# ACQUISITIONS UNDER THE ACA: WHAT YOU NEED TO KNOW BEFORE YOUR NEXT ACQUISITION

## *Introduction*

The employer shared responsibility provisions (also known as the "employer mandate") of the Affordable Care Act (ACA) first became effective in 2015. Under the employer mandate, certain businesses known as Applicable Large Employers (ALEs) must offer affordable, minimum value health coverage to their full-time employees and their dependents or pay penalties. The rules for complying with the various aspects of the employer mandate are extremely complicated for ordinary businesses, and the acquisition of new businesses creates additional complexity.

A company decides to acquire a new business for business reasons without regard to the ACA. However, with the new obligations under the employer mandate and the significant implications of failing to comply, prudent businesses should perform thorough due diligence into their target's ACA compliance and deploy a specific transition strategy to assure all aspects of ACA compliance are covered.

When planning how an acquisition will affect a company's compliance with the ACA employer mandate, there are three elements to consider: how will the acquirer classify the target's employees; who is responsible for reporting pre-acquisition coverage; and will the acquiring business be liable for the target's pre-acquisition ACA penalty liability?

## *Employee Classification*

Characterizing the target's employees as new hires or continuing employees following an acquisition has important effects on how those employees are treated under the ACA. If categorized as new hires, the acquirer can re-start the clock on measurement and limited non-assessment periods for all acquired employees; however, if categorized as continuing employees, the acquirer may need to offer coverage to some acquired employees from the date of the acquisition. Many view the nature of the acquisition as the determinative factor: stock sales result in continuing employees, whereas asset sales result in new hires. This simplistic approach to classifying employees is risky for ACA purposes, especially given the legal uncertainties and the substantial penalties at stake.

The IRS has not yet issued guidance explaining how it will handle these situations; however, it *has* reserved sections in the regulations to address predecessor and successor employer concepts. Additionally, expansion of common law successor liability—particularly in the context of labor and employment laws—makes it increasingly likely that the IRS will view target employees whose employment continues under the acquiring business as continuing employees, even when the acquisition was structured as an asset sale. In such situations, successor liability may arise for the target employees if there is substantial continuity of the business enterprise (continuity of facilities, management, personnel, and operations), regardless of whether ownership continues as well. There is no bright line rule for this determination, meaning the results of this analysis will depend on the facts and circumstances of the particular acquisition.

What does this mean for the acquiring company? First and foremost, the acquirer should not fall into the trap of assuming the acquired employees are new hires. Second, the acquiring company will need to accurately determine whether it should consider these employees as full-time under the ACA rules. To do so requires a large amount of the predecessor's employment, payroll, and leave data. Based on analysis of this data, the acquiring company will need to provide benefits to those employees determined to be full-time. Coverage must be offered beginning on the acquisition date, such that there is no delay in coverage offered and no interruption in coverage if the target company previously covered the employee. The acquiring company will also need to utilize an employee's pre-acquisition hours for future measurement determinations. The IRS has provided specific transition rules for integrating newly acquired employees into their standard workforce measurement cycles, including an option to treat acquired employees as its own group until they have completed the first full standard measurement period.

For most companies, obtaining all the necessary data will pose a challenge in the acquisition process, especially if the acquisition is hostile. It is important to remember that there are federal guidelines for personnel record retention, making this more than just an ACA issue, and the guidelines consider all the requisite data (employment, payroll, leave, and benefits) personnel records. After the acquisition, these employees continue their employment, now for the acquiring company. Therefore, the target company is obligated to transfer those records as part of the acquisition agreement.

## *ACA Reporting Obligations*

The next ACA issue to consider when contemplating an acquisition is who will be responsible for reporting pre-acquisition health coverage offered to the employees. But before discussing who should be responsible for pre-acquisition ACA reporting, it must first be established whether pre-acquisition ACA reporting is required at all. Mainly, is the target company an ALE (did they have more than 50 full-time plus full-time equivalent employees in the prior calendar year)? If not, the question of pre-acquisition reporting is moot (though the acquirer would still need to follow the acquisition transition rules for measurement purposes). However, if it is established that pre-acquisition ACA reporting is required, it is important to determine who will be responsible for its completion. In the future, the IRS may establish 1094/1095 reporting procedures for dissolutions similar to W-2, but for now it is best to clearly outline that responsibility in the agreement.

The ACA reporting obligation does not arise until the following year, at which point the target company may have already closed up operations and dissolved. Therefore, it is important to address this obligation in the acquisition agreement to ensure that both parties understand who will be responsible for the 1094/1095 reporting. Like most tax filings that must be completed following an acquisition, responsibility for ACA reporting should be assigned in the tax covenants of the acquisition agreement.

What happens if the acquisition agreement does not address ACA reporting? That is not clear at this point. But when the IRS finally gets around to auditing the ACA reporting (many months and possibly years after the acquisition occurred and the target company dissolved), if the pre-acquisition reporting was not completed, the fact of the matter is that these are now the acquiring company's employees. Since the target company is no longer around to perform its reporting obligation, it would not be surprising if the IRS made the acquiring company responsible for remedying the reporting deficiency, possibly with late-filing penalty implications. In such a situation, it will be imperative to have employee benefits data (both offer and enrollment) from the target company—in addition to the employment, payroll, and leave data discussed above—to provide the requisite pre-acquisition information.

## *ACA Penalty Liability*

The final consideration—though perhaps foremost on everyone's mind—is whether the acquiring company will be liable for penalties due to a target company's failure to comply with its ACA obligations. In an acquisition, the parties typically negotiate liabilities, with the acquirer explicitly or implicitly agreeing to take on the liability or not. Usually, a sufficient reserve is also set aside from the purchase price to address liabilities that might arise in a certain time frame. If specific tax liabilities are not addressed, the IRS may look to implicit assumption of liability by the acquirer, adequacy of consideration, or ability-to-pay as means for imposing liability on the acquiring company, leaving it to the acquiring company to seek a remedy from the now-dissolved target.

Therefore, thorough tax due diligence is necessary to discover whether the target company was compliant with the ACA and what potential penalty exposure may arise under audit. Was the target company offering an affordable minimum value plan? Was their policy for offering benefits sufficient to cover all ACA-defined full-time employees? Was that coverage offered in a timely manner? Did they accurately and timely deliver and file their Forms 1094-C and 1095-C? Can they provide documentation to support all of these actions?

## *Conclusion*

It is important to consult with legal and tax professionals before entering an acquisition agreement. Careful and thorough due diligence with respect to ACA compliance must be undertaken to ensure the acquiring company understands the target company's compliance efforts and the risk of potential penalty exposure. Negotiation is required to reach agreement on how to handle these provisions. And lastly, the acquiring company must attempt to obtain all relevant personnel data records both to adequately assess the target company's past compliance and to accurately determine the ACA status of continuing employees and transition them into the workforce.

About the author:

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