



# Controlled Group

WHAT IS A CONTROLLED GROUP? HOW DOES THIS IMPACT YOUR BUSINESS?

## Controlled Groups Rules for Qualified Retirement Plans

### Introduction

One of the most common issues that arise when CPAs are counseling clients regarding retirement plans is how the controlled group rules apply in qualified plan world. The controlled group rules ensure that a qualified retirement plan (or plans) maintained by an employer (or group of related employers) does not discriminate in favor of highly compensated employees (HCEs).

### Why is it important?

A controlled group of companies is considered a single employer for qualified plan purposes, and, generally single employers are prohibited from maintaining more than one qualified plan without passing some complicated testing under the IRC 410(b) coverage regulations. Ultimately, the IRS is trying to prevent companies and controlled groups from setting up plans with generous contribution benefits which cover a disproportionate number of HCEs and separate plans which provide lesser or no benefits to Non-highly Compensated Employees (NHCEs).

### Failure to properly identify a controlled group can lead to all of the following issues:

A Simplified Employee Pension (a "SEP") applying to unintended employees. By definition, SEPs apply to **all** eligible employees in a controlled group. If there are multiple companies in a controlled group and one of those companies adopt a SEP, that SEP (and any employer required contributions) apply to **all** members of the controlled group. The same applies to SIMPLE IRAs.

The improper step-up and design of multiple 401(k) plans within the group which might fail the IRC 410(b) coverage tests and lead to disqualification of one or more of the qualified plans.

Incorrect nondiscrimination testing for new comparability plans and cash balance plans.

These issues do come up periodically on IRS audit. From time to time the IRS does initiatives targeted at finding the above issues.

### What constitutes a controlled group?

A controlled group of companies exists when one business owns a controlling interest in multiple businesses or when five or fewer individuals own more than one company.

In determining who the owners are, certain family members are attributed the ownership of the direct owner. This prevents the direct owners from evading the controlled group rules by making their family members owners. Spouses are attributed ownership unless they qualify for an exception, and in community property states some attorneys may assert that the spouse has a direct ownership interest.



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## Parent-Subsidiary Groups:

This type of controlled group exists if one business owns 80% or more of another business. A single parent-subsidiary group may be made up of multiple subsidiaries owned by a common parent, or multiple tiers of subsidiaries owned at least 80% by the common parent.

**Example – Parent and Multiple Subsidiaries:** Holding Company A owns 55% of Company B which in turn owns 100% of Company C. Holding Company A also owns 80% of Company D and 100% of Company E. In this example, there are two controlled groups (CG):

Parent Subsidiary Controlled Group 1: Includes B and C because B owns more than 80% of C, but the Holding Company A only owns 55% of B and thus A is not part of the group.

Parent Subsidiary Controlled Group 2: Includes A, D and E because A owns 80% or more of each of D and E.

**Brother-Sister Groups:** A brother-sister controlled group exists if:

The same 5 or fewer common owners (individuals, estates, or trusts) own at least 80% of each company, and; The same 5 or fewer owners have an identical ownership among all companies which totals more than 50%

The amount of identical ownership is determined by selecting the lowest commonly owned percentage among the companies.

**Example – Brother Sister Controlled Group:**

Owner	Company A	Company B	Identical Ownership
1	40%	30%	30%
2	20%	40%	20%
3	35%	15%	15%
4	5%	0%	0%
5	0%	15%	0%
Total	95%	85%	65%

In this example, Companies A and B are in a controlled group because the same 5 or fewer owners commonly own more than 80% and have identical ownership of more than 50%. Note that owners 4 and 5 are disregarded because they do not have an ownership in both companies.

## Key Take Aways

When assisting clients with SEPs, SIMPLE IRAs and qualified plans, CPAs should ensure that the controlled group rules are taken into account. If it is not clear whether or not there is a controlled group, employers should work with a retirement professional who regularly make these determinations. As clients establish new companies or buy companies, CPAs can add value by reminding their clients to speak with their retirement plan professional about these issues.