



Robert W. Wood

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Forget Carried Interests--- Private Equity Firms Face Union Pension Liabilities

Is private equity a business? Most people—including Mitt Romney—would say yes. Still, what is a “trade or business” can impact tax deductions. For pension liability, the line between business and investment can mean big liabilities or a free ride.

If a private equity fund buys a company that contributes to a multiemployer pension plan and the company fails, is the private equity fund on the hook too? In

[*Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus.*](#)

[*Pension Fund*](#), the First U.S. Circuit Court of Appeals considered whether a private equity group has withdrawal liability to a multiemployer pension fund. The decision could change the private equity industry.

Private equity funds take aggressive stakes in companies, often in heavy industry and manufacturing. They hope to turn the company around. Two private equity funds managed by Sun Capital acquired a brass fabricator that eventually went bankrupt. The company had pension obligations it owed to the New England Teamsters and Trucking Industry Pension Fund.



When the company went under, the two Sun Capital funds claimed they were passive investors. No business, no liability, Sun Capital said in court. Sun Capital sought a declaratory judgment that it was a mere investor with no pension liability. The Teamsters Fund counterclaimed seeking a large withdrawal liability from Sun Capital.

The district court agreed with Sun Capital. But on appeal, the First Circuit reversed, finding that the private equity group operated and managed the failed company and was not merely an investor. The appeals court remanded for further factual development and for further proceedings.

The Teamsters Fund claimed Sun Capital had entered into a partnership or joint venture with Scott Brass and was therefore also liable. The Pension Benefit Guaranty Corporation ([PBGC](#)) filed an [amicus brief](#) in support of the Teamsters Fund. The federal Multiemployer Pension Plan Amendments Act was enacted to protect defined pension benefit plans. One big part of that law is to create a disincentive for employers to withdraw.

When an employer withdraws from a plan with unpaid liabilities, federal law can pierce corporate veils and impose liability on owners and related businesses. The phrase “trade or business” is not defined in the Treasury Regulations. But in 2007, the PBGC applied a two-prong test to determine if a private equity fund was a trade or business: (1) was the private equity fund engaged in an activity with the primary purpose of income or profit; and (2) did it conduct that activity with continuity and regularity?

Sun Capital met both tests, said the appeals court. Sun Capital took an active role in the management and operation of the companies it acquired. Private equity firms that invest in industries with unionized employees and multiemployer pension plans may become more cautious.

Private equity “investors” may also become more subtle in their controls. Such firms can be aggressive and controlling. But they may now need to be more passive, or at least appear that way. Private equity firms—in reality or in presentation—may start to be more in the back seat and less behind the wheel. That should be an interesting transition to watch.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.