Controlled Groups

Part 1 of our series on Understanding Employer Structures

Understanding employer structures is crucial in qualified plan administration. If a company establishes a qualified plan and has controlling interest in another company, the Plan may be required to consider the employees of that company for plan limits, coverage, and testing. Controlling interest may result from ownership interest or a service relationship.

To properly determine controlling interest, consider the following questions.

1. Do the owners of the employer adopting the plan have ownership interest in any other companies?
2. Do the owners have any family members that work at a company in which they have ownership interest in?
3. Does the company provide significant services during the year for any other company?

The Understanding Employer Structures series explains how employer structures can affect qualified retirement plans and tackles the following topics:
Controlled Groups, Affiliated Service Groups, Multiple Employer vs. Multiemployer Plans, & the Family Attribution Rules

Controlled Groups

Two or more companies connected by common ownership.

All employers in a controlled group are viewed as a single employer for qualified plan purposes. Similarly, an employee's service across all employers of the controlled group is aggregated for purposes of eligibility, vesting, accruals, testing, and plan limits.

Three Forms of Controlled Group Relationships

Parent - Subsidiary

A Parent-Subsidiary relationship is formed when one company, the "Parent", owns at least 80% of another company, the "Subsidiary". If the Subsidiary is also a Parent company with at least 80% ownership in another company, the controlled group relationship is extended. Parent-Subsidiary relationships can involve different business types.

Brother - Sister

Brother-Sister controlled groups consist of two or more companies with five or fewer common owners. Common owners must be individuals, trusts, or estates and have an ownership interest in each company of the Brother-Sister group. This type of controlled group must satisfy both the *80% common control test* and the *50% effective control test*.

The 80% Common Control Test
The 80% common control test is satisfied when all common owners have ownership in each company of the controlled group and the combined ownership of the common owners is at least 80% in each company.

Example:

Company A		Company B	
Adam	40%	Adam	30%
Beth	25%	Beth	35%
Corey	30%	Corey	25%
Dawn	5%	Evan	10%

In the above example, Dawn and Evan do not have ownership interest in both Company A and Company B, therefore they are not considered for the controlled group. Adam, Beth, and Corey are common owners as they each have an ownership interest in both companies. The total common ownership among the three owners is 95% for Company A and 90% for Company B, satisfying the 80% common control test.

The 50% Effective Control Test
To satisfy the 50% effective control test, use the lowest percentage of ownership among common owners for each company. When combined together, these percentages must equal at least 50%.

In the above example, the lowest ownership percentage for each company is Beth with 25% in Company A and Corey with 25 % in Company B. The combined total of these is 50% which satisfies the 50% effective control test. Hence, Company A and Company B have a Brother-Sister controlled group relationship.

Combined Group
A combined group is established when the Parent in a Parent-Subsidiary controlled group is also part of a Brother-Sister group. In this scenario, the Parent-Subsidiary group and the Brother-Sister group would be combined and considered as one single employer for qualified plan purposes. However, if the Subsidiary is part of a Brother-Sister controlled group rather than the Parent, the companies involved are not treated as one employer but rather two separate controlled groups.

Special Considerations with Controlled Groups:

- All employees in the controlled group are considered for testing purposes meaning that determination of key employees and highly compensated employees must be done across all employees.

- For purposes of tax deduction, each employer may deduct their own contributions unless more than one employer has adopted the same plan. In this scenario, the limit is applied to the plan, not the employer.
- IRC Section 415 contribution limits are applicable when a Parent company owns more than 50% of a Subsidiary, even though a Parent-Subsidiary controlled group would not exist.
- Lineal relatives, such as parents and children, are deemed to hold the same ownership in a company as the original owner. However, once ownership is attributed to a family member, it cannot be reattributed from that individual to another family member as this would be double attribution. As previously discussed, acknowledging family members working at companies in which the employer has ownership interest is extremely important for determining controlling interest and controlled groups.

Conclusion

Controlled Groups arise when companies are connected by common ownership such as in Parent-Subsidiary or Brother-Sister relationships. In situations such as these, all employers in the controlled group are viewed as a single employer for qualified plan purposes, regardless of whether or not all employers in the controlled group have adopted the Plan. Similarly, all employees of companies in the controlled group are considered for eligibility, vesting, accruals, testing, and plan limits making it crucial to understand and acknowledge ownership interest, including attributed interest, in any other companies.

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