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New Rules for Identifying Controlled Groups Of Tax-Exempt Organizations

Several qualified plan and section 403(b) provisions require plan sponsors to identify participating employers. In some situations, related employers must be treated as a single employer under IRS rules for aggregating controlled groups of corporations, groups of businesses under common control, and affiliated service groups (the “controlled group rules”). Historically, it has been difficult to apply these rules, which refer to ownership percentages, to tax-exempt organizations that do not have owners. Instead, various [IRS Notices](#) and Announcements have allowed governmental and tax-exempt employers, including churches, to apply a “reasonable, good faith interpretation” of the standard controlled group rules when determining which entities should be aggregated and treated as a single employer.

On July 26, 2007, the IRS published guidance specifically addressing the treatment of tax-exempt entities under the controlled group rules. ***These rules apply for plan years beginning on and after January 1, 2009.***

The new rules do not apply to “steeple churches” (i.e., churches, elementary and secondary schools controlled by churches, and qualified church controlled organizations described in section 3121(w)(3)) or to governmental entities. These organizations should continue to apply the controlled group guidance provided in IRS Notice 89-23, even after December 31, 2008.

Importance of Identifying the Employer

The correct identification of the “employer” and application of the controlled group rules is important for purposes of the following qualified plan and section 403(b) provisions:

- To determine an employee’s service for purposes of his eligibility to participate in a plan;
- To identify highly compensated employees, for purposes of coverage and nondiscrimination testing;
- To perform minimum coverage testing;
- To perform nondiscrimination testing, including ADP tests, ACP tests and the 403(b) universal availability requirement;
- To determine an employee’s vesting service;
- To properly monitor the section 415 annual additions and annual benefit limits;
- To identify key employees and perform top-heavy testing;
- To properly apply the compensation limit;
- To properly monitor and apply the elective deferral limit, including limits on various types of catch-up contributions; and
- To identify an employee’s eligibility to receive a distribution on account of severance from employment.

Common Control of Tax-Exempt Organizations

Beginning with the 2009 plan year, tax-exempt organizations will be considered to be under common control if at least 80% of the directors or trustees of one organization are either representatives of the other organization or are directly or indirectly controlled by the other organization.

- A director or trustee is a representative of another organization if he is also a trustee, director, agent, or employee of the other organization.
- A director or trustee is controlled by another organization if the other organization has the power to remove that individual and designate a new director or trustee.

It is important to note that these rules can apply to treat multiple tax-exempt organizations as a single employer, or to treat a group of tax-exempt organizations and a non-tax-exempt organizations as a single employer.

For example: Tax-exempt organization (TEO) A has the power to appoint at least 80% of the trustees of TEO B. TEO B owns the outstanding shares of Corporation C. TEO A also controls at least 80% of the directors of TEO D. As a result, entities A, B, C and D are treated as a single employer under the controlled group rules.

Permissive Aggregation

If multiple tax-exempt entities maintain a qualified plan or 403(b) arrangement that covers one or more employees from each organization, the sponsoring entities may treat themselves as being under common control if each entity regularly coordinates their day-to-day exempt activities.

For example: TEO F provides emergency relief in the Northeast. TEO G provides emergency relief in the Southeast. The two organizations sponsor a single 401(k) plan covering employees of both entities, and the two organizations regularly coordinate their day-to-day activities. The two entities may choose to be treated as a single employer.

Permissive Disaggregation

If two or more entities make contributions to a church plan as defined in Internal Revenue Code section 414(e), the controlled group rules may be applied separately to the entities that are churches and the entities that are not churches.

For example: A church, a secondary school that is treated as a qualified church-controlled organization, and several nursing homes that are not qualified church-controlled organizations (because each receives more than 25% of its support from fees paid by residents) sponsor a single defined benefit plan. The nursing homes may elect to treat themselves as being under common control with each other, but not with the church and the school.

Next Steps

Employers should review these rules and determine if they have any impact on their controlled groups. If these rules change the identification of the employer for any qualified plan or section 403(b) purposes, plan sponsors have slightly more than a year to identify and make appropriate plan design changes.

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