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Related Companies: Who Is In Control?

By Adam C. Pozek, ERPA, QPA, QPFC

It seems that businesses of all sizes are more frequently being structured using multiple companies and/or that business owners are acquiring interests in other companies. With the upcoming implementation of the Affordable Care Act, some companies are actively restructuring to stay below the 50-employee coverage threshold. Regardless of the reason, there are complex IRS rules that must be considered when it comes to both the retirement and health benefits being offered to employees.

Background

During the mid-1980s, Congress created a series of complex rules that require all companies in a related group to be combined when performing annual nondiscrimination testing on the retirement plan(s).

> More recently, Congress decided to apply these same rules to determine which companies are subject to the Affordable Care Act.

While this requirement can be a limitation, with some careful planning, it can also be used to provide retirement benefits to multiple companies more cost effectively. Before considering some examples, it is first necessary to dive a little bit into the weeds to understand the gist of the rules themselves.

What Is Ownership?

Since these rules are primarily driven by the ownership of the companies involved, it is essential to review some of the nuances of this seemingly obvious concept. First, ownership in this context is more of a generic term that refers to not only shares in a corporation but also to membership in an LLC, partnership interest in a partnership or LLP and composition of the Board of Directors in a not-for-profit organization.

Second, and perhaps more important, there are instances in which the ownership held by one person or entity is attributed to another person or entity. While we will spare you the gory details, it is important to provide an overview of how attribution works.

From Company to Individual

In a nutshell, this means that a person who owns at least 50% of a business is deemed to own a proportionate share of whatever that business owns. For example, if Fred owns 80% of Bedrock, Inc., and Bedrock owns 40% of Rubble Rousers, Inc.; Fred is deemed to own 32% of Rubble (80% x 40%). There are a number of variations and exceptions, but we did promise to spare you the details.

All in the Family

The Tax Code requires that an individual's ownership be attributed to his/her spouse as well as lineal ascendants and descendants. There are several very important exceptions that require going a little further down this rabbit hole.

- Attribution between spouses is limited, depending on each person's direct ownership and involvement in the other spouse's business.
- There is limited attribution between parents and children over the age of 21.
- There is no attribution between siblings.
- Attribution may extend only to one generation under certain circumstances, while other times it extends to multiple generations.

Controlled Groups

There are two general types of controlled groups ("CGs"), and we will quickly describe each one before considering some examples.

1. ***Parent/Subsidiary:***
Exists when one entity owns 80% or more of another entity, e.g. Company A owns at least 80% of Company B.

2. ***Brother/Sister:***
Exists when the ownership structure meets two thresholds.

- ***Common Ownership:*** The same 5 or fewer individuals must own at least 80% of each company under consideration.
- ***Identical Ownership:*** The best way to explain this is via an example. If Jane owns 10% of one company and 5% of another company, her identical ownership among the two is 5%. To meet this threshold, the sum of the identical ownership of those from the first step must be greater than 50%.

If you aren't snoring yet, give yourself a pat on the back. You're doing better than most!

Putting It Together

It's time to look at some examples to pull all this craziness together. Our cast of characters will include Fred, Barney, Dino, Mr. Slate, Wilma (Fred's wife) and Pebbles (Fred and Wilma's 18-year-old daughter).

Example #1

Our characters hold the following ownership in two companies:

	Bedrock, Inc.	Rubble Rousers, Inc.	Identical
Fred	40%	30%	30%
Barney	40%	30%	30%
Dino	10%	0%	0%
Slate	10%	0%	0%
Wilma	0%	20%	0%
Pebbles	0%	20%	0%
Common	80%	60%	60%

At first glance, it does not appear that the same 5 people own at least 80% of both companies; however, once we consider family attribution, Fred's total ownership in RR is 70% (30% direct + 20% attributed from Wilma + 20% attributed from Pebbles). Together, Fred and Barney own 80% of Bedrock and 100% of Rubble Rousers, making the two companies part of a CG.

Example #2

Fred owns 100% of Quarry, LLC, and Wilma owns 100% of Stone Age, Inc.; neither is at all involved in the other's company. Under one of the exceptions noted above, their ownership would not be attributed to each other, so it appears no CG exists. However, since Pebbles is under the age of 21, she is attributed the ownership from each of her parents, making her the 100% owner of both companies and causing the two to form a CG.

Related Companies: Who Is In Control? continued

Making Sense of It All

So, what does all of this really mean? Basically, when there is a controlled group, all of the related companies are treated as a single employer for purposes of the retirement plan (and for determining whether the business has at least 50 employees, subjecting it to the Affordable Care Act). In other words, the employees of all the related companies must be included in the annual nondiscrimination testing. That might sound onerous, but it doesn't have to be.

Keep in mind that the annual testing compares the benefits provided to highly compensated employees (HCEs) to those provided to Non HCEs. If two companies in the same CG have similar numbers of HCEs and NHCEs, it is completely plausible that the tests would still pass even if the employees of one of the companies don't receive any plan benefits.

When the goal is to provide similar benefits to the employees of several companies, a CG relationship can make it more cost-effective to do so by creating a single plan covering all of the employees. That means only one plan document to maintain, only one plan to administer and only one Form 5500 to file each year. Through the use of more complex forms of nondiscrimination testing, it might even be possible to provide different benefits to the various companies in the group via a single plan.

Conclusion

There are many facts and circumstances that can affect CG determinations, and even seemingly slight nuances can be game changers. As a result, it is important to work with someone who is knowledgeable and experienced in this area to assist with the analysis. With some due diligence and careful planning, you can make sure that you are in control of your controlled group.

For more articles on this topic, visit DWCConsultants.com/Precision

Adam is a nationally known writer and speaker and 20+ year veteran of the pension consulting business. He is a partner at DWC ERISA Consultants, where he works with businesses of all sizes and industries from across the country.

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