arrangements (cont.)

• Section 409A Compliance
  – Timing Rules
  – Negative Tax Ramifications for Executives
  – Potential Employer Impact

• Equity Plans
  – What Happens to Outstanding Equity Upon Change of Control?
  – Consent Issues
  – Timing Issues in Light of Section 409A

• Incentive Plans
  – Payment Triggers
  – Liability Issues

• Tax Issues: Section 280G, Gross ups
• Practical Concerns: Post-Transaction Retention
Recent Developments Impacting Diligence of Executive Compensation

• Tax Cuts and Jobs Act
  – Changes to Code Section 162(m)
    – Expansion of Covered Employees
    – Elimination of Exception for Qualified Performance-Based Compensation
    – IRS Notice 2018-68
  – Deferral of Income From Stock Options or RSUs under Section 83(i)
    – Qualified Employees of an Eligible Corporation
    – Available only for Qualified Stock
    – IRS Notice 2018-97
  – Excise Tax on Excess Compensation on Employees of Tax-exempt Organizations
    – Remuneration in Excess of $1M to Covered Employee
    – IRS Notice 2019-09
Representations and Warranties

• Definition and List of Plans
  – “Material” Plans
  – Non-Company Sponsored Plans

• Disclosure of Plans and Material Documents

• Compliance with Law and Plan Terms (Including 409A!)

• Tax Exempt Status of the Plan
  – IRS Determination Letter
  – Operational Compliance
  – Not Under Audit & No Pending Requests Relating to Error Corrections

• Plans May Be Amended Freely

• No Late Payments of Benefits

• No Prohibited Transactions/Breach of Fiduciary Duties

• No Participant Claims (other than ordinary course)

• Disclosure of Change of Control Triggers

• No 280G Issues

• No Audits or Pending or Threatened Litigation
Covenants

• Hiring of Employees
• Benefits to be Provided
  – Severance Plan Issues
• Assumption or Mergers of Plans/Benefits
  – Termination of Plans
  – Merger of plans
• Special Rights for Target’s Employees in Buyer’s Benefit Plans
  – Past-service Credit
  – Credit for Amounts Paid Under Seller’s Plans
• 401(k) Vesting, Termination and/or Advance Funding
• Liability Allocation for Unfunded Plan Benefits
• No Third Party Beneficiaries
• No Guarantee of Employment
• No Prohibition on Plan Changes
• Section 280G Executive Waiver/Shareholder Approval Process
• Interim Operating Covenants (i.e., Restrictions on Post-signing, Pre-Closing Employment, Compensation and Benefits-Related Actions)
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PRE- AND POST-CLOSING CONSIDERATIONS
Pre-Closing Actions

• Board/Committee Resolutions and Plan Amendments
  – Certain Actions Must be Taken to Effectuate Covenants
• Notification to and/or Consent from Participants/Beneficiaries
• Special Enrollment Periods
• Third-Party Service Agreements
  – Notice, Consent and Actions to Transfer Sponsorship, Terminate Plans
• 280G Calculations and Waivers/Shareholder Approvals
• Executive Incentive Arrangements
• Offers of Employment / New/Amended Employment Agreements
Post-Closing Actions

• Transition Services
• Partial Termination of Seller Plans
• Employee Communications
• Addressing Diligence Correction Issues
• Compliance with Covenants
  – Drafting of New Plan Documents
  – Enrollment in Buyer Plans
  – Satisfy “Comparability” Standard
    – Substantially similar in the aggregate
    – Substantially similar to similarly situated EEs
• Plan Mergers
  – Transfer of Seller Plan Assets
  – Determination Letter Filing
THANK YOU