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## Who's the Employer – Part 1

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We're related. So what?

## Ask the right question

- The related employer rules don't directly answer the question: What employees need to be included in the plan?
- Instead, the related employer rules answer these questions:
  - **Who are the employees of this employer?**
  - **Who is the employer of this employee?**
- Easiest way to resolved related employer consequences questions – ask yourself:
  - **If this was one corporation with two different offices, what would the Code tell me?**

## Typical related employer question

- Scenario:
  - A and B are in a controlled group
  - A sponsors a plan
  - Does the plan need to cover the employees of B?
- The related employer rules don't answer that question
- The related employer rules tell you all employees of A and B are deemed to have a single employer
  - For coverage
  - For most other Code provisions
- So what's the answer?
  - SEPs, SIMPLEs, standardized plans: cover them
  - Other plans: you don't have to cover B if you can pass coverage and nondiscrimination (and minimum participation for defined benefit)

## The long arm of the related employer law

| Section | Topic                    | Controlled group | Common control | ASG      |
|---------|--------------------------|------------------|----------------|----------|
| 401     | Qualified plan           | Yes              | Yes            | Specific |
| 408(k)  | SEP                      | Yes              | Yes            | Yes      |
| 408(p)  | SIMPLE IRA               | Yes              | Yes            | Yes      |
| 410     | Eligibility; coverage    | Yes              | Yes            | Yes      |
| 411     | Vesting; benefit accrual | Yes              | Yes            | Yes      |
| 415     | Limits                   | Yes              | Yes            | Yes      |
| 416     | Top heavy                | Yes              | Yes            | Yes      |
| 404     | Deduction                | Yes if joint     | ????           | Special  |

## Welfare plan rules also affected

|        |   |
|--------|---|
| 105(h) | Self-insured medical reimbursement plan |
| 125    | Cafeteria plan                          |
| 220(c) | Archer MSAs                             |
| 4980G  | Nondiscrimination for HSAs              |
| 79     | Group term life insurance               |
| 106    | Accident and health plans               |
| 117(d) | Qualified tuition reduction             |
| 120    | Group legal service                     |
| 127    | Educational assistance programs         |
| 129    | Dependent care assistance               |
| 132    | Misc. fringe benefits                   |
| 137    | Adoption assistance                     |
| 274(j) | Employee achievement awards             |
| 505    | VEBAs                                   |
| 4980B  | COBRA                                   |
| 500    | Large group health plans                |

## How do I count hours and compensation of employees who work at both companies?

- Pretend it's a single company with two divisions
- You must count hours from both companies
- 415 compensation includes compensation from both companies



## Counting service

- X and Y are related employers
- Don has three years of service with X
- Don transfers from X to Y 4/15/2015
- The Y plan requires 1 years of service to enter the plan and has January 1/July 1 entry dates
- When does Don enter the Y plan?
- Does Don's X service count with Y for purposes of vesting?
- Does Don's Y service count with X for purposes of vesting?
- For purposes of the X plan, is Don still in service at X?

## Switching employers

- X and Y are related employers
- Each maintains a separate 401(k) plan covering its employees
  - 6 year graded vesting schedule
  - 1 YOS/Age 21 eligibility; dual entry dates
- Dianne has 4 YOS with X; she leaves X and immediately goes to work for Y February 12, 2014
- a) When does Dianne enter the Y plan? Would the answer be the same if Dianne had stopped working for X in 2009?
- b) Must the Y plan count Dianne's X service for purposes of vesting?
- c) If Dianne goes immediately from X to Y, can the X plan distribute her deferrals to her? If not, can the X plan transfer her account to the Y plan?

## When does it count

- X buys 100% of Y stock September 1, 2015
- X has a plan and allows Y employees to participate
  - Y never had a plan
- Does X credit the Y service after September 1?
- Does X credit the Y service before September 1?

## Predecessor employer guidance spread throughout Code

|                       |                                     |
|-----------------------|-------------------------------------|
| 414(a)                | Mandatory service crediting         |
| 401(a)(4)             | Nondiscriminatory service crediting |
| 415 final regulations | Limits, compensation                |

- These cover situations where the related employer rules would not require you to count the service

## 414(a)(1) Mandatory crediting

- “In any case in which the employer maintains a plan of a predecessor employer, service for such predecessor shall be treated as service for the employer”
  - Plan merger
  - Transfer of assets
  - Buyer adopts seller’s plan

## 414(a)(2) Regulatory crediting

- “In any case in which the employer maintains a plan which is not the plan maintained by a predecessor employer, service for such predecessor shall, to the extent provided in regulations prescribed by the Secretary, be treated as service for the employer”
  - No regulations before 415
  - So no requirement outside of 415

## Treas. Reg. §1.401(a)(4)-11(d)(3)(iii) Nondiscriminatory service crediting

- If prior service credits available to any HCE, they must be available to similarly situated NHCEs
- There must be a legitimate business reason for recognizing prior service
  - Such as merger or acquisition
- Provision can't discriminate in operation or design

## 415 regulations: Definition of predecessor employer

- Two ways to be a predecessor employer:
  - Plan sponsor maintains plan of predecessor
    - Like 414(a)
  - “Employer constitutes a continuation of all or a portion of the trade or business” of former entity
    - Facts and circumstances
    - Example: “Formation of the employer constitutes a mere formal or technical change in the employment relationship and continuity otherwise exists in the substance and administration of the business operations of the former entity and the employer”

## Lear Eye Clinic: Example of continuation of business

- Dr. Pallin starts sole proprietorship in 1975.
- In 1979, he incorporates the clinic
  - Pallin 51%
  - Wallman 49% (previously employee of sole prop)
- Clinic adopts DB plan
- Dr. Pallin wanted to count sole prop service in computing maximum 415 DB benefit
- The Tax Court agreed,
  - The corporation was merely a formal change, but the substance of the business operations did not change
  - Did not discuss controlled groups, ASGs, etc.



## Effect of 415 regulations on predecessor employer

- Must aggregate benefits from plan of predecessor employer
- Credit service from predecessor employer to apply 415(b) limits
- Does not require counting service for other purposes

## Predecessor employer and acquisitions

- If the money follows the participants (414(a)(1)), then the buyer must count service with the seller for all purposes
  - If you don't like that result, don't:
    - Take a plan to plan transfer (spin-off)
    - Do a plan merger
    - Take over the seller's plan
  - You can allow participants to roll over
- If buyer and seller are in a controlled group, you will count the prior service
- Otherwise, buyer can count service with seller on nondiscriminatory basis

## Counting compensation

- General rule: Compensation follows service
- If you count the service, count the compensation
- Mandatory for total compensation
  - 415
  - Top heavy
  - Deductions
  - HCE
  - 5%/7.5% gateway
- Don't have to count related employer service for nondiscrimination
  - But must pass compensation ratio test

## HCE status

- HCE status determined group-wide
  - Count comp from all related employers
  - Top 20% rule considers all related employers
    - And, if it applies at all, must apply to all plans of all related employers
  - 5% owner of any related employer is HCE of all related employers

## How many plans

- X and Y are related employers
- Each is considering establishing a 401(k) plan
- Assuming the plan(s) can pass coverage and nondiscrimination, which of the following plan designs are feasible? What are the advantages of each?
  - a) X and Y jointly maintain a plan.
  - b) X maintains a plan for its employees and Y a separate plan for its employees.
  - c) X maintains a plan for its employees and Y doesn't maintain a plan.

## Coverage

|       | HCE | NHCE |
|-------|-----|------|
| X     | 4   | 6    |
| Y     | 6   | 14   |
| Total | 10  | 20   |

- X and Y are related employers. Each has a 401(k) plan covering its own employees. The nonexcludable employees are shown.
  - a) Does the X plan pass ratio percentage?
  - b) Does the Y plan pass ratio percentage?
  - c) If either plan doesn't pass in a given year, what can they do?

## Permissive aggregation

- Valuable option: Can facilitate passing coverage or nondiscrimination
- Requirements:
  - Same plan year end
  - Same testing method
    - Safe harbor contribution method
    - Current or prior year testing
  - Similar benefits, rights, and features
    - Since you'll be testing the plans as a single plan for all elements of 401(a)(4)
    - Different vesting schedules OK
  - Same eligibility requirements
    - Or else when you test on a combined basis, you must count all employees who could satisfy either set of requirements
      - Otherwise excludable employee rule can help

## Exclusive benefit rule

- X and Y are a controlled group
- X has sponsored a SIMPLE 401(k) on a standardized prototype since 2005
  - Y does not cosponsor the prototype
- a) Does the plan cover the Y employees?
- b) Does it violate the exclusive benefit rule for the plan to cover the Y employees?
- c) If the Y employees haven't been allowed to participate, what are the consequences?  
What is the correction?

## 415 and related employers

- Each related employer is deemed to maintain any plan that any other related employer maintains.
- The compensation paid by all group members is also aggregated, whether or not the corporation that paid the compensation maintains a qualified plan.
- With regard to a participant, all defined benefit plans of all related employers or predecessor employers under which the participant has ever accrued a benefit are considered a single plan for purposes of satisfying Code §415(b).
- Similarly, all defined contribution plans of all related employers or predecessor employers under which the participant has received an annual addition are considered a single plan for purposes of satisfying Code §415(c).

## 415 and separate employers

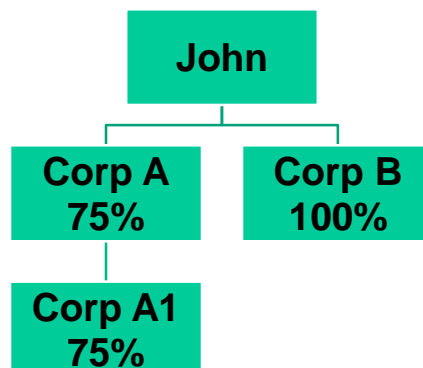
- Andrea owns 75% of each of two corporations, each of which manufactures a product. The remaining 25% of each is owned by different unrelated parties. Each corporation sponsors a plan and Andrea participates in both plans. *Can Andrea receive a \$53,000 allocation from each plan in 2015?*



## 415(h) expands parent-sub

- IRC 415(h) says that two corporations will be treated as being in a parent-subsidary group for 415 purposes if the 80% test were dropped to more than 50%.
- Does not modify brother-sister rules
- Does not apply for anything other than 415

## Majority ownership



- John owns 75% of A and 100% of B. A owns 75% of A1
- a) Are A and A1 a controlled group for any purpose? **YES, Code §415**
- b) Are A and B a controlled group for any plan purpose? **NO**

## 415 change midyear

- Companies A and B each sponsor a 401(k) plan
  - Calendar year
  - John participates in both plans
- A purchases 100% of the stock of B June 30, 2015
- January 1 – June 30, 2015
  - John has two separate 415 limits
- After June 30, 2015
  - John has one 415 limit
  - If he already accrued more than limit (total) by June 30, then no more contributions in 2015

## Deduction limits

- A and B are in a controlled group. They jointly sponsor a plan. They have a single deduction limit under Code §404.
  - May not be ordinary and necessary business expense for A to provide benefits for B employees
- C and D are in an ASG. They jointly sponsor a plan. If the plan was established after 1988, each must compute the 404 limit separately. Otherwise, they have a joint limit.

## Deductions

- Dr. Leonard McCoy owns 100% of a medical corporation and 60% of the Real McCoy Clinic, a partnership
  - Leonard's daughter, Joanna, owns the remaining 40% of the clinic
  - The clinic employs 6 NHCEs with a total compensation of \$300,000
  - Leonard works exclusively for his medical corporation with a W-2 of \$160,000
  - The corporation and the clinic jointly sponsor a cross-tested profit sharing plan giving McCoy \$50,000, the 6 NHCEs 5% of comp (\$15,000), and Joanna \$0
- a) Are the corporation and the clinic in a controlled group?
  - b) Can Dr. McCoy deduct the entire \$50,000?
  - c) How does the situation change if Leonard and Joanna aren't related?
  - d) What can Leonard do about it?

## Top heavy

- All related employers are single employer for top heavy
- Required aggregation group includes all plans in which a key EE participates
  - Or which enable such a plan to pass coverage or nondiscrimination
- Key employee status determined group-wide
- Highest key employee contribution rate determined group-wide
- Limit on officers determined group-wide



## Deferrals

- No participant can defer more than the 402(g) limit, plus catch-ups, to any and all plans of all related employers
- Example
  - X and Y are related
  - Each has a plan
  - Syd (40) defers \$10,000 to each plan in 2015
  - Not only does Syd have excess deferrals for 2015, each plan is subject to disqualification for letting Syd exceed the limit

## Catch-up

- All deferral plans of all related employers must offer catch-ups
  - Or none of them can
- There is one catch-up limit for all plans of all related employers

## QSLOBs

- Can provide a way out of related employer status
- Must satisfy detailed tests
  - Each separate line of business must have at least 50 employees and each employee of the (combined) employer must be in a separate line of business
- ASG cannot use QSLOBs

## 5500 filing

- Related employers participating in a single plan file as a single employer
- They generally do not file separate returns
  - Even if forfeitures are allocated separately
- Before 2009, related employers couldn't file 5500-EZ
  - Now they can, even when filing late for pre-2009 years, but must use current year form

## Participant loans

- Aggregate all related employers to determine if a participant loan exceeds the limit
- Example:
  - X and Y are related and each maintains a plan
  - Kay has a vested account balance of \$60,000 in each plan
  - Kay's loan limit is \$50,000
  - Suppose Kay borrows \$30,000 from each plan
  - Kay has \$10,000 deemed distribution

## Comparison of MEP to controlled group

| Issue                | Controlled group                        | MEP   |
|----------------------|---|---|
| Exclusive benefit    | Can cover EEs of any related ER         | Can cover EEs of any participating ER                             |
| Eligibility; vesting | Count all years with all related ERs    | Count all years with any participating ER                         |
| 415 limits           | Single limit for all related ERs        | Single limit within plan; aggregate with other plans ER maintains |
| Coverage             | Test together                           | Test each ER separately   |
| ADP/ACP/401(a)(4)    | Related ERs test together in joint plan | Test each ER separately   |
| HCE status           | HCE of one related ER is HCE of all     | Determined separately   |
| Deductibility        | One deduction limit                     | Separate deduction limits   |
| Top heavy            | Test together                           | Test separately   |