

**COVERAGE AND NONDISCRIMINATION  
CALCS IN CONTROLLED GROUPS  
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# What we'll cover

- Basic principles
- Plan considerations and strategies
- Compensation
- Top heavy
- Coverage and minimum participation
- 401(k) issues
- Nondiscrimination under 401(a)(4)
  - Allocations/Benefits
  - Benefits, Rights, and Features



# **BASIC PRINCIPLES**

# Ways to have related employers

- Controlled group
  - Parent-subsidiary
  - Brother-sister
  - Combined
- Common control
  - Special tax-exempt rules
- Traditional affiliated service groups
  - A-Org
  - B-Org
- Management function groups

# Consequences of related employer status

- All employees of all related employers are deemed to be employed by a single employer for most retirement plan purposes
  - Exclusive benefit rule
  - Crediting service for eligibility, vesting and benefit accrual
  - Coverage
  - Nondiscrimination
  - 415 limits
  - Top-heavy

## What does that really mean?

- Who are the employees of this employer?
  - Count all employees of any related employer
- Who is the employer of this employee?
  - Count the employee's employer and any business related to that employer
- Moving from one related employer to another isn't a separation/severance
- All related employers count all service with any related employer

# 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?**

## All service with all related employers counts

- 10/15/2026, Dan began work at X
- 10/14/2027, Dan credited with 1 YOS at X
- 1/1/2028, Dan enters X 401(k) plan
- 4/2/2031 Y buys the **stock** of X
  - X and Y become controlled group
  - Y terminates the X plan
- Y has 401(k) plan with 1 YOS eligibility requirement
  - Dan has already satisfied it; enters plan immediately
  - All of Dan's service counts for vesting



## **PLAN CONSIDERATIONS AND STRATEGIES**

Alternative  
approaches

# Common misconceptions

- Many practitioners think:
  - All related employers must cosponsor a plan
  - Employees of all related employers must participate in the plan
  - If employees of a related employer don't participate, you need to file under VCP
- None of these is necessarily true!

# These plans must cover all related employers

- SEP
  - If it doesn't, can't use model SEP
- SIMPLE IRA treats all related employers as single employer
  - 100 employee maximum
  - No other plan
  - Participation
- Standardized plan
  - After coverage transition period

# Nonstandardized and individually designed plans don't have to cover all related employers

- They do have to pass coverage, however, taking into account all related employers
  - That's why it can be simpler to cover all the employees in a single plan
    - Easier testing
    - Lower cost

# What happens if related employers don't cosponsor nonstandardized plan?

- Check plan document:
  - Standard clause: Employees of related employer that doesn't cosponsor plan are ineligible to participate
    - No operational failure for excluding the employers
    - But it may be a coverage failure
  - Some documents say employees of all related employers automatically are participants
    - Creates operational failure
    - Typical for solo(k)



# COMPENSATION

Total  
Nondiscriminatory  
Allocation

# Total (415) Compensation

- Compensation for 415 purposes includes all compensation from all related employers
- A and B are related employers
  - Each has a separate plan
- Jack works for both A and B
  - Each pays Jack \$80,000 in 2025
- Result: Jack has \$160,000 compensation for purposes of
  - 415 limit
  - Top heavy minimum
  - Key employee determination
  - HCE determination
  - Deduction limit
  - 5%/7.5% minimum gateway

# Nondiscriminatory (414(s)) compensation

- Plan must use nondiscriminatory definition of compensation for:
  - Coverage testing
  - ADP/ACP testing and safe harbor
  - Other nondiscrimination testing
- Safe harbor nondiscriminatory definitions include all compensation from all related employers
- Alternative definition: Just count compensation from one of the related employers
  - Must pass compensation ratio test each year

## Using “Single-Employer” Compensation? Test It!

- X and Y are controlled group
- Each sponsors a plan for its employees considering its own comp

Name	X Comp	Y Comp	Total Comp	X %
Henry	\$200,000		\$200,000	100%
Hope		\$220,000	\$220,000	
Nick	\$60,000		\$60,000	100%
Norma		\$50,000	\$50,000	
Neville	\$30,000	\$30,000	\$60,000	50%

# Allocation definitions

- Need not use nondiscriminatory definition for purposes of:
  - Determining deferrals
  - Limitations on matching contributions
    - Although if the definition is discriminatory, it could create a discriminatory right or feature; must test
  - Allocating employer nonelective contribution
- So, you can consider compensation from only one related employer even if that is discriminatory
  - Example
    - X contributes 10% of compensation allocated to X employees
    - Y contributes 5% of compensation allocated to Y employees
- But you must use nondiscriminatory definition to test

## Top Heavy



# Key Employee Status Is Determined Group-Wide

- All related employers are treated as one for top-heavy testing
- Officer count is group-wide (limited to 10% of total employees, max 50)
- An individual is an officer only based on their own employer's duties
- Compensation for determining 1% owner status = total from all group members
- 5% owner status = determined employer-by-employer (not aggregated)

# Plans That Don't Cover Key Employees May Still Be Top Heavy

- The aggregation group includes:
  - All plans with key employees
  - Any plan used to pass coverage or nondiscrimination
- All related employers are treated as one in defining the aggregation group
- Example: A partnership and three medical PCs form an ASG.
  - Each sponsors its own plan; permissively aggregated
  - The partnership plan covers **only non-key staff**, but is part of the aggregation group.

## Top-Heavy Minimums Apply Across Entities

- For DC plans: In-service with any related employer on last day = eligible
- For DB plans: 1,000 hours across the group = eligible for top-heavy accrual
- Compensation for minimums = total from all related employers

**Coverage and  
minimum  
participation**



# Coverage testing with separate plans

	HCE	NHCE
A	4	6
B	6	14
Total	10	20

- A and B are related employers. Each has a 401(k) plan covering its own employees. The nonexcludable employees are shown.
- Does the A plan pass ratio percentage?  
 $6/20 \div 4/10 = 30\% / 40\% = 75\%$
- Does the B plan pass ratio percentage?  
 $14/20 \div 6/10 = 70\%/60\% = 116.67\%$

# Coverage testing with separate plans

	HCE	NHCE
A	4	6
B	6	14
C	2	10
Total	12	30

- C is now part of the group and doesn't have a plan or participate in the A or B plan
- Does the A plan pass ratio percentage?  
 $6/30 \div 4/12 = 20\% / 33\% = 60\%$
- What can A do?
  - Bring in some C employees
  - Pass average benefit test
  - Permissively aggregate the A and B plans  
 $20/30 \div 10/12 = 67\%/83\% = 80\%$

# Average benefit test for coverage

	Alloc.	HCE	NHCE
A	10%	4	6
B	6%	6	14
C	0%	2	10
Total		12	30

- Nondiscriminatory classification
  - Covering employees of only one employer is reasonable, objective classification
  - A's coverage fraction of 60% exceeds safe harbor % (41.75%)
- Average benefit % test (AB%T)
  - $$\text{NHCE\%} = (6 \times 10\% + 14 \times 6\%) / 30 = 4.80\%$$
  - $$\text{HCE\%} = (4 \times 10\% + 6 \times 6\%) / 12 = 6.33\%$$
  - $$\text{AB\%} = 4.80\% / 6.33\% = 75.83\%$$

# 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
- Helpful features:
  - 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
    - Otherwise excludable employee rule can help

# Try it again with a larger company

	HCE	NHCE
A	4	6
B	20	194
Total	24	200

- A covers 6/200 NHCEs = 3%
- A covers 4/24 HCEs = 16.67%
- Coverage fraction for A = 18% **FAIL**
- Options:
  - Permissively aggregate plans
  - Include some B employees in A plan
    - Concentration % is 89%
    - 28.25% safe harbor percentage
    - Just 4 more employees needed!
    - Must pass AB%T

## Actual case from this month

- We have a plan that was deemed to be part of an affiliated service group for 2021
  - Plan A: 2 HCEs (husband/wife), no NHCEs, and does not have safe harbor contributions.
  - Plan B: 1 HCE, 7 NHCEs, and has a safe harbor match.
- The plans were combined for coverage and are passing the ABPT with deferrals, match, and profit sharing contributions.
- Can the plans be tested separately for ADP/ACP testing?

## Reply

- You can't aggregate ADP-tested with safe harbor
- So you can't test the two plans together
  - So Plan A runs ADP test and Plan B uses safe harbor
- But Plan A fails coverage
  - Cover  $\frac{2}{3}$  HCEs and  $\frac{0}{7}$  NHCEs: Coverage fraction is 0%
    - It fails ratio percentage and nondiscriminatory classification

# Correction Calculations

- To pass ratio percentage test, Plan A must benefit at least 4 NHCEs
  - Given that plan covers 2/3 of HCEs
- To pass nondiscriminatory classification test, Plan A must benefit at least 2 NHCEs
  - Concentration percentage is 70% (7 of 10 employees are NHCEs)
  - Safe harbor percentage is 42.5%
  - Must also pass average benefit % test

NHCEs Covered	NHCE Ratio	Coverage Fraction
0	0.0%	0.0%
1	14.3%	21.4%
2	28.6%	42.9%
3	42.9%	64.3%
4	57.1%	85.7%
5	71.4%	107.1%
6	85.7%	128.6%
7	100.0%	150.0%

## Correction

- 1.401(a)(4)-11(g) amendment to add 4 NHCEs to Plan A
  - Doesn't matter that they are eligible to defer to Plan B
- Must make QNEC for them
  - 100% of NHCE ADP in Plan A
  - Problem: There are no NHCEs in Plan A
  - Recommendation: Use ADP that allows Plan A to pass ADP test
    - If HCEs deferred 6.5%, use 4.5% QNEC
  - Can't count QNEC in average benefit percentage test

**Minimum  
Participation:  
A Trap for ASGs and  
Professional Groups**

- Only applies to DB plans
- Requires lesser of 50 employees or 40% of nonexcludable employees benefit
  - Minimum of 2 if there are at least 2 employees
- Count all nonexcludable employees of all related employers
- **Permissive aggregation not available**
- Clinic has 6 NHCEs and is in ASG with 3 doctors (each of which is sole employee of a PC)
- Dr. X wants to set up a defined benefit plan
- The plan must benefit at least 4 employees

## 410(b)(6)(C) coverage transition rule

- Sometimes called “free pass”
- Applies to ownership transactions:
  - Formation of controlled group/ASG, etc.
  - Change in controlled group/ASG, etc.
  - Asset or stock acquisition
  - Merger
- Plan must be in existence prior to transaction
  - Must satisfy coverage and minimum participation immediately prior to transaction

## Result of free pass

- If free pass applies, then plan passes 410(b) and 401(a)(26) throughout coverage transition period
  - Transition period:
    - Begins on date of transaction
    - Ends at earlier of:
      - End of following plan year
      - Change in coverage or benefits

# SEPS and SIMPLE IRAs

- No coverage transition rule for SEPs
- SIMPLE IRAs:
  - Rule protects
    - 1 plan requirement
    - 100 employee maximum
    - Don't have to expand coverage
  - Coverage transition rule lasts extra year
    - BigCo buys LittleCo today
    - LittleCo sponsors SIMPLE IRA; BigCo sponsors 401(k)
    - LittleCo can continue with SIMPLE IRA through 2027
    - BigCo has to take LittleCo employees into account in testing after 2026

# **401(K) ISSUES ADP/ACP TESTING**



# ADP and ACP tests

- ADP test considers only employees eligible to defer to the plan
- ACP test considers only employees eligible to receive a match (if they defer to the plan)
- A sponsors a 401(k) plan covering the 30 A employees and not the 20 B employees
  - The ADP test only considers the A employees eligible to defer
- One plan means one ADP/ACP test
- A and B jointly sponsor a 401(k) plan
  - A provides a match of 50% of deferrals up to 6% of comp
  - B provides a match of 100% of deferrals up to 4% of comp
  - There is a single ACP test
  - Check benefits, rights, and features because of different match rates

# HCE in multiple plans

- A and B sponsor separate plans
  - A is a safe harbor plan a 3% nonelective contribution
  - B is an ADP-tested plan
- Harry, an HCE, is eligible to defer to both plans
  - But only defers to the A plan
- The B plan counts Harry's deferrals to both plans in the ADP test (ADR = 10%)
- Same applies to ACP

	Comp	Deferral
A	\$100,000	\$15,000
B	\$50,000	\$0
Total	\$150,000	\$15,000

- » Use the comp definition and plan year of the plan being tested
- » This rule is for HCEs only
- » If the B plan fails the ADP test, Harry's excess deferrals returned to him can't exceed his B deferrals

## Problem for ACP safe harbor

- ACP safe harbor condition: Rate of match of any HCE at any level of deferrals cannot exceed rate of match of any NHCE at same level of deferrals
  - HCE aggregation rules (adding match from all plans) apply to determine if this limit is satisfied
  - This could easily blow ACP safe harbor
  - Escape hatch:
    - HCE didn't participate in both plans simultaneously (e.g., employee moved from A to B and switched plans at same time)
    - Period used to determine match for each plan limited to period HCE participated in the plan

# Can't combine safe harbor/ADP tested

- A and B jointly maintain a 401(k) plan
  - A wants a 3% safe harbor nonelective plan for its employees
  - B wants an ADP-tested plan
- Can't do it in a single document
  - All NHCE participants of the employer (A and B) would have to receive the safe harbor contribution
  - Can't restructure or split a single employer in a single plan for ADP/ACP
    - Exceptions: Otherwise excludable employee rule, union/nonunion, QSLOBs, and ESOP/non-ESOP

# Coverage transition and safe harbor termination

- If a safe harbor plan has an event that qualifies for the coverage transition rule, then the employer can terminate the plan midyear
  - Without giving 30 days advance notice
  - Keeping the ADP/ACP safe harbor and top-heavy exemption (if applicable)
  - But has to fund up to date of termination
- The termination must be “in connection with” the merger, acquisition, controlled group change, etc.

# LTPT Employees: Service Counts Across Entities

- All service with related employers counts toward LTPT status
- Once an employee becomes an LTPT Employee under any related employer, they're an LTPT Employee for all
- Entry into a plan depends on the plan's eligibility rules—not just LTPT status

## Example: Meg Moves from Out to In

- In and Out are controlled group
- Meg is part-time at Out from 8/1/2024
- She becomes LTPT Employee on 7/31/2026 based on service at Out
- In's 401(k) excludes Out employees—so she's still ineligible
- Hired by In on 4/7/2027 → becomes eligible immediately



# **Nondiscrimination under 401(a)(4)**

# Principles for 401(a)(4)

- If the plan is a 401(a)(4) safe harbor design plan, then it satisfies 401(a)(4), regardless of whether all employees are participants
  - The key is to pass coverage
    - Or have the benefit of the coverage transition rule
- If the plan is not a safe harbor design, and must perform the general nondiscrimination test then:
  - You must take into consideration all nonexcludable employees of all related employers (regardless of whether they benefit from the plan being tested)
  - If you must run the average benefit % test (AB%T) then you must take all plan maintained by any related employer into consideration

# Average benefit test in nondiscrimination

	Alloc.	HCE	NHCE
A	10%	4	6
B	6%	6	15
C	0%	0	9
Total		10	30

- A, B and C are related employers
- A and B jointly sponsor a plan for their employees; C employees have no plan
- A contributions go to A employees and B contributions go to B employees
- Plan as a whole passes ratio percentage test for coverage (70%)
- Not a safe harbor plan; general test required for nondiscrimination

# Average benefit test in nondiscrimination

	Alloc.	HCE	NHCE
A	10%	4	6
B	6%	6	15
C	0%	0	9
Total		10	30

- Divide employees into rate groups based on allocation rate
- Two rate groups: 10%, 6%
- 10% rate group includes 6/30 NHCEs and 4/10 HCEs
  - Coverage fraction = 50%, passes nondiscriminatory classification test
- 6% rate group includes 21/30 NHCEs and all HCEs
  - Coverage fraction = 70% passes ratio percentage test
- $AB\%T = 5\%/7.6\% = 65.79\%$  **FAIL**

# Alternative approach: restructuring

- No special plan provisions needed
- Allows you to divide plans into component plans, each consisting of the benefits provided to a group of employees
  - You pick who is in what group
- If each component passes coverage and nondiscrimination alone, plan as a whole passes nondiscrimination
- Plan as a whole must pass coverage
- Can use different testing methods for different parts:
  - Example: One part is cross-tested, another is safe harbor
- Can't use restructuring to:
  - Satisfy minimum gateway
  - Pass ADP
  - Pass ACP

## Restructuring example

- X and Y are in controlled group
- X plan covers X employees only and provides:
  - 3% safe harbor nonelective for all
  - 10% additional PS based on last day (5 NHCEs only get 3%)
- Divide plan into two groups; 3%; 13%
- 3% group covers only NHCEs: Automatically passes
- 13% group covers 50% of NHCEs (15/30) and 60% of HCEs
  - Coverage fraction = 83.33%
  - Uniform allocation

	X	Y	Total
HCE	3	2	5
NHCE	20	10	30

# BRF Testing May Be Required When Aggregating Plans

- Particularly a problem if you are permissively aggregating two plans maintained by different related employers
- Aggregating plans for coverage or nondiscrimination testing may require formal BRF testing using nondiscriminatory classification
  - Coverage fraction should equal safe harbor %
  - No need to perform AB%T
- A plan has 59½ distributions; B does not
- A plan has different investment options than B plan
- A plan allows participant investment direction; B plan is trustee directed
- A plan has different match rate than B plan
- A plan allows deferral from bonus; B plan does not

## Coverage transition rule and 401(a)(4)

- Can use coverage transition rule to pass coverage for component plans if restructuring
- Can't use coverage transition rule to pass general nondiscrimination test
- Uncertain what approach IRS would take:
  - Take into account all employees of newly related employer
  - Perform nondiscrimination testing as though merger/acquisition/change had not occurred
  - Argue that the coverage transition rule somehow applies

# Cross-testing related employers

## Company A only

Name	Allocation	EBAR
Hilda	20%	3.78%
Nick	5%	2.14%
Nancy	5%	7.27%
Norman	5%	3.22%
Nadia	5%	16.45%

**3.78% rate group covers 50% of NHCEs  
(30% midpoint)  
AB%T = 192.07%  
Plan passes**

## A and B together

Name	Allocation	EBAR
Hilda	20%	3.78%
Harry	0%	0%
Nick	5%	2.14%
Nancy	5%	7.27%
Norman	5%	3.22%
Nadia	5%	16.45%
6 other NHCES	0%	0%

**3.78% rate group covers 50% of HCEs and  
20% of NHCEs = 40% (27.75% midpoint)  
AB%T = 153.66%  
Plan passes**

## Common Pitfalls with Related Employers

- Forgetting that service counts across entities for eligibility, vesting, and LTPT
- Aggregating for ADP but ignoring BRF implications
- Using comp definitions that aren't safe harbor under 414(s)
- Miscounting employees for DB participation or SIMPLE eligibility
- Overlooking coverage transition rules or failing to document them
- Not understanding document provisions on related employers