Related Employer Rules

Information about Special "Related Employer" Rules and Their Impact on Retirement Plans Sponsors

This document provides an overview of "related employer" rules that impact employers adopting 401(k) and other tax-qualified retirement plans. These rules are complex, and a full explanation is beyond the scope of this document. This information should only be used as an introduction and not as final guidance on any client situation.

Because of the negative consequences from failure to apply the rules properly, we advise clients to consult with their CPA or attorney to determine how the rules might impact them before adopting a 401(k) or qualified plan.

Overview

Companies that are considered "related" under ERISA must ensure their plans pass special non-discrimination and coverage tests. In calculating these tests, the company sponsoring the plan must consider all employees of "related" companies. If a company adopts a plan, determines it is "related", and fails one of the required tests, it must correct the test by making contributions to the other "related" companies' employees.

While it is feasible for a company that is considered "related" to adopt a plan and pass when the other companies' employees are not covered, the more likely scenario is that the plan will fail and need to make corrective contributions.

Depending on the specifics of the situation, the amount of contributions can be quite large.

When are Companies "Related"?

Companies are considered "related" if they meet the definition of a "Controlled Group" or "Affiliated Service Group" as defined by ERISA. At first glance, the application of these rules seems straightforward, but they are complicated by special ownership attribution requirements and by other rules that consider companies with a common business relationship and no common ownership.

Controlled Group Definition

Two or more companies are considered a "Controlled Group", and therefore "related", if they meet one of the following definitions:

Parent-Subsidiary - A parent-subsidiary exists when one business (the common parent) owns at least 80% of one or more other businesses.

Brother-Sister – A Brother-Sister Controlled Group exists if five or fewer common owners satisfy both an 80% common control test (=> 80%) and a 50% effective control test (> 50%).

Ownership Attribution

For the above calculations, family members of owners are attributed ownership themselves.

- Spouse to spouse
- Minor children under 21 to parent
- Adult child to parent if parent owns > 50%
- Parent to adult to child if adult child owns > 50%
- Grandchild to grandparent if grandparent owns > 50%
- Grandparent to grandchild if grandchild owns > 50%
- Corporate, partnership, or LLC to owner that owns > 5% of entity
- Trust to beneficiaries in certain situations

Affiliated Service Groups

While the Controlled Group Rules require a substantial amount of common ownership, the Affiliated Service Group Rules are more subjective, and in some instances, require very little common ownership. They look more closely at whether certain service-oriented businesses (Accountants, Actuaries, Architects, Medical, etc.), are providing management functions primarily for another business. A full explanation of the Affiliated Service Group Rules is beyond the scope of this document.

Summary

Companies adopting a 401(k) or other tax-qualified retirement plan need to carefully review the impact that related employer rules can have on their businesses. The rules are complex and if applied incorrectly, they can result in substantial costs to the employer.

Please contact JULY at **888.333.5859** for more information on plan loans.