

This Month's Compliance Corner: Controlled Group Status

By Claire Martin

Controlled group status is something that employers should always keep in mind for several reasons, but particularly as it relates to their employee benefit plans. Controlled group status can determine whether two or more companies, or certain other groups of related trades and businesses, will be treated as a single employer for purposes of their employer-sponsored health and welfare plans, as well as for purposes of certain other federal rules and regulations. Note that while this month's Compliance Corner focuses on controlled group considerations for health and welfare plans, controlled group status is equally as important for employer-sponsored retirement plans (specifically, whether the plan satisfies certain coverage, participation, vesting, and nondiscrimination rules).

What is a controlled group?

At its most basic level, a "controlled group" is a group of companies that have a certain level of common ownership or control. The Internal Revenue Code ("IRC"), and its Treasury regulations establish the specific definition of what constitutes a controlled group (see 26 U.S.C. §§ 414(b) and 1563(a) and under these rules, the following groups are treated as a single employer for certain purposes:

- **Parent-subsidiary group:** This group consists of a parent company and any number of direct and indirect subsidiaries, where (a) the parent company owns at least 80% of at least one subsidiary and (b) at least 80% of company in the group (other than the parent company) is owned by the other companies in the group. (See 26 U.S.C. §§ 414(b) and 1563(a) and 26 C.F.R. § 1.414(b)-1.) Example: Parent owns 100% of the stock of Subsidiary A. Subsidiary A owns 80% of the stock of Subsidiary B and 60% of the stock of Subsidiary C. The parent and Subsidiaries A and B are part of a controlled group of corporations. Subsidiary C is not part of the controlled group.
- **Brother-sister group:** This group consists of the same 5 or fewer individuals, trusts, or estates, who own (a) at least 80% of all companies in the group (aka, a "Controlling Interest"), taking into account only those individuals who own at least some interest in each company, and (b) more than 50% of all companies in the group (aka, "Effective Control") taking into account only such individual's ownership that is identical across each company. Example:

Member	Company Y	Company Z	Dual Ownership
A	70%	25%	25%
B	15%	55%	15%
C	10%	10%	10%
D	5%	10%	5%
Total	100%	100%	55%

Based on the table above, Companies Y and Z are in a brother-sister controlled group, since all shareholders together own 80% or more of the stock in each company and own more than 50% of the stock of each company taking into account their identical ownership in each company.

- ***Combined parent-subsidiary and brother-sister groups:*** This group consists of a combined parent- subsidiary group and a brother-sister group. A combined group exists if three or more organizations are organized as follows: (a) each company is a member of either a parent-subsidiary group or a brother-sister group; and (b) at least one of the companies is the common parent of one group and such company is a member of the brother- sister group.

In addition to controlled groups, employers should also be cognizant of potential “affiliated service group” (“ASG”) status, which is different from controlled group status but is subject to similar rules and regulations regarding whether two or more companies or groups will be treated as a single employer. The determination of whether an ASG exists is complex (and beyond the scope of this Compliance Corner), but the ASG rules aim to capture separate but affiliated companies that provide services to one another, or that jointly provide services to third parties, to such a degree that the rules require such companies to be treated as a single employer for certain purposes, even if there is not enough common ownership for the companies to be in a controlled group.

What health and welfare plan rules are affected by controlled group status?

Controlled group status is important because all employees in a controlled group, even when employed by different companies, will be considered to be employed by a single employer for the purposes of applying certain health and welfare plan rules and regulations, including but not limited to the following: (i) the nondiscrimination rules for self-insured medical reimbursement plans under IRC § 105(h); (ii) the nondiscrimination rules for cafeteria plans under IRC § 125; (iii) the rules for determining “applicable large employer” status for ACA purposes under IRC § 4980H(c)(2)(c); and (iv) the health plan continuation coverage requirements under IRC § 4980B.

Self-Insured Medical Reimbursement Plan Nondiscrimination

Self-insured medical reimbursement plans (*e.g.*, self- insured health, dental, and vision plans; health flexible spending accounts (FSAs); and health reimbursement arrangements (HRAs) are subject to certain nondiscrimination rules that prohibit the plans from discriminating in favor of highly compensated individuals in terms of plan eligibility or benefits. (*See* 26 U.S.C. § 105(h).) While the specific rules for the various nondiscrimination tests are complex, employers should understand that controlled group status is an important factor in conducting these tests for their plans. Generally, if multiple employers are part of the same controlled group, all employees of those employers must be included in the nondiscrimination testing for the employers’ plans. For example, when one employer in the group conducts nondiscrimination testing for its health FSA, it must count all employees in the controlled group. Failure to include such employees in testing could result in unintended tax consequences for participants.

Cafeteria Plan Eligibility and Nondiscrimination

With regard to cafeteria plan compliance, controlled group status is relevant in several ways, the first of which relates to eligibility to participate in the plan. Companies in a controlled group can provide a single cafeteria plan under which all employees of the controlled group can participate. Additionally, similar to the nondiscrimination rules for self-insured medical reimbursement plans, the controlled group rules also apply with regard to nondiscrimination testing for cafeteria plans. (*See* 26 U.S.C. § 125.) This means that when one employer in the controlled group conducts nondiscrimination testing for its cafeteria plan, all employees in the controlled group must be included in testing. The controlled group rules also apply to the annual limit on salary reduction contributions to a health FSA under a cafeteria plan.

ACA's Employer Mandate

The controlled group rules apply for purposes of counting “full-time” (and/or “full-time equivalent”) employees (“FTEs”), which is necessary to determine if an employer is an “applicable large employer” (“ALE”) subject to the ACA’s employer mandate. (*See* 26 C.F.R. § 54.4980H-1(a)(16).) All members of a controlled group will be considered a single ALE if they collectively employ 50 or more FTEs. In that case, each separate entity in the controlled group is an “ALE member” that is subject to the ACA’s employer mandate and reporting obligations (ACA reports must be filed and furnished by each ALE member separately). Failure to satisfy these obligations can result in financial penalties. The rules for determining liability for such penalties (and the amount) are applied separately to each member of the controlled group.

Health Plan Continuation Coverage (COBRA)

With regard to health plan continuation coverage requirements under the Consolidated Omnibus Budget Reconciliation Act (“COBRA”), controlled group status comes into play in two (2) significant ways:

1. Employers with fewer than 20 employees (on 50% or more typical business days in the prior calendar year) are exempt from COBRA’s continuation coverage requirements; however, this is determined on a controlled group basis, so if an employer is in a controlled group, it must also count all employees in the controlled group to determine if the exemption applies.
2. Controlled group status is also significant in the event of a merger or acquisition of a company. While the rules on COBRA liability in the event of a merger or acquisition are complex and depend on the type of merger or acquisition at issue, there are circumstances when the buying or selling company’s COBRA liability can extend to members of its controlled group.

How can plan sponsors determine controlled group status?

If you are unsure about the controlled group status of your company, you should start by asking the following preliminary questions:

- Does the company have any direct or indirect ownership interests in another company (or

companies)?

- Is the company owned directly or indirectly by another company (or companies)?
- Is the company owned by a small number of individuals, estates, or trusts? If so, do they have common ownership in another entity?

You should also reach out to management regarding the company's ownership status as necessary. Even if management is unable to say whether the company is in a controlled group, the managers will likely have some helpful preliminary information regarding the company's ownership structure.

Another step is to reach out to any retirement plan or health plan TPAs. Controlled group status is often taken into account during the plan design process, so TPAs may have helpful information in this regard. Plan sponsors can also reach out to their benefits consultants for assistance. In-house or outside benefits counsel may also be a good resource and can assist with the controlled group determination process.

Once controlled group status is determined, plan sponsors should take steps to ensure they have been administering their plans in accordance with the controlled group rules. This will require coordination with TPAs, as well as your benefits consultants, and may necessitate consideration of corrective measures in the event of noncompliance.