
Navigating Controlled Group and Affiliated Service Group Rules

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Jessica helps clients navigate the complex and evolving area of employee benefits law, including health care reform, tax-qualified retirement plans and executive compensation. She also frequently handles employee benefits issues arising in corporate transactions, employment agreements, and vendor contract negotiations.

Jessica works with clients on a broad array of employee benefits matters, advising on compliance with ERISA, the Internal Revenue Code, the Affordable Care Act, HIPAA and COBRA. She regularly advises on compensation and benefits aspects of employment agreements and severance arrangements. She also frequently works with clients on negotiating employee benefit vendor contracts and HIPAA business associate agreements for employee benefit plans.

In corporate transactions, Jessica negotiates employee benefits representations and covenants, conducts due diligence review of employee benefit plan documentation, and advises clients on executive compensation issues arising under Section 409A and Section 280G.

Upcoming 2021 Webinars

- **Upcoming 2021 webinars:**
 - **November 18:** Year-End Benefit Plan Requirements/End of Year Benefits "To Do" List
- Sign up here: [Employee Benefits Academy Webinar Series - Subscribe](#)

- Controlled Groups
- Affiliated Service Groups
- Application in the Employee Benefit Plan Context
 - Pension liability under Title IV of ERISA
 - Qualified plan compliance and nondiscrimination testing
 - Affordable Care Act compliance
 - COBRA compliance
 - Multiple employer plans
 - Multiple employer welfare arrangements
 - Executive compensation considerations

- A “controlled group” of corporations, or a “controlled group” of trades or businesses, are treated as a single employer entity for numerous purposes under ERISA and the Internal Revenue Code.
- A “controlled group” means a combination of two or more corporations, or two or more trades or businesses, that are under “common control.”
- Affiliated service groups may also be treated as a single employer in many contexts

These rules are highly complex, and each situation should be addressed individually based on the particular facts and circumstances.

Types of Controlled Groups

There are 3 types of controlled groups:

- Parent-Subsidiary
- Brother-Sister
- Combination

Parent-Subsidiary Controlled Group

- 80% of each organization (except the parent company) is owned by one or more organizations in the group
- The parent owns 80% of at least one other organization
- Example: A Company owns 100% of B Company, which owns 100% of C Company.
- A, B, and C Companies are all in a parent-subsubsidiary controlled group

Brother-Sister Controlled Group

A group of two or more trades or businesses in which 5 or fewer common owners (which must be individuals, trusts or estates) own directly or indirectly a “controlling interest” in each organization and have “effective control” of each organization

- “Controlling interest” generally means 80% or more ownership (but only if the common owner has an ownership interest in each organization)
- “Effective control” generally means more than 50% ownership, but only to the extent that the ownership is identical with respect to such organization

Brother-Sister Controlled Group

Example:

- Shareholder A owns 50% of the stock of Company X and 30% of the stock of Company Y
- Shareholder B owns 20% of the stock of Company X and 20% of the stock of Company Y
- Shareholder C owns 20% of the stock of Company X and 40% of the stock of Company Y
- Controlling interest: Together, the three shareholders own 90% of the stock of Company X and 90% of the stock of Company Y
- Effective control: Taking into account the identical ownership, the Shareholders own more than 50% of the two companies
 - Shareholder A: 30%
 - Shareholder B: 20%
 - Shareholder C: 20%
 - Total: 70%

- Consists of three or more organizations that are related as follows:
 - Each organization is a member of either a parent-subsidary or brother-sister group, AND
 - At least one organization is the common parent of a parent-subsidary group and is also the member of a brother-sister group

- Ownership interests are assessed differently depending on the type of organization involved
 - Corporate: value of stock or voting power of stock
 - Partnership: capital interest or profits interests
 - Trust: actuarial interest
- For corporations with multiple classes of stock, ownership analysis can be complex
- Ownership of certain individuals may be attributed to others in certain circumstances (e.g., spouses, minor children).
 - Attribution rules are highly fact-specific
- As a result, ownership needs to be scrutinized carefully to identify whether a controlled group relationship exists

In some cases, organizations are treated as a single employer for certain purposes due to their service relationship

- A-Organization groups
- B-Organization groups
- Management groups

- Consists of a first service organization (“FSO”) and at least one “A Organization” (“A-Org”)
- The FSO must be a *service organization*
 - The performance of services is the principal business of the organization
- The “A-Org” must be a service organization that is a partner or shareholder in the FSO, and must either:
 - Regularly perform services for the FSO, or
 - Be regularly associated with the FSO in performing services for third parties

- Consists of a first service organization (“FSO”) and at least one “B-Organization” (“B-Org”)
- The FSO must be a *service organization* (the performance of services is the principal business of the organization)
- The “B-Org” must meet the following requirements:
 - A significant portion of its business is performance of services for the FSO, one or more A-Orgs, or both; and
 - The services must be of a type historically performed by employees in the service field of the FSO or the A-Org; and
 - 10% or more of the interests in the B-Org must be held (in the aggregate) by highly-compensated employees of the FSO or the A-Org

- Organizations in certain fields are considered service organizations
 - Including health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, and insurance
 - Exception for organizations engaged in manufacture or sale of equipment or supplies, research, and publishing
- Whether providing services is a “significant portion” of the business is determined based on the facts and circumstances
 - IRS proposed rules include tests based on service receipts and total receipts
 - Determination includes consideration of whether capital is a material income-producing factor

- Group consisting of:
 - An organization the principal business of which is performing, on a regular and continuing basis, management functions for one organization (or for that organization and organizations related to it); and
 - The organization (and related organizations) for which the management functions are performed
- Unlike A-Orgs and B-Orgs, no common ownership required between the entities
- Guidance on these types of arrangements is limited

Controlled Groups in the Private Equity Context

- The controlled group rules can be especially complex in private equity-owned companies
- The *Sun Capital* case raised the question of whether a private equity fund is a “trade or business” for purposes of establishing controlled group relationships
 - At issue in that case was whether the funds could be liable for pension obligations of a portfolio company
 - The First Circuit held that the funds are a “trade or business,” but were not part of a controlled group because no single fund owned 80% or more of the portfolio company

- Pension liability under Title IV of ERISA
- Qualified plan compliance and nondiscrimination testing
- Affordable Care Act compliance
- COBRA compliance
- Multiple employer plans
- Multiple employer welfare arrangements (MEWAs)
- Executive compensation considerations

**NOTE: The remainder of this presentation focuses on the controlled group rules. Many of these requirements also apply to affiliated service groups, but others do not (e.g., Title IV pension liability).*

- Under ERISA, members of a controlled group are “jointly and severally” liable for any defined benefit pension obligations
 - Single employer defined benefit pension plans
 - Multiemployer defined benefit pension plans
- Example: If a contributing employer withdraws from a multiemployer plan that has unfunded benefits, then that company *and all members of its controlled group* are jointly and severally liable for the liabilities associated with those unfunded benefits.

- If the sponsor of a single employer pension plan or contributing employer to a multiemployer pension plan is insolvent or declares bankruptcy, its controlled group members may be held liable for any pension liabilities
- In the transaction context, buyers often request information regarding pension obligations not only of the entity being acquired, but also of controlled group members (often referred to as “ERISA Affiliates”) to understand potential liabilities

- Entities within a controlled group are treated as a single employer for purposes of various rules applicable to qualified plans, such as the following:
 - Nondiscrimination testing
 - Identification of highly-compensated employees
 - Limitations on compensation and contributions
 - Eligibility to participate
 - Service counting
 - Termination of employment
 - Plan termination for defined contribution plans
- Failure to apply the rules properly can result in operational errors and potentially jeopardize a plan's qualified status

- Many nondiscrimination tests must be done on a controlled group basis – meaning that they look at the entire employee population in the controlled group (and not just the employees eligible for the plan)
- Common types of testing include:
 - Coverage testing
 - Average deferral test
 - Average contribution test
 - Top heavy testing
- Special rules can allow a transition period after a merger or acquisition

Compensation and Contribution Limits

- The IRS establishes annual limits on compensation that may be counted for purposes of qualified plans (\$290,000 for 2021)
 - Limit applies to compensation paid by all controlled group members
- IRS rules also limit total contributions to qualified plans (\$58,000 for 2021) and total elective deferrals (\$19,500 for 2021)
 - Limits apply to plans of all controlled group members

Controlled Group Issues in Qualified Plans

- Plan language may provide for participation by all members of the plan sponsor's controlled group, or may specify participating employers
 - Confirm that plan language aligns with intent
- To be eligible to take a distribution following a termination of employment, the participant must have terminated employment with all members of the controlled group
 - If the employee transfers between controlled group members, they are still considered employed
- Service with all controlled group members must be counted for eligibility and vesting purposes
- IRS rules prohibit termination of a defined contribution plan and distribution of account balances if a controlled group member sponsors another defined contribution plan

- Whether an employer has 50 full-time equivalent employees and is subject to the ACA “employer mandate” is determined looking at the controlled group as a whole
- Example: Company A owns 100% of Company B. Company A has 30 employees; Company B has 40 employees.
 - While neither company on its own is over the 50-employee threshold, together they exceed 50 employees and are subject to the employer mandate
 - Each employer has a separate obligation to offer coverage and report its offers of coverage to the IRS
 - The filings for each company should list affiliated employers on Form 1094-C

Other Health and Welfare Plan Considerations

- COBRA
 - If an employer terminates its health plan entirely, generally that entity is not obligated to offer COBRA (because there is no health plan under which COBRA can be offered).
 - But, if the plan sponsor is in a controlled group with an entity that *does* offer a health plan, the controlled group member will be responsible for offering COBRA to the affected employees who lose coverage due to the plan termination
- Nondiscrimination requirements for health plans and cafeteria plans

- If two employers that are not part of the same controlled group participate in the same qualified plan, it is treated as a “multiple employer” plan.
- Nondiscrimination testing is done separately for each employer/controlled group that participates
- Form 5500 filings should designate the plan as a multiple employer plan

Multiple Employer Welfare Arrangements (MEWAs)

- The rules for determining common ownership for purposes of MEWAs are similar, though not identical, to the controlled group rules
- If two unrelated employers participate in a welfare benefit plan, this can create a “multiple employer welfare arrangement” (MEWA)
 - MEWAs are not entitled to ERISA preemption – meaning that they are subject to ERISA and also subject to state laws
 - Many MEWAs, particularly self-insured plans, will not be able to comply with state insurance laws
 - MEWAs are also subject to an annual filing requirement with the DOL (form M-1)

- Section 409A (applicable to “nonqualified deferred compensation”) also applies the controlled group rules, including for the following:
 - Determination of when a separation from service occurs
 - Plan aggregation rules
 - Identification of specified employees
- Section 280G (rules for “parachute payments”) applies similar (though not identical) “common control” rules
 - These rules can impact when a change in control is determined to occur for 280G purposes, as well as who is a “disqualified individual”

Next Month's Webinars

Executive Compensation Academy

- Title: A Review of Unique Non–Employee Director Compensation Arrangements
- When: November 11, 2021
- Time: 10:00 am – 11:00 am CT
11:00 am – 12:00 pm ET

Employee Benefits Academy

- Title: Year-End Benefit Plan Requirements/End of Year Benefits "To Do" List
- When: November 18, 2021
- Time: 10:00 am – 11:00 am CT
11:00 am – 12:00 pm ET

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