

Worksheet 9-1. How to Determine Membership in the Top-Paid Group	9-36
Worksheet 9-2. How to Determine When an Officer Was Considered a Highly Compensated Employee	9-39
Flowchart 9-2. Determining HCEs for Plan Years Beginning On or After January 1, 1997	9-41
Flowchart 9-3. Determining HCEs for Plan Years Beginning Before January 1, 1997	9-42
What Is Compensation?	9-43
Table 9-1. Compensation Definitions That Satisfy Code Section 414(s)	9-49

Who Is the Employer?

To prevent taxpayers from avoiding nondiscrimination and other qualification requirements through the use of multiple entities, rules have been developed that require certain related entities to be treated as a single employer for purposes of these requirements. Where there is sufficient common ownership to form a *controlled group* of corporations, the employees are treated as employed by a single employer. Similar controlled group rules also apply to groups consisting of at least one noncorporate employer. Even where there may not be sufficient common ownership to form a controlled group, other rules require the aggregation of members of an *affiliated service group*. Although aggregation of related entities is the general rule, it is possible for multiple entities (and even parts of a single entity) to be treated as separate employers if the *qualified separate lines of business* (QSLOB) rules are satisfied.

Controlled Groups

Q 9:1 Must business entities under common control be aggregated as a single employer when applying the nondiscrimination and other qualification requirements?

→ Yes, provided the entities meet the definition of a controlled group as set forth in Code Sections 414(b) and 414(c).

Q 9:2 How many kinds of controlled groups are there?

In general, there are three kinds of controlled groups:

1. A parent-subsidiary controlled group;
2. A brother-sister controlled group; and
3. A combined group.

[Treas. Reg. §§ 1.414(c)-2(a), 1.1563-1(a)]

Q 9:3 What is a *parent-subsidiary controlled group*?

A *parent-subsidiary controlled group* consists of one or more chains of organizations in which a controlling interest in each of the organizations,

except for the common parent, is owned by another organization. [Treas. Reg. §§ 1.414(c)-2(b)(1), 1.1563-1(a)(2)(i)]

Q 9:4 What is a controlling interest?

For a corporation, a controlling interest means ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or at least 80 percent of the total value of shares of all classes of stock. In the case of a trust or estate, it means ownership of an actuarial interest of at least 80 percent of the trust or estate. Finally, in the case of a partnership, a controlling interest means ownership of at least 80 percent of the profits or capital interest of the partnership. [Treas. Reg. §§ 1.414(c)-2(b)(2), 1.1563-1(a)(2)(i)]

Example. The ABC Partnership owns stock possessing 80 percent of the total combined voting power of all the classes of stock of S Corporation entitled to vote. S Corporation owns 80 percent of the profits interest in the DEF Partnership. The ABC Partnership is the common parent of a controlled group consisting of the ABC Partnership, S Corporation, and the DEF Partnership. The result would be the same if the ABC Partnership, rather than S Corporation, owned 80 percent of the profits interest in the DEF Partnership.

***Q 9:5 What is a brother-sister controlled group?**

A brother-sister controlled group consists of two or more organizations satisfying two requirements:

1. The same five or fewer persons who are individuals, estates, or trusts own a controlling interest (see Q 9:4) in each organization; and
2. Taking into account the ownership of each such person only to the extent ownership is identical with respect to each organization, such persons are in effective control of each such organization.

The persons whose ownership is considered for purposes of the controlling-interest requirement in (1) above must be the same persons whose ownership is considered for purposes of the effective-control requirement in (2) above. [Treas. Reg. §§ 1.414(c)-2(c)(1), 1.1563-1(a)(3)(i)]

Q 9:6 What constitutes effective control?

In the case of a corporation, effective control means owning stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock. For a trust or estate, it means owning an actuarial interest of more than 50 percent of the trust or estate. Finally, in the case of a partnership, effective control means owning more than 50 percent of the

profits or capital interest of the partnership. [Treas. Reg. §§ 1.414(c)-2(c)(2), 1.1563-1(a)(3)(i)]

Example 1. The outstanding stock of corporations P, Q, R, S, and T, which have only one class of stock outstanding, is owned by the following unrelated individuals:

<i>Individuals</i>	<i>Corporations</i>				
	<i>P</i> <i>(Percentage)</i>	<i>Q</i> <i>(Percentage)</i>	<i>R</i> <i>(Percentage)</i>	<i>S</i> <i>(Percentage)</i>	<i>T</i> <i>(Percentage)</i>
A	55%	51%	55%	55%	55%
B	45	49			
C			45		
D				45	
E					45
Totals	100%	100%	100%	100%	100%

Corporations P and Q are members of a brother-sister controlled group. Although the effective-control requirement is met for all five corporations, corporations R, S, and T are not members of the controlled group because a controlling interest in each of those corporations is not owned by the same five or fewer persons whose stock ownership is considered for purposes of the effective-control requirement.

Example 2. The outstanding stock of corporations U and V, which have only one class of stock outstanding, is owned by the following unrelated individuals:

<i>Individuals</i>	<i>Corporations</i>	
	<i>U</i> <i>(Percentage)</i>	<i>V</i> <i>(Percentage)</i>
A	12%	12%
B	12	12
C	12	12
D	12	12
E	13	13
F	13	13
G	13	13
H	13	13
Totals	100%	100%

Any group of five of the shareholders will have effective control of the stock in each corporation. However, U and V are not members of a brother-sister controlled group because a controlling interest in each corporation is not owned by the same five or fewer persons.