Ordinary Employee Benefits Issues That Can Cause Extraordinary Problems in M&A Deals

December 23, 2020

Employee benefits rarely drive corporate transactions, but if the benefits of a target company are not reviewed carefully, they can sometimes derail the transaction. Even some of the most routine facets of benefit plan administration can result in significant potential financial exposure (*e.g.,* additional employer contributions, taxes, penalties, and fees as well as fees associated with the preparation and filing of IRS and DOL correction program applications) that could negatively affect the overall value of the target company. By identifying issues early in the transaction, the seller can prevent costly purchase price reductions and identify issues that need correction, while the buyer can avoid overpaying for a target and ensure that representation and warranty insurance will be available to cover potential claims. Some of those routine compliance issues include, but are not limited to, the following:

- Failing to timely file an annual Form 5500. The DOL can assess a penalty of up to $2,233 per day each Form 5500 is filed late.
- Permitting pre-tax payment of health and welfare premiums without adopting a Code Section 125 cafeteria plan, which could result in the value of benefits provided to employees being treated as taxable income.
- Not performing required annual nondiscrimination and coverage testing on a retirement plan, which could affect the plan?ÃÃs tax qualified status (or performing it incorrectly by excluding certain controlled group members from testing).
- Not performing required annual nondiscrimination testing on self-funded health plans, cafeteria plans, and flexible spending accounts, which could affect their tax favorable treatment as to highly compensated employees.
- Permitting distributions from the target?ÃÃs retirement plan in connection with certain stock deals, which would require the plan to be terminated at least one day prior to closing.
- Permitting employees acquired in an asset sale to remain covered by the seller?ÃÃs benefit plans for a period of time post-closing. Unless that arrangement is pursuant to a transition services agreement between the buyer and the seller, with the employees remaining employed by the seller until the end of the transition period, the plans would constitute multiple employer plans. Any such retirement plans would have to be amended to include multiple employer plan provisions, and health and welfare plans would constitute MEWAs, subject to additional federal reporting requirements (Form M-1) and state insurance laws and regulations. The DOL can assess a penalty of up to $1,625 per day each Form M-1 is filed late.
- Failing to comply with various requirements under the Affordable Care Act (*g.,* failing to make qualifying offers of health coverage: penalties of up to $2,570 per employee; failing to file and distribute annual IRS Forms 1094 and 1095: penalties of $540 per form not timely filed and distributed).
- Documentary or operational compliance failures related to nonqualified deferred compensation arrangements under Code Section 409A. If there is a violation, the affected individual may be subject to a 20% excise tax and penalties, and the Company may be subject to additional reporting and penalties for failing to withhold taxes.
- Transaction-related compensation payable to certain officers, stockholders, and highly compensated employees that exceeds certain limits under Code Section 280G, which can

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result in a 20% excise tax payable by such individual on amounts that constitute ?ÃÂ£excess parachute payments?ÃÂ¥ and the loss of the corresponding compensation deduction on such amounts by the company.
- Ineffective equity awards that were approved by the company but never fully documented or executed.

If you have not reviewed your benefit plan operations recently and your company anticipates an exit event in 2021, you should work with your service providers and outside counsel to review your plans for compliance issues before the deal begins. By reviewing plans prior to the deal, you can prevent correctable errors from causing problems in the transaction.

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