Related Employer Coverage and Nondiscrimination Testing

Webcast Questions and Answers – S. Derrin Watson

In this document, I answer all the questions that came during the recent seminar on November 16, 2017. Most of these questions address topics that I discuss more fully in Who’s the Employer (WTE). If you see a refer such as Q 23:1, that means you can find more information at the first question in chapter 23 of WTE. Hyperlinks are available for those who subscribe to WTE.

1. *What is the rule for counting service prior to becoming a member of related group?*

Count it. How’s that for simplicity?

[Chapter 19](https://www.ERISApedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER19) of WTE addresses service and [Q 19:27](https://www.ERISApedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER19&TARGET=270) focuses on this question. It notes:

The Department of Labor regulations put the matter plainly:

[I]n determining an employee’s service for eligibility to participate and vesting purposes, all service with any employer which is a member of the controlled group of corporations shall be taken into account. . . . [I]n determining a participant’s service for benefit accrual purposes, all service during periods of participation covered under the plan with any employer which is a member of the controlled group of corporations shall be taken into account. [[DOL Reg. 2530.210(d)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=DOLRegs&ID=2530.210&A=D&t=md5&SID=638268f1)]

The DOL regulations contain an identical provision for groups of trades or businesses under common control. The regulations predate the adoption of the affiliated service group rules of [Code §414(m)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=M&t=md5&SID=c312e305), but there is no reason to suppose ASGs would be treated differently. Note that the regulations do not exclude service credited before a company was a member of a controlled group

1. *Sole proprietor has a "solo 401K"; owns 80% of a c-corp which has a Safe Harbor 401k, but he is not an employee or does not receive any form of comp from the c-corp. Must the plans be identical as to provisions & contributions, etc.?*

Legally, no. But since the two businesses are under common control, he will need to permissively aggregate the plans to pass coverage. Having aggregated them for coverage, he must aggregate them for nondiscrimination, including nondiscrimination of benefits, rights, and features. For more about benefits, rights, and features testing, see [Q 10:19](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER10&TARGET=190), [Q 11:7](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER11&TARGET=070), and [Q 19:23](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER19&TARGET=230).

1. *If company A and company B were related employers, company A is in the plan but B is not. An employee is participating in A's plan and moves to company B. Should the employee be allowed to continue to participate in the plan?*

Check the plan document. I mentioned the analogy of a company with employees in Los Angeles and San Francisco. For this, it is helpful to use a different analogy. Suppose a company has both union and non-union employees but the plan covers only the nonunion employees. Mary has 5 YOS as a nonunion employee and is 80% vested. She switches positions and becomes a union employee. In the documents with which I am most familiar, she would cease to be an active participant. However, she would still be accruing vesting credits. However, if the plan is top-heavy she should receive her top-heavy minimum for the year.

1. *In the standardized Plan example, if the B employees were covered without B adopting the plan, what are the consequences?*

There are three major issues:

* The plan has an operational failure for not following its terms (which require coverage of those employees). Correct by making a QNEC for the missed deferrals and the missed SIMPLE contribution, for each year, plus earnings. Alternatively, Accept the consequences of disqualification.
* Contributions are deducible only to the extent they don’t exceed 25% of the compensation of the A participant. Because B does not cosponsor the plan, the compensation of the B employees does not count in computing the limit. See [Q 10:21](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER10&TARGET=210)
* The extent to which A can deduct the contributions it makes for B employees is questionable under the “ordinary and necessary” standard of [Code §162](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=162&t=md5&SID=7e6b32ea). See [Q 10:22](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER10&TARGET=220).

1. *Are there any types of SEP documents that do not mandate covering all related employers?*

No. I quote from WTE [Q 25:1](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER25&TARGET=010):

All related employers are deemed a single employer for a SEP or SARSEP under [Code §408(k)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c). [[Code §414(b)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=B&t=md5&SID=c312e305), [(c)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=C&t=md5&SID=c312e305), [(m)(4)(B)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=M&t=md5&SID=c312e305)} Therefore:

* Employees of all group members who satisfy the plan’s age, service, and compensation requirements, if any, must be eligible to participate. [[Code §408(k)(2)](https://www.erisapedia.com/selector?Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c)]
* All eligible employees of all group members are considered in determining if contributions are discriminatory. [[Code §408(k)(3)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c)]
* Compensation paid to employees by all group members is considered in determining the contribution for each eligible employee. [[Code §408(k)(3)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c)]
* If the plan is a SARSEP:
  + All employees of all group members are added to determine if the plan has over 25 eligible employees at any time during the prior plan year and hence must be discontinued. [[Code §408(k)(6)(B)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c)]
  + All eligible employees of all group members must be considered to determine if the 50% participation rate requirement has been satisfied for the current plan year. [[Code §408(k)(6)(A)(ii)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c)]
  + All eligible employees of all group members must be considered in determining the 125% deferral ratio test under [Code §408(k)(6)(A)(iii)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=408&A=K&t=md5&SID=3a6a5c6c).

1. *Are all entities wholly owned by an international holding company related employers regardless of location in the world?*

Yes. Interestingly, [Code §1563(b)(2)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=1563&A=B&t=md5&SID=7e6b32ea) excludes foreign corporations from being a *component member* of a controlled group for ordinary income tax purposes. But [Code §414(b)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=B&t=md5&SID=7e6b32ea) does not concern itself with the component member rules. See [Q 8:37](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER08&TARGET=370). Two corporations are related for retirement purposes if they are in a controlled group, whether or not they are component members of the group. WTE gives two examples involving Acme, a parent corporation, which owns United (and in the second example Universal):

**Example 8.39.4** Acme is a foreign corporation owned and operated by Hambonian nationals. It is subject to taxation under [Code §882(a)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=882&A=A&t=md5&SID=1bde827d). It is excluded from being a component member of a controlled group. Neither corporation is subject to the [Code §1561](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=1561&t=md5&SID=8ef899b6) ordinary income tax restrictions. . . . Both corporations are part of a controlled group for retirement plan purposes.

**Example 8.39.5** Continuing Example 8.39.4, Acme also owns 100% of Universal Corporation. Acme, United, and Universal are a single controlled group. Acme is excluded from being a component member of the group because it is a foreign corporation. However, United and Universal are both component members of a controlled group and must file their corporate income tax returns on that basis. All three are a single controlled group for retirement plan purposes.

1. *When plans are tested separately, is the testing population the workforce of the controlled group or the single firm.*

The population used for the denominator includes the employees of the entire group. That is the consequence of them being treated as a single employer. [Q 23:4](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER23&TARGET=040) says:

A plan must consider all employees of the employer as defined in [Chapter 1](https://www.erisapedia.com/selector?Source=BOOKWHOER&ID=CHAPTER01TOC&t=md5&SID=f9c65451). This includes common-law employees, self-employed individuals, leased employees, and shared employees (which are a type of common-law employee). Since all employees of controlled group, common control, and affiliated service group members are deemed employed by a single employer, the plan must consider all employees of all related employers. [[Treas. Reg. §1.410(b)-9](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.410(b)-9&t=md5&SID=5f9d6054)] However, the plan disregards excludable employees from the coverage test. [[Q 23:5](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER23&TARGET=050)]

1. *As far as the permissive aggregation is concerned with safe harbor plans, what if the same contribution method is used, but at different levels: plan one has 3% SHNEC; plan 2 has SHNEC of 5%. Is this permissible? If so, Is this a BRF issue or a 401(a)(4) issue?*

The answer differs depending on whether you are talking about nonelective or match.

The safe harbor match rules include the requirement that no HCE can have a rate of match higher than that of any NHCE. This is true of both the ADP and the ACP safe harbor. [Treas. Reg. §§1.401(k)-3(c)(4)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-3&A=C&t=md5&SID=57b00085), [Treas. Reg. 1.401(m)-3(d)(4)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(m)-3&A=D&t=md5&SID=57b00085). That standard would apply to the aggregated plan as a whole. This effectively prevents an employer from permissively aggregating two safe harbor match plans unless they use the same rate of match at every level of elective deferrals.

The safe harbor nonelective rules do not have any such requirement. The only limitation on safe harbor nonelective contributions is that each NHCE must receive at least a 3% allocation. [Treas. Reg. §1.401(k)-3(b)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-3&A=B&t=md5&SID=57b00085). This is because the safe harbor 401(k) rules do not provide a safe harbor for nonelective contributions. Nonelective contributions, including SHNECs, are tested together under [Code §401(a)(4)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=401&A=A4&t=md5&SID=7e6b32ea). As a result, the employer could permissively aggregate the two plans you describe. It would not be a BRF issue, although the plan would likely need to satisfy the general nondiscrimination test.

1. *Regarding A and B jointly adopting one plan, can plan sponsor merely adopt a joinder agreement/cosponsor documents instead of TWO adoption agreements as you indicated on slide 11?*

Yes. It is all a matter of the document design.

1. *If one plan is SH (to NHCE only) and the other isn't, under permissive aggregation, could you just run ADP on the whole group?*

No. You cannot permissively aggregate the plans at all. See [Treas. Reg. §1.401(k)-1(b)(4)(B)(iv)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085). [Chapter 22](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22) of WTE discusses permissive plan aggregation extensively. [Q 22:14](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22&TARGET=140) explains:

The 401(k) regulations contain a definition of “plan.” This definition starts with the coverage definition of plan. [[Q 22:6](https://www.ERISApedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22&TARGET=060); [Treas. Reg. §1.401(k)-1(b)(4)(iii)(A)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085)] However, the regulations impose some modifications:

* *ESOP*. Solely to test the 401 (k) portion of the plan, the employer can choose to permissively aggregate ESOP and non-ESOP plans. [[Treas. Reg. §1.401(k)-1(b)(4)(iii)(A)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085)]
* *Union employees*. To test the 401 (k) portions of the plan, the employer can treat employees covered under different collective bargaining agreements as being in a single plan, so long as the aggregation is performed on a reasonable, consistent basis from year-to-year. [[Treas. Reg. §1.401(k)-1(b)(4)(iii)(B)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085)] There is also a special rule for multiemployer plans. [[Treas. Reg. §1.401(k)-1(b)(4)(iii)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085)]
* *CODAs within a plan*. All cash or deferred arrangements (CODA) within a plan are treated as a single plan, subject to a single ADP test, even though there may be different benefit structures. [[Code §401(k)(3)(A)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=401&A=K3&t=md5&SID=7e6b32ea); [Treas. Reg. §1.401(k)-1(b)(4)(ii)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085)]
* *Inconsistent testing*. Because all CODAs in a plan are subject to a single ADP test, an employer cannot permissively aggregate two plans which use inconsistent testing methods. [[Treas. Reg. §1.401(k)-1(b)(4)(iii)(B)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=B&t=md5&SID=57b00085)] An employer cannot aggregate:
  + An ADP-tested plan which uses current year testing with an ADP-tested plan which uses prior year testing; or
  + An ADP-tested plan with a safe harbor plan.

The 401(m) regulations dealing with matching contributions and employee after-tax contributions use essentially the same plan definition as the 401(k) regulations. [[Treas. Reg. §1.401(m)-1(b)(4)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(m)-1&A=B&t=md5&SID=7cb223cd)]

1. *Control Group, 2 companies, 2 plans. Some employees work for both companies. How do they count for coverage if you want to separately test both plans?*

Perhaps I can explain this most easily with an example. Employers A and B are related. Each employer sponsors a plan covering only its employees. Consider the following three NHCEs:

* Adam works exclusively for A. Adam benefits from the A plan. He does not benefit from the B plan.
* Betty works exclusively for B. Betty does not benefit from the A plan. She does benefit from the B plan.
* Barney works for both A and B. Barney benefits from both the A plan and the B plan.

In counting coverage, the A plan covers 2 of the 3 NHCEs shown. The B plan covers 2 of the 3 NHCEs shown. All three employees count the in denominator of the testing fractions. Barney counts in the numerator of both because Barney participates in both.

1. *Bad news also, if the solo is actually a standardized plan document. Wouldn't the other company have to participate?*

No, depending on the plan terms. This question is drawn from an example in which Solo sponsors a plan for its employees, and is subsequently purchased by BossCo. Most standardized plans include a clause delaying coverage during the coverage transition period. For example, here is the language from a widely used standardized prototype. Notice particularly the second sentence.

If the Employer's Plan is a Standardized Plan, all Employees of the Employer or of any Related Employer, are Eligible Employees, irrespective of whether the Related Employer directly employing the Employee is a Participating Employer. Notwithstanding the immediately preceding sentence, individuals who become Employees of a Related Employer as a result of a transaction described in [Code §410(b)(6)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=410&A=B&t=md5&SID=7e6b32ea) are Excluded Employees during the Plan Year in which such transaction occurs and in the following Plan Year, unless the Related Employer which employs such Employees becomes during such period a Participating Employer by executing a Participation Agreement to the Adoption Agreement; or the Plan benefits or coverage change significantly during the transition period resulting in the termination of the transition period.

1. *What if Company A has auto-enroll and B doesn't? Is that a problem in permissive aggregation?*

It certainly would be if you were dealing with a QACA; it would be fatal. But otherwise I don’t believe it’s a problem. I don’t see anything to suggest that the IRS views automatic enrollment as a benefits, rights, and features issue. Recall that the Treasury, as it said when it put forth the 401(k) regulations, views automatic enrollment as a change in default. Both traditional plans and automatic plans give a participant a choice to defer or not. The only real difference is in the default option if the participant does not reply. But the participant has the same options ultimately, regardless. The Treasury’s concern is that the participants have an effective opportunity to make a choice.

Let me add that if a EACA were to be aggregated with a non-EACA (or a EACA with different defaults), the plan would lose the benefit of the 6-month window to make ADP/ACP corrections. But even in this situation, I see nothing to prevent plan aggregation. In fact, the regulations expressly allow a 401(k) plan to have some participants in a EACA and others not subject to automatic enrollment.

1. *Last example. You said you can transfer account from Co. A to Co. B. Same answer if the participant is NOT fully vested? If the participant terminates from Co. B, the non-vested portion would go to Co. B?*

I have severe concerns about transferring a nonvested or partially nonvested balance in the absence of a plan merger, for the reason you suggest.

1. *Wouldn’t different vesting schedules be a BRF issue?! Everything I have says they are.*

Let me be technical here. They are not a benefits, rights, and features (BRF) issue because the regulations say that the manner benefits vest is not considered for BRF. See [Treas. Reg. §1.401(a)(4)-4(e)(1)(ii)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(a)(4)-4&A=E&t=md5&SID=57b00085) and [Treas. Reg. §1.401(a)(4)-4(e)(3)(ii)(B)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(a)(4)-4&A=E&t=md5&SID=57b00085). Instead, there is a separate subsection of the regulations that deals with vesting nondiscrimination. See [Treas. Reg. §1.401(a)(4)-11(c)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(a)(4)-11&A=C&t=md5&SID=57b00085). This section reduces the fairness of vesting to a facts and circumstances test, although it contains some valuable rules, including the facts that statutory vesting schedules are equivalent. So, if one plan had a 6-year graded vesting schedule and the other a 3-year cliff (which would be common with the combination of a cash balance plan with a 401(k) plan), the two schedules are equivalent.

1. *A Volume Submitter 401(k) adoption agreement [effective 1/1/2016] indicates, "Yes...A controlled group" AND, "Yes, affiliated ER adopts the Plan as Participating Employer." (And, yes, executed participation agreement in place.) Plan permits pre-tax, Roth, and has SH basic match. Has not made PS contributions. Now, almost 2 years later... TPA contacted to see IF two EEs of this other business could participate in plan? Of course, answer is yes, but TPA realizes that EE census data of participating employer has never been provided. Likely missed opportunity to defer, at the very least. Other concerns here..?*

I don’t know all the facts. Would you like a parade of possibilities?

* Missed deferrals
* Missed match
* Failure to provide safe harbor notice
* Failure to provide participant fee disclosures
* Incorrect coverage testing
* Incorrect 401(a)(4) testing of nonelective contributions
* Improper allocation of nonelective contributions
* Incorrect allocation of forfeitures
* Late distributions
* Failure to contribute and allocate top-heavy minimums
* Malpractice in not noticing this issue sooner

1. *If A sponsors a Safe Harbor 401k and is related to B but the plan passes testing so B is not included. An employee works for both A and B. Does the compensation from B need to be included in determination of the match or other non-elective contribution such as profit-sharing?*

Safe harbor contributions must be based on a nondiscriminatory definition of compensation. Check your document. Does it count compensation from all employers or just the sponsoring employer? Limiting compensation to that provided by the sponsoring employer is perfectly acceptable for safe harbor contribution if it is nondiscriminatory under [Code §414(s)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=S&t=md5&SID=7e6b32ea). See [Q 20:28](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER20&TARGET=280) and [Q 20:33](https://www.ERISApedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER20&TARGET=330). Whether it is nondiscriminatory will turn on whether it passes the compensation ratio test. [Q 20:27](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER20&TARGET=270).

A plan can use any definitely determinable definition of compensation to allocate a nonelective contribution outside the 401(k) safe harbor rules. However, the fairness of that contribution must be tested using nondiscriminatory compensation.

1. *You have eligibility of three months of service. For coverage testing, can you also exclude those employees who have not completed one year of service and attained age 21?*

The otherwise excludable employee (OEE) rule can allow you to treat separately those employees who have entered the plan because of generous eligibility provisions but have not earned 1 year of service, attained age 21, and passed an entry date, from those who have satisfied these maximum eligibility provisions. I discuss the OEE rule extensively at [Q 22:10](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22&TARGET=100), [Q 22:15](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22&TARGET=150), and [Q 23:7](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22&TARGET=070).

1. *Slide 25: forgot to say "what does the plan document state" - some plans have detailed steps for failed 410b testing and don't permit average benefits testing. Many are flexible, but some are not.*

If a plan preapproved plan uses a coverage failsafe provision, the plan is required to pass the ratio percentage test. But remember, that provision is designed to address people who fail to receive an allocation because they did not satisfy an allocation provision. I have yet to see one that dealt with groups excluded from the plan altogether, such as a related employer situation.

You are correct that you must check the document carefully. In one preapproved plan I helped author, the plan says that if the employer elects the failsafe, the plan is barred from using the average benefits test unless the plan will still fail even after waiving all allocation conditions.

1. *Company A and B are related. Company A has a SIMPLE 401(k) and Company B has a profit sharing plan. No employees from either plan benefit in the other plan (is this an issue because the SIMPLE has to cover all EEs of the related employer?). Assume, they pass coverage excluding the other plans. Does this violate the SIMPLE exclusive plan rule? This assumes the transition period has already passed. Thank you!*

* A SIMPLE 401(k) need not cover all employees, unlike a SIMPLE IRA.
* The B plan violates the exclusive plan rule. See [Q 25:4](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER25&TARGET=040).

1. *Average benefit test you used just the % contribution can you add age based testing. Under the Average Benefits Test, if there are no employer contributions for the Plan Year for all Plans, does the Plan fail the Average Benefits Percentage test?*

You can perform the average benefits percentage test on a benefits basis. Deferrals are treated as employer contributions and are included in the test. See [Q 23:18](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER23&TARGET=180).

1. *We have a client with a safe harbor 401k plan that includes employer securities. The only asset in the plan is the employer securities. All eligible employees have declined participation so to date there have been no deferrals or matching provided. The company is part of a controlled group and the plan does not pass the ratio percentage test but would it pass the average benefits test since there are no HCE or NHCE contributions for the year?*

A plan automatically passes coverage if no HCE benefits from the plan for the plan year. It need not satisfy either the ratio percentage test or the average benefits test. See [Treas. Reg. §1.410(b)-2(b)(6)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.410(b)-2&A=B&t=md5&SID=57b00085); [Q 23:3](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER23&TARGET=030).

1. *If doing the Average Benefits Test, can you permissively aggregate the Cash Balance Contribution (DB) and a Non-elective under DC to determine EBAR*

Yes. This is a common technique for passing coverage and nondiscrimination with a DB/DC combo. Of course, when performing the average benefit percentage test (which is part of the average benefit test), one aggregates all benefits and contributions from all plans of all related employers. See [Q 23:22](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER23&TARGET=220).

1. *If during a 410(b)(6)(C) transition period following an acquisition that created a controlled group, the acquired company merges its plan into a MEP (not part of the related group), in effect terminating that plan. Does that grace period still cover the plan in the plan year that the merger took place, or does the merger closing the plan result in a loss of the free coverage pass for that short plan year? The Merged plan as part of the MEP does not have any pass under the transition period, correct?*

I’m not sure of all the facts, and would suggest you review this situation with ERISA counsel. That said, I think it is safe to say that the free pass continues until the date of termination. On these facts, I don’t see that the sponsor’s portion of the MEP has the benefit of a free pass.

1. *Controlled group - 1 plan has SH match, one plan regular match. Controlled group passes coverage using ABT. Can tested plan, pass ADP/ACP on a standalone basis?*

Yes. The ADP test looks only at those with the effective opportunity to defer to the plan being tested. It disregards employees who are part of the controlled group but who lack the opportunity to defer to that plan. Similarly, in a plan without voluntary after-tax contributions, the ACP test considers only those who are participants in the plan and satisfy the allocation conditions to receive a match.

1. *2 plans in CG one makes a sh match the other makes a reg. match the plans do not pass coverage on their own can we permissively aggregate for adp / acp throwing the one plan out of sh status?*

No. Not only does this violate the prohibition on aggregating 401(k) plans with inconsistent testing methods, discussed above at question 10, it also violates the prohibition on performing the ADP test on a safe harbor plan. [Treas. Reg. §1.401(k)-1(e)(7)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.401(k)-1&A=E&t=md5&SID=57b00085): “a plan that uses the safe harbor method of section 401(k)(12), . . . must specify whether the safe harbor contribution will be the nonelective safe harbor contribution or the matching safe harbor contribution and is not permitted to provide that ADP testing will be used if the requirements for the safe harbor are not satisfied.” The only way to convert to an ADP tested plan midyear, without terminating the plan, is to reduce or suspend the safe harbor contribution after giving the participants 30 days advance notice. That procedure is unavailable after the year ends.

1. *Regarding 410(b)(c)(6) employees, if the plan terms exclude this group from participation in the plan, then the plan can pass all testing including 401(a)(4)?*

Not necessarily. It depends on the plan. As [Q 11:5](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER11&TARGET=050) points out:

The [Code §401(a)(4)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=401&A=A4&t=md5&SID=7e6b32ea) regulations provide several safe harbors for nondiscrimination testing, most notably the uniform allocation safe harbor for defined contribution plans. A plan which satisfies the conditions of a safe harbor satisfies nondiscrimination automatically.

For such a plan, the [Code §410(b)(6)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=410&A=B&t=md5&SID=0dde65e3) free pass of coverage (combined with a nondiscriminatory definition of compensation [[Q 20:22](https://www.ERISApedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER20&TARGET=220)]) ensures that the plan is nondiscriminatory. [[Rev. Rul. 2004-11](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSOther&ID=RevRul2004-11.pdf&t=md5&SID=e0863b83)]

However, many plans do not use a nondiscrimination safe harbor and instead rely on the general test. As [Q 11:7](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER11&TARGET=070) says:

It is important to note that [Code §410(b)(6)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=410&A=B&t=md5&SID=0dde65e3) only addresses coverage. It does not address nondiscrimination directly. There are three possible ways of viewing the situation, which we will discuss in the context of a cross-tested plan which satisfies nondiscrimination by reference to the general nondiscrimination test:

* At one extreme, unless the IRS provides relief, a cross-tested plan must consider all nonexcludable employees during the coverage transition period, even though the plan would have a free pass of the coverage requirements themselves. Each rate group would consider all nonexcludable employees of all related employers. A plan would perform the average benefit percentage test based on all employees and plans of all related employers. [[Q 10:18](https://www.ERISApedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER10&TARGET=180)]
* At the other extreme, a cross-tested plan automatically passes nondiscrimination. While one can make such an argument based on the regulations, realistically the only hope that the IRS would accept such an interpretation is to spike the coffee of all national office personnel with large doses of Prozac (a course I do not advocate).
* At the 2005 ASPPA Annual Conference, IRS representatives opined that a cross-tested plan should perform nondiscrimination testing during the coverage transition period as though the acquisition or other change had not occurred. For most cases, this seems like an eminently reasonable application of the rules.

1. *Although we might be able to terminate the safe harbor plan mid-year, don't we still need to be concerned with the successor plan rules?*

Of course.

1. *If a controlled group of employers each sponsors a 401(k) plan covering only their employees utilizing the same testing method and they each pass coverage separately can they opt to aggregate testing for coverage and if they do so, can they aggregate coverage for ADP and ACP testing? No employer elective contributions for any of the plans.*

WTE [Chapter 22](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER22&TARGET=15) discusses plans and plan aggregation at length. Let me summarize some core principles. I will do so in the context of two related employers, A and B, each of which sponsors a current year ADP-tested 401(k) plan with a current year ACP-tested match. Each plan uses a calendar plan year. This analysis is for purposes of testing coverage and nondiscrimination.

* There are four plans for purposes of coverage: A deferrals, A match, B deferrals, and B match.
* The employers can test the two deferrals plans separately or together (via permissive aggregation). If they are aggregated, they are aggregated for both coverage and ADP. It is impossible to aggregate them for ADP and not aggregate them for coverage. The employer can aggregate them even though the plans could pass coverage separately.
* The employers have similar choices for the two match plans. The choice for the match plans is independent of the choice for the deferral plans. For example, the plans could be aggregated for deferrals and separate for match, or vice versa.

1. *Company A has a cross tested 401k plan and is purchased in an asset sale on November 16, 2017 by Company B that has another plan... and they have decided to merge the plans either in 2017 or 2018. Is there any way for Company A to run its own separate testing for the ADP test and 401(a)(4) using just data from company A?*

Yes. In fact, with an asset sale, that is what I would expect up to the date the plans were merged.

1. *Our client “A” set up a new employer “B” in Puerto Rico in April of 2017 with the exact ownership as “A”. “A” has a calendar year 401(k) plan and “B” was going to set up their own plan under Puerto Rico laws using a local bank. We had planned on using the coverage and non-discrimination free pass under this situation until January 1, 2019. However, “A” and “B” sold 100% of their stock to a private equity firm (PEF) in October 2017. The PEF owns 100% of several other corporations and continues to buy up more. I don’t know if there is a special rule for PEF’s but I believe this would cause “A” and “B” to be part of a parent-subsidiary controlled group with PEF and the other companies owned by PEF.*

Assuming PEF is unincorporated, there is debate over whether PEF would be a trade or business subject to [Code §414(c)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=414&A=C&t=md5&SID=7e6b32ea) common control rules. That is an issue that should be resolved by counsel. But there is no question that A and B would be in a controlled group/group under common control with the other 80% or more subsidiaries of PEF.

* *Does this sale to the PEF tank the free pass period for “A” and “B”? It would not really be a big deal since “A” has a year of service requirement but I would like clarification.*

It does not kill the free pass.

* *When will “A” have to consider the other entities owned by the PEF?*

For coverage purposes, the transition rule will protect it through the end of 2018. For 415 purposes, on the other hand, the change is immediate. For example suppose there is a PEF subsidiary C, and Chris participates in the A plan and the C plan, both of which are defined contribution plans. Beginning on the date of the acquisition, Chris has a single 415 limit between the two plans.

* *Will “A” have to consider other entities purchased after October 2017 or does the “free pass” for the newly purchased entities work both ways?*

It works for each plan in effect at the time of the transaction. A has a free pass through December 31, 2019, unless there is a significant change in coverage or benefits.

* *According to our client who is still part of the management team at “A” and “B”, these other companies owned by the PEF also have their own individual qualified retirement plans.*

Those plans may also be in a coverage transition rule status. However, [Q 11:1](https://www.erisapedia.com/search?e82a984fa00eba24c=Y&Source=BOOKWHOER&ID=CHAPTER11&TARGET=010)Q notes:

In determining whether a plan satisfies the coverage requirements before the change in group membership, the plan must satisfy those requirements without regard to the free pass of [Code §410(b)(6)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=410&A=B&t=md5&SID=0dde65e3). In other words, you cannot “tack” transition periods ad infinitum to avoid all coverage testing. [[Treas. Reg. §1.410(b)-2(f)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSRegs&ID=1.410(b)-2&A=F&t=md5&SID=ccfd72ba)]

**Example 11.1.6** Fickle Co. in 2020 is not a part of a controlled group. It maintains a calendar year defined plan covering only workers at Fickle Co. May 3, 2021, it becomes part of a controlled group with Suitor Corp. It relies on the free pass of [Code §410(b)(6)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=410&A=B&t=md5&SID=0dde65e3) to satisfy coverage requirements. August 10, 2022, vulture.net buys all the stock of Fickle from Suitor and Fickle thereby joins a new controlled group. Fickle’s plan can continue to rely on its 2021 free pass until December 31, 2022. However, if it wants a new free pass, expiring December 31, 2023 (based on the transaction with vulture.net) it must demonstrate that it actually met the [Code §410(b)](https://www.erisapedia.com/selector?Source=IRSStatutes&ID=410&A=B&t=md5&SID=0dde65e3) and [Code §401(a)(26)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=401&A=A26&t=md5&SID=7e6b32ea) requirements on August 10, 2022, the date of the vulture.net transaction. It cannot rely on the free pass of [Code §410(b)(6)(C)](https://www.erisapedia.com/selector?e82a984fa00eba24c=Y&Source=IRSStatutes&ID=410&A=B&t=md5&SID=0dde65e3) in showing that it met those requirements on August 10, 2022.

* *Whose responsibility is it to keep all of this straight and how does anyway gather all of the information needed?*

Ideally, PEF would be on top of this, but you cannot assume that. Ultimately, it is the responsibility of the plan sponsor. As for your responsibility, check your service agreement.