

APRIL 20, 2020

## FROST INSURANCE COMPLIANCE TIP

### CONTROLLED GROUPS AND HEALTH CARE REFORM

Remember when the Volkswagen Beetle first rose to fame in the 60s? Popular with its rear-located, rear-wheel drive, air-cooled four-cylinder, boxer engine housed in two-door bodywork, it featured a flat front windscreen, with luggage storage under the front hood and behind the back seat. Just as the Beetle was gaining popularity in the United States, the Revenue Act of 1964 codified the original definition of “common control” in Section 414 of the IRS Code. These rules are commonly known as the controlled group rules. Just a decade later, in 1974, the Employment Retirement Income Security Act, ERISA, was born. ERISA, a federal law, set the minimum standards for pension and health and welfare plans in private industry. While ERISA didn’t require an employer to establish either a pension or health and welfare plan, it did require that those who established plans meet certain minimum standards.

#### ERISA DOES THE FOLLOWING

- Requires plans to provide participants with information about the plan including important information about plan features and funding
- Sets minimum standards for participation, vesting, benefit accrual and funding
- Gives participants the right to sue for benefits and breaches of fiduciary duty
- Guarantees payment of certain benefits if a defined plan is terminated through the Pension Benefit Guaranty Corporation

The point here is that controlled group rules were expanded and incorporated into ERISA law when VW Beetles first occupied our streets decades ago. The original intent behind these provisions was to protect employees so that employers could not use multiple corporations to escape coverage or nondiscrimination rules set forth under ERISA.

Let’s fast forward to today. We now have what Volkswagen refers to as the all-new Beetle, with an engine now located in the front, a coupe, four-door, turbo, or convertible, available in every color of the rainbow. Just as the new Beetle made its famous revival, the controlled group rules of ERISA made a popular return with the signing of the Patient Protection and Affordable Care Act (commonly known as the ACA). To the surprise of many, health care reform did not create the definition of a controlled group. The ACA merely incorporates the existing controlled group provisions under ERISA. Most notably, legislators wanted to ensure that companies wouldn’t sub-divide and separately incorporate to evade the employer shared responsibility provisions of the ACA, where applicable large employers (ALEs) must offer coverage to employees in order to evade an excise tax penalty. As you may have heard, if two or more companies fall within a controlled group, the number of employees are aggregated across all companies (ALE members) to arrive at the number of full-time employees (and full-time equivalent employees) to determine whether the employer is an ALE.

#### WHAT IS A CONTROLLED GROUP OF CORPORATIONS, ALSO KNOWN AS A CONTROLLED GROUP?

The employer shared responsibility rules found in IRS Code Section 4980H apply the controlled group test to determine which entities are treated as a single employer. This section cross references Sections 414(b), (c), (m) and (o) of the IRS Code for this determination.

- **Section 414(b)** of the Internal Revenue Code defines a controlled group as a combination of two or more **corporations** that are under common control.
- **Section 414(c)** of the Internal Revenue Code applies to a controlled group of trades or businesses, such as **partnerships and proprietorships**. Note that effective December 18, 2015, this section now includes subsection (2) addressing special rules relating to church plans.
- **Section 414(m)** of the Internal Revenue Code introduces the term affiliated service group, which is a specific type of service organization providing services among multiple, related organizations under a very specific set of facts.

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- **Section 414(o)** of the Internal Revenue Code incorporates regulations promulgated by the Secretary of the Treasury which are necessary to prevent the avoidance of any employee benefit requirement through the use of separate organizations, employee leasing or other arrangements.

There are three controlled group categories:

### 1. PARENT-SUBSIDIARY GROUP

A parent-subsidiary controlled group exists when:

- One or more chains of corporations are connected through stock ownership with a common parent corporation
- 80 percent of the stock of each corporation (except the common parent) is owned by one or more corporations in the group
- The parent corporation owns 80 percent of at least one other corporation

### 2. BROTHER-SISTER GROUP

A brother-sister controlled group is a group of two or more corporations, in which five or fewer common owners (a common owner must be an individual, a trust or an estate) own directly or indirectly a controlling interest of each group and have effective control.

- **Controlling interest** generally means 80 percent or more of the stock of each corporation (but only if such common owner own stock in each corporation)
- **Effective control** generally means more than 50 percent of the stock of each corporation, but only to the extent such stock ownership is identical with respect to such corporation

### 3. COMBINATION CONTROLLED GROUP

A combined group consists of three or more organizations that are organized as follows:

- Each organization is a member of either a parent-subsidiary or brother-sister group
- At least one corporation is the common parent of a parent-subsidiary and is also a member of a brother-sister group

## AFFILIATED SERVICE GROUPS

As discussed above, Section 414(m) of the Internal Revenue Code also defines what is referred to as an Affiliated Service Group. This arrangement is one where two or more organizations have a service relationship, and in some cases, an ownership relationship and may be treated as a single employer. The employer shared responsibility provisions of the ACA specifically mention that for purposes of determining a single employer, affiliated service groups apply in addition to consideration of controlled groups.

## ATTRIBUTION RULES

- Family attribution rules apply, so stock owned by a spouse, parent or child is often deemed to be owned by one person. This is typically known as constructive ownership and can be very complex.
- State law typically determines the actual ownership of stock.
- Ownership can be based on voting power, stock value, and sometimes more complex structures can include property and the use of operating funds or supervision (such as in the case of a church plan).

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## AM I IN A CONTROLLED GROUP?

Company structures can be highly complex, and there are dozens of variations under which corporations can be structured amongst shareholders, subsidiaries and conglomerates. To determine whether your organization is a member of a controlled group, Frost Insurance insists that you consult with your company's tax advisor or legal counsel for an official determination. Although the test may differ depending on the type of benefit plan, typically, when companies structure retirement plans there is an evaluation that takes place concerning whether controlled groups and affiliated services groups are aggregated in the plan. Point being, somebody in your organization likely already knows the answer to your controlled group questions whether it be your ERISA attorney, chief financial officer or accountant. If not, please know that Frost Insurance is not qualified to advise on controlled group or affiliated service group status, but will certainly refer you to a trusted advisor who can evaluate your particular situation.

## RESOURCES:

Final Rules Employer Shared Responsibility	<a href="https://www.gpo.gov/fdsys/pkg/FR-2014-02-12/pdf/2014-03082.pdf">https://www.gpo.gov/fdsys/pkg/FR-2014-02-12/pdf/2014-03082.pdf</a>
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IRS-Controlled and Affiliated Service Groups	<a href="http://www.irs.gov/pub/irs-tege/epchd704.pdf">http://www.irs.gov/pub/irs-tege/epchd704.pdf</a>
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Church Plans were amended under the Consolidated Appropriations Act, 2016	Pub. L. No. 114-113, Division Q, § 336 (2015)
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Special thanks to Wikipedia's VW Beetle Page

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