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MERGERS AND JOB CHANGES:

Being Hired By A "New" Employer Does Not Always Mean Re-Starting Tax W/H

My friend Charlie was a little anxious about his job. He works for a graphic design company that is being acquired by a competitor. As we talked, Charlie told me his real concern was that by "starting over" with a new employer, he thought he would become subject again to Social Security and perhaps other employment taxes, as if nothing had been withheld already this year . . . in effect, he would duplicate his tax payments.

I told Charlie that the answer depended entirely on whether the "new" employer and the "old" employer were related; and if related, how that had come about. Here is how I explained it with respect to Federal employment taxes. If time had permitted, we also would have discussed the impact on state unemployment insurance taxable wage limits and on successor-employer unemployment insurance experience rates.

Employees Who Work For Two or More UNRELATED Employers In The Same Year

Charlie acknowledged that one of his options was simply to quit working for his present employer, and start doing graphic design for another company. If he were to start working for a second, UNRELATED employer in the same year, prior taxable wages would not be carried forward to the second employer. Each unrelated employer must withhold the employee's full share of Social Security and Medicare taxes, and is liable for the employer's matching share on the wages each pays to the worker, up to the limit of the employee's taxable wage limit. Each employer also would duplicate the FUTA tax paid by the other.

However, where the combined wages from two or more employers exceed the employee's annual taxable wage limit, a refund or credit can be obtained for any excess Social Security taxes withheld. On the other hand, neither of the employers would be entitled to a refund of the employer's portion of the Social Security taxes paid. Note that the 2007 taxable wage limit for Social Security is $97,500, while there is no annual wage limit for Medicare tax. The 2007 taxable wage limit for FUTA tax is $7,000.

Working Sequentially For RELATED Employers In the Same Year

This situation can occur in several ways. First, the employee may be transferred from one business unit of the employer to another, but if both of them are reported under the same Employer Identification Number (EIN) for purposes of Form 941, the I.R.S. deems that only one employer is involved, even though the employee may feel he or she has a new employer. Therefore, the employee's wages continue being applied against the same taxable wage limit, and no duplicate withholding occurs.

The second situation involves businesses and/or corporations actually combining their operations. In effect, the employee continues doing the same job, but the entity for which he or she works undergoes some change, and the question is whether that imposes a NEW taxable wage base on the transferred employees. There are three ways that companies may combine: 1.) purchase of stock, 2.) purchase of assets, or 3.) statutory merger or consolidation. Each method has its own implications for the employees' taxable wage limits.

Returning to Charlie's situation, the acquiring employer may simply PURCHASE THE STOCK of Charlie's present employer. In this way a change of ownership occurs, but the separate operations of the two companies continue as before. This method will cause no change to the EIN of either the purchased company or the acquiring company, so the employees of each continue to accrue wages against their respective taxable wage limits as though nothing had happened.

Alternatively, the successor might simply purchase the assets of the predecessor. Such a PURCHASE OF ASSETS may or may not involve the hiring of any predecessor company employees by the successor. But, if two conditions exist concurrently, the purchase of assets will create a "successor/predecessor" relationship between the two companies, which permits the carry-forward of prior wage balances. The two required conditions are: 1.) that the acquiring company must gain possession of substantially all the property used in the trade of the acquired employer, AND 2.) the acquiring company must immediately employ the employees of the predecessor company.

Third, is a STATUTORY MERGER or CONSOLIDATION between the two companies, with the acquiring company being the survivor. With one entity absorbed by the other, the surviving entity is considered the "original" employer. The surviving entity continues using its own EIN. Although technically not a "successor/predecessor" relationship because the absorbed predecessor entity ceases to exist, the result is the same because prior balances can be carried forward to the surviving company.

Special Rules For "Successor/Predecessor" Relationships

Because the transferred employees and business of a predecessor company are reported under the EIN of the successor company, the latter may apply the prior wages and taxes toward the satisfaction of the Social Security and FUTA wage limits of the successor company.

For example, suppose Charlie had earned $50,000 while working for the predecessor employer, before being employed by the successor company in a "successor/predecessor" relationship. The successor employer is only required to withhold (and match) Social Security tax on the next $47,500 ($97,500 - $50,000) that Charlie earns this year. Medicare tax has no taxable wage limit, so that withholding will continue on all wages paid to Charlie. However, the FUTA wage base ($7,000) already has been met and does not need to be satisfied again.

The Special Rules For Statutory Merger or Consolidation Situations

If a corporation or business is absorbed by another firm in a statutory merger or consolidation, the resulting entity is considered the same employer for Social Security and FUTA tax purposes. Often this consolidation is accomplished by an exchange of shares. Based on a negotiated value ratio, some shares of the acquiring corporation may be exchanged for all the outstanding shares of the company to be absorbed.

Under I.R.S. rules, the surviving corporation following a statutory merger or re-incorporation that qualifies as a re-organization under the Internal Revenue Code, should use its previously assigned EIN. For example, suppose corporations X and Y have different EINs. X is merged into Y in a statutory merger. X files a final return and its EIN is discontinued. The surviving corporation (Y) should continue using its previously assigned EIN.

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