



Commonwealth of Puerto Rico
DEPARTMENT OF LABOR AND HUMAN RESOURCES

November 6, 2000

Re: Inquiry No. 14839

This is in reference to your inquiry regarding Act No. 74 of June 21, 1956, as amended, known as the Puerto Rico Employment Security Act, to Act No. 139 of June 30, 1968, as amended, known as the Disability Benefits Act, and to Act No. 148 of June 30, 1969, as amended, known as the Annual Bonus Law. Your inquiry is submitted as "a request for a ruling in connection with the unemployment, Christmas bonus and disability insurance wage base limitations covered by a predecessor employer with respect to a successor employer."

Your inquiry is submitted on behalf of a firm engaged in the operation of restaurants ("the successor corporation") which will acquire business operations previously conducted by two other corporations ("the predecessor corporations"). The predecessor corporations are described as "existing credit claimants pursuant to Section 936 of the United States Internal Revenue Code (USIRC)." The relevant facts, as described in your inquiry, are as follows:

Due to the elimination of the benefits provided by Section 936, the Board of Directors, as part of the successor corporation business planning, decided to create one new foreign corporation. To these effects [sic], such corporation will be organized under the laws of the Cayman Islands with the purpose of transferring the business operations currently carried [on] by the predecessor corporations to the successor corporation.

The predecessor corporations['] business operations will cease on October 1, 2000, whereas the successor corporations [sic] will uninterruptedly continue with the operations on October 2, 2000 ("the transaction date").

The operations to be carried [on] by the successor corporation are identical to the ones currently carried on by the predecessor corporations. The successor corporation will acquire all the property held by the predecessor corporations and the business operations will continue to take place in the same facilities used by the predecessor corporations. Furthermore, the successor corporation will continue to employ all of the predecessor corporations' employees.

The unemployment and disability insurance payments made pursuant to the Puerto Rico Employment Security Act of 1956, as amended (hereinafter referred to as the "PRESA") and the Disability Benefits Act of 1968, as amended (hereinafter referred to as the "DBA") will have covered the \$7,000 and \$9,000 annual taxable wage base, respectively, for many employees as of the transaction date.

DISCUSSION

Both the PRESA and the DBA are silent as to the treatment that the payments made by an employer, with respect to the unemployment and disability insurance wage base limitation, will have at the time a successor employer continues to employ the [same] employees.

Before continuing with the discussion, it is important to first define the term "successor" employer. To these effects [sic], §8(g) of the PRESA refers to a successor employer as one that succeeds or acquires from an employer the organization, commerce, or business, or substantial assets of one of these. The term successor employer is also defined as an employer that acquires substantially all property used in a trade or business of another employer (predecessor) or in a separate unit of its trade or business, and immediately after the acquisition employs individuals who worked for the predecessor immediately before and during the same calendar year of the acquisition. [Citations omitted]. Based on the above, [our client] is a successor employer with respect to both [the previous corporations].

As previously mentioned, neither the PRESA, nor the DBA provide for the treatment of the wages paid by a predecessor employer for purposes of computing the wage base limitation of a successor employer. However, both the PRESA and the DBA contain provisions which treat successor employers as a continuing employer. For example, §8 of the PRESA provides for a different treatment at the time of determining an employer's experience rate for purposes of computing its unemployment insurance tax liability, if it is considered a successor employer. To these effect [sic] Subsection 8(g) provides that if the successor was not an employer at the time of acquisition,

as happens to be in our case, the successor employer will pay the unemployment insurance tax based on the predecessor's experience rate. Also, §9(h) of the DBA provides that a successor employer will be liable for the contributions, interest or penalties due or accrued and unpaid by a predecessor employer.

In addition, it is important to note that the legislative intent of Act 52 of August 9, 1991 (hereinafter referred to as the [sic] "Act 52"), which added to §8 of the PRESA the provisions with respect to successor employers, provides that Act 52, "in addition to providing tax relief to employers, will assure an equitable distribution of the costs associated with the unemployment compensation system".

In general, federal cases and rulings, although not binding authority in Puerto Rico, are considered persuasive and accorded substantial weight in the interpretation of the equivalent provisions of the PR law. Therefore, we will examine the federal legislation for purposes of our analysis and discussion.

For federal tax purposes, when a successor and predecessor employer relationship as described above exists, the wages paid during the calendar year by the predecessor are taken into account in order to calculate the successor's liability under the Federal Insurance Contributions Act (hereinafter referred to as the "FICA") and the Federal Unemployment Tax Act (hereinafter referred to as the "FUTA"). That is, the wages paid by the predecessor employer can be counted by the successor employer in figuring the wage base limits for FICA and FUTA purposes. [Citations omitted].

In our particular circumstances, the previously discussed federal payroll tax legislation should be considered a determinative factor of the issue at hand, in light of the influence and relation of the FICA and FUTA with the Puerto Rico payroll tax law. In fact, the legislative intent of Act 15 of May 25, 1985, (hereinafter referred to as the [sic] "Act 15"), which amended the PRESA, provides that "Puerto Rico is part of the Federal-State Employment Security System and its unemployment compensation insurance act must conform to the Federal Unemployment Contributions Act, Public Law 97-248, the 1982 Tax Equity and Fiscal Responsibility Act, which amended the FUTA[.]"

In conclusion, when the PRESA and the DBA refer to successor employers[,] both legislations [sic] treat them as a continuing employer and not as a new employer, therefore the unemployment and disability insurance wage base limitations covered by a predecessor employer should be considered at the

time of computing the successor's employer liability. Also, the scheme proposed by the Department of Labor does not achieve the legislative intent of assuring an equitable distribution of the unemployment insurance cost.

Furthermore, the federal treatment, highly persuasive if not determinant on this matter, which takes into account the payments made by the predecessor for purposes of computing the successor employer's responsibility, supports our position and clarifies the issue beyond any doubt. The \$7,000 and \$9,000 annual taxable wage base limitation of the predecessor employer should be considered for purposes of computing the tax liability of the successor employer, thus conforming the local payroll legislation to the federal legislation as the legislative intent of Act 15 states.

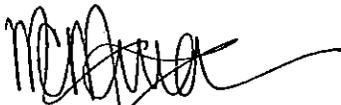
Based on the above facts, we hereby respectfully request your determination with respect to the payments made by [the predecessor corporations] for purposes of computing the unemployment and disability insurance wage base limitations of [the successor employer].

During the past two years the Department of Labor and Human Resources has issued several rulings in similar cases. Said rulings have been consistent in allowing the successor employer to receive credit for unemployment and disability insurance payments made by the predecessor employer during the same calendar year. In the first place, we regard the federal rulings in analogous cases as a compelling consideration, given Puerto Rico's inclusion in the Federal-State Employment Security System. Moreover, we believe a denial of such credit would lead to an inequitable result, yielding tax collections in excess of the \$7,000 and \$9,000 unemployment and disability insurance wage base limitations, respectively, despite the fact that the benefits to which the employees are entitled are limited by law to those levels, and thus cannot be exceeded. Based on that reasoning, we conclude that the successor employer is entitled to credit for payments made by the predecessor employer in this case.

Finally, at the outset your inquiry also purported to deal with the application of Act No. 148, *supra*, but you posed no questions in regard to that law.

We trust the foregoing is responsive to your inquiry.

Cordially,



María C. Marina Durán
Solicitor of Labor