
Controlled Group Of Corporations (IRC §414(b))

The Controlled Group rules require closely related companies to be treated as a single employer for benefit plan purposes. This means that employees of all the related companies must be considered when conducting the coverage and discrimination tests for the plans, even if they do not participate in the particular plan being tested. Under IRC §414, controlled group of corporations means a parent-subsidary controlled group, a brother-sister controlled group, or a combined group.¹

Parent-Subsidiary Controlled Group

A parent-subsidary is a chain of corporations where the controlling interest of each organization is held by another organization within the chain (with the exception of the common parent).

More specifically, one or more chains of corporations connected to a common parent corporation through stock ownership, as long as both of the following are true:

1. one of the other corporations owns stock of at least 80% of the total combined voting power of all classes of stock entitled to vote, or at least 80% of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation; and
2. the common parent corporation owns stock of at least 80% of the total combined voting power of all classes of stock entitled to vote, or at least 80% of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

Note: For purposes of complying with IRC §415 (limitations on benefits and contributions under qualified plans), it is necessary to substitute "more than 50%" for the phrase "at least 80%".

1. Treas. Reg. 1.414(b)-1

Brother-Sister Controlled Group

This means the same five or fewer persons (i.e., individuals, estates, trusts) when they own a controlling interest in each organization, and when taking into account the ownership of each person only to the extent ownership is identical with respect to each organization those persons are in effective control of that organization.

More specifically, two or more corporations, if five or fewer "persons" (i.e., individuals, estates, or trusts) own:

1. stock of at least 80% of the total combined voting power of all classes of stock entitled to vote, or at least 80% of the total value of shares of all classes of stock of each of the corporations; and
2. stock of more than 50% of the total combined voting power of all classes of stock entitled to vote, or more than 50% of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

Example #1: The outstanding stock of Corporations A, B, C, D, and E, which have only one class of stock outstanding, is owned by the following unrelated individuals.

	Corp A	Corp B	Corp C	Corp D	Corp E
Joe	55%	51%	55%	55%	55%
Emily	45%	49%			
Frank			45%		
Marsha				45%	
Nathan					45%
Totals	100%	100%	100%	100%	100%

Corporations A and B are members of a brother-sister controlled group, since together Joe and Emily own more than 80% of Corp A and more than 80% of Corp B. Although the "effective control" requirement (50% threshold) is met for all five corporations through Joe's ownership, corporations C, D, and E are not members of the controlled group because a controlling interest (80% threshold) in each of those corporations is not owned by the same five or fewer persons whose stock ownership is considered for purposes of the "effective control" requirement.²

2. From the 401(k) Answer Book, 2001 Edition

Example #2: The outstanding stock of Corporations F, G, and H, which have only one class of stock outstanding, is owned by the following unrelated individuals.

	Corp F	Corp G	Corp H
Amy	65%	40%	55%
Brian	35%	60%	0%
Carla	0%	0%	45%
Totals	100%	100%	100%

Corporations F and G are members of a brother-sister controlled group. Amy and Brian together have a controlling interest (80% threshold) in F and G. Amy's ownership for purposes of the effective controlled test is 40%, the lesser of her ownership in F and G. Brian's ownership for effective control is 35%. Together, Amy and Brian own 75% (which is greater than the 50% threshold) of corporations F and G, so they also have effective control, which makes F and G a brother-sister controlled group. Note: Since the three individuals together do not own more than 50% of G and H for the effective control test, H is not part of the brother-sister controlled group.³

Combined Group

This means three or more corporations, each of which is a member of a group of corporations described in the Parent-Subsidiary or Brother-Sister sections, and one of which:

1. is a common parent corporation included in a group of corporations described in the Parent-Subsidiary section, and also
2. is included in a group of corporations described in the Brother-Sister section.

“Assumed” Controlled Group

Assuming three individuals own all of the interests in a group of corporations at identical percentage levels, those corporations would make a brother-sister controlled group. In that event, qualified plan and welfare plan benefits should be provided to all employees of these corporations as if the whole group were a single employer. The plans should be tested under the various required coverage, nondiscrimination and benefit availability tests on this deemed "single employer" basis as well.

“Over-Inclusion” Issues

Occasionally it is possible for an entity to be mistakenly included in a Controlled Group for benefits purposes when it doesn't satisfy the controlled group ownership interests. In this event, the benefit plans may become multiple employer plans.

This type of situation can require additional filing, disclosure and compliance. Failure to correctly report, communicate and test a plan can result in fines, penalties, corrections

3. Paraphrased from Who's the Employer? A Guide to Employee and Aggregation Issues Affecting Qualified Plans

obligations and even disqualification. The failure to properly structure the plan design can also result in employee-participants being retroactively taxed on what were previously "pre-tax" amounts. Amended federal and state tax filings often are necessary, and employers may owe additional employment taxes (again, being subject to amended corporate tax returns.)

To avoid this result, the separate Controlled Group entities should maintain separate plans. The separate plans can be clones of each other, if consistency is desired within the overall group.

“Under-Inclusion” Issues

If members of a Controlled Group maintain separate plans for their own employees, those plans must satisfy the required coverage, non-discrimination and benefit availability tests on a Controlled Group basis. This means all employees of the Controlled Group must be considered in performing the tests, *even if plan participation has not been available to them.*

Objective

If the goal is to provide the same benefits for all employees of the entities in question, that can be accomplished through a single set of plans for members of a Controlled Group and "mirror plans" for entities that aren't part of the Controlled Group.

QSLOB Considerations

Even when corporate entities are a Controlled Group, it may be preferable to consider some entities separately from the others. In this case, the Qualified Separate Line of Business ("QSLOB") rules may be helpful. They deem related entities to be separate for certain purposes, subject to certain requirements.

The QSLOB rules are based on data which depend on facts and circumstances to determine if a specific Controlled Group member may be considered a Separate Line of Business from the other Controlled Group members. For this reason, it is usually desirable to obtain IRS approval of QSLOB status.

Commonly Asked Questions

Q1: Why is it important to know if we are part of a Controlled Group?

A1: Regulations require all employees of a Controlled Group to be included in certain "coverage" tests. If your company is part of a Controlled Group and Zingle & Associates is not provided with this information, your test results will not be accurate. This could jeopardize your plan's tax qualification status. Additionally, your Controlled Group status could impact the type of plan document you should be using. For example, if you are on a standardized prototype document, all members of your Controlled Group may need to be included in your plan. On the other hand, if you have two unrelated employers participating in the same plan, prototype documents are not available to you at all, and you must use an individually-designed plan document; other members of your Controlled Group will need to adopt the plan.

Q2: Are there any other corporate structures that have retirement plan requirements similar to the Controlled Group requirements?

A2: Yes. It is just as important to know if an employer is part of an Affiliated Service Group, or a group of Trades or Businesses under Common Control, described elsewhere in this paper.

Q3: Can Zingle & Associates determine if we are part of a Controlled Group?

A3: Generally, no. The descriptions in this paper should be used only as a general outline. Since the Controlled Group rules are very complex and subject to change, not all of them are included here. For that reason, in many situations plan sponsors should consult an attorney and/or accountant to determine their Controlled Group status. Where possible, Zingle & Associates may be able to indicate what the Controlled Group status appears to be and will ask plan sponsors to verify this with their attorney and/or accountant.

Q4: Do we need to notify Zingle & Associates if we are undergoing a corporate acquisition, merger or disposition? When should Zingle & Associates be notified?

A4: Yes. A corporate acquisition, merger or disposition can impact your plan significantly. You may need to implement many plan changes before or immediately after a company sale or purchase. Some of the questions you should consider include:

- To what extent will the transaction affect your Controlled Group status?
- What will happen to participants involved in the transaction?
- Will you continue to maintain the plan?
- Should / must employees of other companies be brought into the plan?