



Ohio Tax Talk: Unemployment Ruling May Offer M&A Savings

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As with many things in life and business, timing is important. The same was true with regards to the timing of hiring — or rehiring — employees for Ohio unemployment tax purposes in the case of *Delphi Automotive Systems LLC v. Ohio Department of Job and Family Services*.^[1]

In this case, the Ohio Supreme Court held that the phrase “at the time of transfer” actually meant a specific moment in time; not an abstract period of time, as was argued by the Department of Job and Family Services and upheld by Ohio’s 10th District Court of Appeals.

This means that an acquiring or successor entity can avoid inheriting a predecessor’s annual unemployment-contribution rate, known as its “experience rating,” and corresponding unemployment tax rate if the two entities are not under common ownership, management or control at the time of the transfer.

The holding in *Delphi Automotive* sets an important precedent for the treatment of experience rating for purposes of the Ohio unemployment tax in the context of merger and acquisition transactions and corporate reorganizations. This will be particularly important because of the potential increase in experience rating and resulting increase in unemployment tax for many employers in Ohio in the wake of the COVID-19 disruption.^[2]

Acquirers looking at potential targets with Ohio operations and workforces affected by COVID-19 should be mindful of the unemployment tax consequences of the transaction. Transactional planning can lead to significant unemployment tax savings.

Ohio’s Unemployment Tax

Ohio employers must pay into the state’s system of unemployment compensation benefits.^[3] These employer payments are called contributions.

The Ohio director of the Department of Job and Family Services keeps a separate account for each employer and designates an experience rating for each employer that determines their unemployment tax rate.

An employer's experience rating is determined in part by the amount of unemployment compensation benefits paid by an employer to its former employees. Therefore, employers who lay off high numbers of employees will have a higher experience rating and pay more taxes into Ohio's unemployment fund.

Ohio's unemployment tax is imposed on the first \$9,000 in wages paid to an employee.[4] Ohio unemployment tax rates will range from 0.3% to 9.4% for the calendar year 2020.[5]

New employers in the state will automatically pay at the rate of 2.7%; there is an exception for new construction employers, who will pay at 5.8% for 2020.[6] An employer's experience rating and unemployment tax amount is adjusted on an annual basis.

Because the rate for new employers is relatively low, in the past it became advantageous for employers with higher experience ratings to transfer employees to newly created companies under the same corporate umbrella.

This was an attempt by those employers with high experience ratings to obtain a new rating as a new employer and a better unemployment tax rate. To curb this practice, Ohio enacted what is now Section 4141.24(G)(1) of the state code, which provides as follows:

If an employer transfers its trade or business, or a portion thereof, to another employer and, at the time of the transfer, both employers are under substantially common ownership, management or control, then the unemployment experience attributable to the transferred trade or business, or portion thereof, shall be transferred to the employer to whom the business is so transferred. The director shall recalculate the rates of both employers and those rates shall be effective immediately upon the date of the transfer of the trade or business.

Under this rule, if companies are under the same corporate ownership, management or control at the time of transfer, the

experience rating of the former employer will automatically be imposed on the new employer. The above provision in Section 4141.24(G)(1) came under scrutiny in Delphi Automotive.

The Holding in Delphi Automotive

The case of Delphi Automotive involved the reorganization of an automotive parts manufacturer named Delphi Corp. Delphi Corp. transferred certain assets held by one of its subsidiaries named Delphi Automotive Services LLC, referred to herein as “old Delphi,” to a newly created entity owned by two third-party hedge funds also named Delphi Automotive Services LLC, referred to herein as “new Delphi.” The transfer of assets from old Delphi to new Delphi occurred on Oct. 6, 2009, the closing date.

On the closing date, new Delphi issued a press release declaring “[Old Delphi’s] president and CEO, and the current leadership will continue to manage the company’s global operations.” A few weeks later, on Oct. 23, new Delphi rehired old Delphi’s management team, including its president and CEO, treasurer, general counsel and secretary to similar positions to those they had at old Delphi. During the interim period — after Oct. 6 and before Oct. 23 — new Delphi was under the management of representatives of its new hedge fund owners.

In June 2011, the Ohio Department of Job and Family Services notified new Delphi that it would have old Delphi’s experience rating under the state mandatory transfer provision — Section 4141.24(G)(1). New Delphi appealed this determination because it argued that “at the time of transfer” it did not share substantially common ownership, management or control with old Delphi. This issue ultimately made its way to the Ohio Supreme Court.

Interestingly, the state did not argue that new Delphi and old Delphi were under different ownership, management and control on the specific date of the transfer. Instead, the argument was based on statutory interpretation.

The state argued that the term “at the time of transfer” is a reference to a period spanning weeks during which the company operations transitioned to new ownership, not a specific date.

As a result, the two entities were arguably under the same management at the time of transfer because the same management team was brought in to manage the company weeks after the closing date.

The state went so far as to argue — and the 10th Appellate Court went so far as to accept — that the statute referred to a period in the abstract. By analogy, when someone makes a reference to “at the time of the American Revolution,” they are likely not referring to a specific date but a period of years.

The Ohio Supreme Court’s majority opinion strongly rejected the state’s argument in this case. The court found that the operative statute made clear that it was referring to a precise time at which the transfer of a business occurs.

It notes that without the understanding that there is a definitive date of transfer, the taxing scheme would be impossible to administer: “Who could know what tax is owed when and by whom and who is responsible for other legal obligations, without some clear demarcation of when the transfer of the business occurred?”

Ultimately the Supreme Court held that when the transfer occurred on Oct. 6, 2009, old Delphi and new Delphi were under separate ownership, management and control. It did not matter that new Delphi ultimately retained the same management group later to run the company or that new Delphi publicly announced on the closing date that it would retain the old Delphi’s leadership team. Therefore, new Delphi was eligible for a new experience rating and did not have to inherit the same from old Delphi.

Implications for Acquisitions and Reorganizations

Companies engaging in strategic transactions should consider the unemployment tax liabilities of their target companies. During the due diligence phase of a transaction, potential buyers and successors should evaluate a company’s experience rating and consider whether the company has taken any actions over the past year (e.g., layoffs) to increase or decrease their experience rating. While unemployment taxes alone would likely not dictate the form of the transaction, it may become a factor.

If the predecessor company has or is likely to have a poor experience rating, then it may be worth structuring the transaction so that it has no continuation of ownership, control or management with the acquiring entity.

If the transaction is being entered into by third parties, then separate ownership and control would be expected. However, just as in Delphi Automotive, management can also be separated if the successor does not officially hire the predecessor's employees on the date of closing.

The holding in Delphi Automotive seems to indicate that a period of only one day would be enough time to keep the entities under different management for purposes of Ohio's mandatory transfer provision.

Alternatively, a successor entity may wish to be considered a successor-in-interest and obtain its predecessor's experience rating. An employer may voluntarily elect to become successor-in-interest if all the following requirements are satisfied:

- (1) At least 75% of the assets of the transferor's trade or business located in the state of Ohio are transferred to the transferee;
- (2) Immediately after the acquisition, the transferee employs 75% or more of the same individuals covered under the Ohio unemployment compensation law who immediately prior to the transfer were employed in such business; and
- (3) An application signed by both the transferor and the transferee requesting that the transferee be made a successor in interest is submitted to the Ohio Department of Job and Family Services (Form JFS-201118).[7]

Conclusion

By appropriately planning and timing the hiring of company management, businesses can obtain significant savings. State unemployment insurance taxes will likely become a special consideration for mergers, acquisitions and reorganizations occurring in the wake of COVID19 because of the increased number of layoffs. Businesses should be aware of their options to minimize or manage those taxes when structuring transactions and taking on

new employees.

For more information, contact any member of Frost Brown Todd's [Tax Practice](#).

***Note:** *This article was originally published by Law360 (June 1, 2020)*

[1] Delphi Automotive Systems LLC v. Ohio Dept. of Job & Family Servs., Slip Opinion No. 2020-Ohio-2793.

[2] Ohio Governor Mike DeWine issued Executive Order 2020-3D, which provides that “[u]nemployed workers will include individuals requested by a medical professional, local health authority, or employer to be isolated or quarantined as a consequence of COVID-19 even if not actually diagnosed with COV[ID]-19. [sic]”

However, the Order also stated that “[a]ny benefit paid on these unemployment claims shall not be charged to the account of the employer who otherwise would have been charged but instead shall be charged to the mutualized account, except reimbursing employers.” Therefore, certain (but not all) employers with workforces required to be “unemployed” as a result of COVID-19 will not have their Experience Rating negatively impacted.

[3] Ohio Revised Code (“O.R.C.”) 4141.09.

[4] O.R.C. Section 4141.01.

[5] Ohio Office of Unemployment Insurance Operations, available at: <http://jfs.ohio.gov/ouio/uctax/rates.stm> (last accessed May 26, 2020).

[6] *Id.*

[7] Ohio Administrative Code Section 4141-17-03.

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