CONTROLLED GROUPS AND BENEFITS COMPLIANCE CONSIDERATIONS: A GUIDE FOR EMPLOYERS

Many employee benefits compliance obligations turn on the answer to a deceptively simple question: *Who is the employer?*

For organizations operating through multiple related entities, the answer is not always obvious. Importantly, however, it often determines whether employee counts must be aggregated and whether related businesses are treated as a single employer for purposes of applying employee benefits laws. As a result, employers may find that obligations under the ACA, COBRA, ERISA, or similar laws apply to otherwise small employers, even when no single entity meets the applicable definition of a large employer on its own.

To address these issues, employee benefits laws rely on the aggregated employer concepts of "controlled group" and "affiliated service group" status to determine when related entities are treated as one employer for specific benefits purposes. This publication focuses on why those determinations matter and how they affect common benefits obligations. The publication is not intended to serve as a guide to determining controlled group or affiliated service group status, which requires a fact-specific legal or tax analysis. For an illustration of the controlled group and affiliated service group rules, see Appendix B, **Controlled Group and Affiliated Service Group Examples**.

Employers may be subject to benefits compliance requirements based on the number of employees working for related employers, not just their own employee headcount.

At a Glance:

1. Controlled Group and Affiliated Service Group Concepts

Controlled group and affiliated service group rules, also called employer aggregation rules, determine when two or more related entities are treated as a single employer. When entities are treated as a single employer, the employees of each entity must be counted together to determine whether a benefits law applies. Controlled groups (but not affiliated service groups) may offer benefits under the same plan.

2. Effect of Controlled Group and Affiliated Service Group Status on Employee Benefits Obligations

Each employee benefits law applies the employer aggregation rules differently. Special rules often apply to mergers and acquisitions, so compliance considerations should be investigated when performing due diligence ahead of a transaction.

A. ACA Employer Mandate

Each entity in a Section 414 controlled group or affiliated service group is subject to the ACA employer mandate if the entities in the aggregated employer group collectively employ 50 or more full-time employees, even if no single entity independently meets the

threshold for applicable large employer (ALE) status. If the aggregated employer group meets this threshold, each entity – called an "ALE member" – is separately responsible for offering affordable, minimum value coverage to its own full-time employees and for satisfying its own ACA reporting obligations. Likewise, ACA penalties and reporting liabilities are assessed separately for each ALE member, so one entity is not liable for another's compliance failures.

B. ACA Insured Group Market Size

ACA insurance reforms restrict the criteria carriers can use to underwrite insurance policies and set premium rates in the small group market compared to the large group market. For purposes of determining market size, an entity's employee count includes employees of other entities in its Section 414 controlled group or affiliated service group, which can cause an otherwise small entity to be treated as part of the large group market. Employers seeking fully insured coverage must accurately disclose the aggregated employer group's total employee count.

C. ERISA

Under ERISA, entities in the same Section 414 controlled group are treated as a single employer and are permitted, but not required, to offer benefits jointly to their employees through one benefit plan. By contrast, membership in an affiliated service group is not sufficient on its own for entities to offer a joint plan to their employees. Entities that offer benefits together without belonging to the same controlled group risk creating a multiple employer welfare arrangement (MEWA), triggering additional federal and state compliance obligations.

D. IRC Cafeteria Plan and Nondiscrimination Rules

Employers in the same Section 414 controlled group or affiliated service group are treated as a single employer under Internal Revenue Code (IRC) Section 125 and are permitted, but not required, to offer a single cafeteria plan covering all of their employees. However, this single-employer treatment is limited to cafeteria plan administration and does not, by itself, determine whether employers may jointly sponsor the underlying ERISA health or welfare plans funded through the cafeteria plan. IRC nondiscrimination rules also apply on an aggregated basis, meaning employee populations across the entire controlled group or affiliated service group must be considered when testing whether the plan improperly favors highly compensated employees (HCEs), regardless of whether the entities maintain a joint cafeteria plan or separate ones.

E. COBRA

COBRA generally applies to group health plans maintained by employers with at least 20 employees on more than half of their typical business days during the preceding calendar year. All full- and part-time employees of entities in the same Section 414 controlled group or affiliated service group must be counted in determining whether COBRA applies to a group health plan. In some cases, like when retirees lose coverage due to a bankruptcy or when a plan terminates, an employer's obligations to qualified beneficiaries may depend on whether another employer in its controlled group continues to offer a group health plan to its own employees.

F. MHPAEA

The Mental Health Parity and Addiction Equity Act (MHPAEA) generally requires a plan that offers mental health or substance use disorder (MH/SUD) benefits to do so in parity with the plan's medical or surgical (MED/SURG) benefits and to perform and document a comparative analysis for each nonquantitative treatment limitation that applies to MH/SUD benefits. Self-insured plans sponsored by small employers – those with 50 or fewer total employees during the preceding calendar year, including employees of entities belonging to the employer's Section 414 controlled group or affiliated service group – are exempt from MHPAEA. For plans subject to MHPAEA, parity is assessed separately at the group health plan level, not across multiple group health plans maintained by other employers in the aggregated employer group.

G. Medicare Secondary Payer Rules

Age- and disability-based Medicare Secondary Payer (MSP) rules generally require an employer's group health plan to pay primary for active employees who are entitled to Medicare, and they prohibit an employer from offering incentives to Medicare-eligible individuals to waive employer-sponsored health coverage. These rules apply to employers with at least 20 employees (for age-based MSP) or 100 employees (for disability-based MSP) in the applicable time period. MSP rules count employees from a wide

base of commonly owned entities; in addition to Section 414 controlled groups and affiliated service groups, employees of Section 52 controlled groups (which require a lesser degree of common ownership) must be counted.

H. FMLA

Private employers are subject to the federal Family and Medical Leave Act (FMLA), which entitles eligible employees to unpaid, benefits-protected leave for specified family and medical reasons if they employed 50 or more employees in 20 or more workweeks in the current or preceding calendar year. Separate businesses may be considered a single employer for purposes of counting employees if they are an "integrated employer." The integrated employer analysis is highly fact-specific, based on factors like common management, interrelation between operations, centralized control of day-to-day labor operations, and degree of common ownership or financial control.

3. Summary

Appendix A: Applicable Employer Aggregation Rules: Quick Reference Chart

Appendix B: Controlled Group and Affiliated Service Group Examples

a. Controlled Groups

b. Affiliated Service Groups

1. CONTROLLED GROUP AND AFFILIATED SERVICE GROUP CONCEPTS

For purposes of employee benefits, whether related entities are treated as a single employer is typically determined by reference to controlled group and affiliated service group rules drawn from the Internal Revenue Code (IRC) (collectively referred to as employer aggregation rules). Although these concepts originate in the tax code, they are incorporated – sometimes differently – across a range of employee benefits laws. While the general concepts are described below and in Appendix B, the specifics of employer aggregation rules fall outside the scope of this publication. Employers must consult with their tax advisor or legal counsel to determine their specific controlled group or affiliated service group status, which they need to know for benefits compliance purposes.

Controlled Group

A controlled group generally exists when two or more entities are sufficiently related through common ownership or control such that they are treated as a single employer for certain purposes. Controlled group rules are set out primarily in IRC Sections 414(b) and (c) (collectively referred to as controlled group rules) and apply to both corporate and noncorporate entities.

While the technical tests vary depending on entity type, a central concept is that where the same person or group effectively controls multiple businesses, those businesses may be aggregated and treated as one employer under the law. As a general matter, the controlled group rules look to ownership thresholds that reflect a high degree of common control. For example, a "parent-subsidiary" controlled group typically exists where a parent entity owns at least 80% of a subsidiary, while a "brother-sister" controlled group may exist where a small group of owners collectively owns a substantial majority of multiple entities and has significant overlapping ownership (often measured using an 80% total ownership test and a 50% identical ownership test).

For employee benefits compliance, controlled group status often determines when employees of related entities must be counted together and when those related entities may act together as a single employer, including for purposes of sponsoring employee benefit plans and applying ERISA's single-employer framework.

IRC Section 52 includes a definition of controlled group similar to Section 414, except that for Section 52 purposes, the 80% ownership threshold is reduced to 50%. This means more related entities will be considered controlled groups under Section 52 than under Section 414. For health and welfare benefits compliance purposes, the Section 52 definition applies only to Medicare Secondary Payer (MSP) rules. Accordingly, references to controlled groups in this publication are to Section 414 controlled groups unless noted otherwise.

Affiliated Service Group

An affiliated service group is a related but distinct concept set out in IRC Section 414(m). Unlike controlled group status, which focuses primarily on ownership or control, affiliated service group status emphasizes service relationships between and among related organizations, particularly in professional or service-based arrangements. Affiliated service group status does not turn on high ownership thresholds like the 80% or 50% tests commonly associated with controlled groups. Instead, affiliated service group status may arise even where ownership overlap is limited, indirect, or secondary to the nature of the service relationship between the entities. For example, an affiliated service group may exist where one organization regularly performs services for another as part of an integrated business arrangement, even if there is minimal overlapping ownership between the entities.

For employee benefits purposes, affiliated service group status can require related entities to be aggregated for certain tax-based compliance rules, such as employee counting and nondiscrimination testing. However, affiliated service group status generally does not allow entities to act as a single employer for all purposes. In particular, ERISA typically does not treat members of an affiliated service group as a single employer for purposes of jointly sponsoring a health or welfare plan unless the entities also satisfy the controlled group requirements.

Our Observation	IRC Sections 414(b), (c), and (m) are often described collectively as employer aggregation rules because they determine when separate entities must be treated as a single employer for certain tax and employee benefits purposes. This discussion is limited to controlled groups and affiliated service groups, as those concepts most directly affect health and welfare benefits compliance and plan sponsorship decisions. Other aggregation rules may apply in different contexts but are beyond the scope of this publication.

2. EFFECT OF CONTROLLED GROUP AND AFFILIATED SERVICE GROUP STATUS ON EMPLOYEE BENEFITS OBLIGATIONS

Although controlled group and affiliated service group concepts provide a common framework, employee benefits laws apply them differently. Depending on the law, related entities may be required to aggregate employees or may be permitted to act together as a single employer. However, in some circumstances, related entities may be treated as separate employers altogether. The discussion below highlights how these distinctions affect common compliance obligations.

Special rules apply in the context of mergers and acquisitions depending on the transaction structure, benefits offerings, employer size, and plan funding, among other factors. Benefits compliance requirements often implicated in the mergers and acquisitions context include the ACA employer mandate timing of offers of coverage and employer reporting obligations, COBRA continuation coverage and disclosures, ERISA plan amendments, handling of plan assets and other continued ERISA fiduciary obligations, Section 125 plan transitions, IRC nondiscrimination testing, and liabilities for past compliance oversights or special coverage obligations. Benefits compliance concerns should be addressed early in the process (e.g., the due diligence stage) so the transacting parties can plan accordingly. For more information on benefits considerations in mergers and acquisitions, see the PPI publication **Health Benefits Compliance Considerations in Mergers and Acquisitions: A Guide for Employers**.

A. ACA Employer Mandate

Under the ACA employer mandate, employers with at least 50 full-time employees – known as "applicable large employers" or ALEs – must offer affordable, minimum value coverage to substantially all full-time employees and their dependents, or risk paying a penalty for their failure to do so. This requirement, formally called the "employer shared responsibility" provision of the ACA, is discussed in detail in the PPI publication **ACA: Applicable Large Employers**. For detailed information about the employer mandate penalties, see the PPI publication **ACA: Employer Mandate Penalties and Affordability**.

ALE status is based on the number of full-time employees (including full-time equivalents) employed by all entities that are treated as a single employer under the IRC, including controlled groups and affiliated service groups. If the entities that comprise an aggregated group collectively employ 50 or more full-time employees, the group is an ALE and each entity within the aggregated ALE group, whether part of a controlled group or an affiliated service group, is an ALE member subject to the ACA employer mandate (regardless of whether any single entity independently employs 50 or more full-time employees).

Example: Lo-Dee Grocery Inc. and Stacey's Gas Station Inc. are members of a controlled group. Lo-Dee employs 100 full-time employees and Stacey's employs 15 full-time employees. The controlled group is an aggregated ALE group, Lo-Dee and Stacey's are each ALE members, and both ALE members are required to offer affordable, minimum value coverage to their full-time employees.

Example: T Wine Bar LLC, Tara's Kitchen LLC, and Bella's Catering LLC belong to the same controlled group. T Wine Bar employs 15 full-time employees, Tara's Kitchen employs 25 full-time employees, and Bella's Catering employs 20 full-time employees, for a total of 60 full-time employees. The controlled group is an aggregated ALE group, all three entities are ALE members, and each ALE member must offer affordable, minimum value coverage to its full-time employees.

While an entity's status as an ALE member depends on the number of employees employed by the controlled group or affiliated service group as a whole, liability and compliance responsibilities belong to each ALE member individually. Each ALE member is responsible for offering coverage to enough of its own full-time employees and for ensuring such coverage is affordable and provides minimum value. Likewise, each ALE member is required to report information to the IRS about the health coverage provided during the prior calendar year pursuant to IRC Sections 6055 (for sponsors of self-insured plans) and/or 6056 (for all employers subject to the employer mandate) using Forms 1094/5-C, and each report must list other ALE members of the aggregated ALE group. For detailed information about ACA reporting, see the PPI publication **ACA: Employer Mandate Reporting Requirements**.

ACA penalties are calculated and imposed separately for each ALE member. As a result, one ALE member is not liable for another ALE member's failure to offer coverage to enough of its full-time employees. For aggregated ALE groups, each ALE member may separately submit its Sections 6055 and/or 6056 reports, or one ALE member may submit reports on behalf of all other ALE members. However, each ALE member remains separately liable for its own reporting obligation even if another ALE member agrees to file on its behalf.

Example: T Wine Bar LLC, Tara's Kitchen LLC, and Bella's Catering LLC belong to the same controlled group and are each required to file Section 6056 reports with the IRS. T Wine Bar agrees to file the reports for itself and the two other ALE members in its aggregated ALE group. T Wine Bar files for itself and for Tara's Kitchen, but it fails to file the required report for Bella's Catering. Bella's Catering is liable for this failure, but T Wine Bar is not.

Example: Lo-Dee Grocery Inc., an ALE, acquires all of the ownership of non-ALE Anderson's Corner Grocery Inc. on August 31. Both entities keep separate EINs and corporate structures. Anderson's Corner becomes part of the Lo-Dee controlled group as of the August 31 closing date. If Anderson's Corner fails to offer coverage to at least 95% of its full-time employees in any subsequent month, Anderson's Corner (but not Lo-Dee) could be subject to employer mandate Penalty A. Similarly, if Anderson's Corner offers coverage to 95% of its full-time employees but the coverage is not affordable, Anderson's Corner (but not Lo-Dee) could be subject to employer mandate Penalty B. After the end of the calendar year, both Lo-Dee and Anderson's Corner will have reporting obligations under Section 6056.

B. ACA Insured Group Market Size

The ACA's healthcare reforms sort employers into two categories: small employers and large employers. In the insured group market, policy ratings, minimum participation requirements, and other restrictions are based on employer group size. Specifically, premium rating requirements limit the criteria insurers may use to vary health insurance premiums in the small group market.

By default, small employers are defined as employers that averaged at least one, but not more than 50, employees in the preceding calendar year. Large employers are those that averaged at least 51 employees in the preceding calendar year. States have the option to expand these thresholds such that small employers and large employers are those that averaged up to 100 employees and at least 101 employees, respectively. Three states – California, New York, and Vermont – have elected to do so.

All employees of entities that are treated as a single employer for this purpose must be counted when determining whether an employer is small or large, including entities that belong to a controlled group or affiliated service group. This means that an entity that employs 50 or fewer employees (or 100 or fewer employees in expansion states) may belong in the large group market if it belongs to a controlled group or affiliated service group whose members collectively employ more than 50 (or 100) employees.

Example: Bobby Jean's Thrift Store, Rosie's Café, Kitty's Pet Store, and Sandy's Fireworks all belong to the same Section 414 controlled group. Last year, including full-time equivalents, Bobby Jean's employed an average of 15 full-time employees, Rosie's employed 20, Kitty's employed 10, and Sandy's employed 10, for a total of 55 full-time employees. In a state that uses the default definitions of small and large employers, each entity would belong in the large group market because the controlled group employed at least 51 employees in the preceding calendar year. However, in a state that defines a small employer as one that employed not more than 100 employees in the preceding calendar year, these employers would remain in the small group market.

Our Observation	An employer shopping for group health insurance must disclose the total number of employees employed by the controlled group or affiliated service group, even if the employees of other entities in the aggregated employer group will not be covered by the insurance policy. While the ACA's restrictions on insurance rating criteria apply to insurance carriers and not directly to plan sponsors, contract law principles generally require an employer purchasing insured coverage to convey truthful information and avoid making material misrepresentations. Failing to disclose material information, like an accurate employee count, could expose an employer to liability, including the potential for the insurer to rescind the policy.

C. ERISA

For ERISA purposes, employers that belong to a controlled group are generally treated as a single employer for most compliance requirements. By contrast and as further discussed below, members of an affiliated service group are not treated as a single employer under ERISA for purposes of jointly sponsoring a health or welfare plan.

Our Observation	ERISA does not establish its own ownership-based test for single-employer treatment, and in practice the DOL has relied on controlled group concepts drawn from the IRC. As a result, practitioners and regulators generally look to Section 414 controlled group principles when applying ERISA's single employer framework. Although DOL guidance recognizes a 25% common control threshold for limited multiple employer welfare arrangement (MEWA) reporting purposes (Form M-1), that standard does not define controlled group status under ERISA and does not authorize joint plan sponsorship. Employers that are not members of the same controlled group therefore risk creating a MEWA if they offer benefits jointly. (See MEWA discussion below.)

Employers within a controlled group may offer benefits jointly to their employees through one benefit plan, or they may maintain their own separate benefit plans. However, for members of a controlled group to offer benefits jointly under one plan, the ERISA plan documents must reflect the intent to maintain one plan — for example, by specifying one entity as the plan sponsor and the other entities as participating entities. Additionally, all funds under the plan must be available to provide benefits to all participants and beneficiaries. In other words, plan assets may not be earmarked to pay benefits only for employees of a particular participating entity.

Welfare benefit plans are required to file a Form 5500 annually with the DOL unless they qualify for the small plan exemption. Because this filing generally is required for each plan, a controlled group offering benefits utilizing a single plan would need to file only one Form 5500 annually. The plan sponsor and participating entities listed on the Form 5500 should match those listed in the plan documents.

In contrast, a benefit plan maintained by two or more employers that do not belong to the same controlled group is considered a MEWA. MEWAs are subject to additional filing and recordkeeping obligations at the federal level (including an annual Form M-1 filing requirement) as well as more stringent regulation by states.

While ERISA treats members of certain controlled groups as one employer, the same is not necessarily true for members of affiliated service groups. Two or more entities belonging to the same affiliated service group may offer a single-employer plan together only if they also have the necessary common ownership or control to belong to a controlled group. If two entities belong to the same affiliated service group but not the same controlled group, offering a plan jointly would create a MEWA.

Example: David's Drywall LLC and Ian's Ice Cream Inc. have some common ownership, but they are not sufficiently related to belong to the same controlled group. If David's Drywall and Ian's Ice Cream jointly maintain a benefit plan, the plan will be a MEWA.

Our Observation	Two or more employers risk inadvertently creating a MEWA – and exposing the arrangement to enhanced federal and state oversight – if they jointly maintain a benefit plan without knowing their controlled group status. Accordingly, employers should consult with their attorney or tax advisor to confirm their controlled group status prior to establishing a benefit plan that will be open to participation by another entity's employees. Given the prevalence of fraud and abuse perpetrated by MEWA operators, the DOL and state insurance commissioners have historically prioritized enforcement of MEWA laws and regulations.

D. IRC Cafeteria Plan and Nondiscrimination Rules

IRC Section 125 Cafeteria Plans

IRC Section 125, which governs cafeteria plans, allows employees to make pre-tax elections to pay for certain qualified benefits. For cafeteria plan purposes, employers that are part of a controlled group or an affiliated service group are treated as a single employer. As a result, those employers may sponsor a single cafeteria plan covering all employees, or they may each maintain separate cafeteria plans. That said, this single-employer treatment is limited to cafeteria plan administration and does not, by itself, determine whether employers may jointly sponsor the underlying health or welfare plans funded through the cafeteria plan.

Example: Big Box Holdings wholly owns three subsidiaries: LargeMart Stores, Bulk Warehouse Stores, and Small Town Pharmacies. Big Box Holdings may sponsor a single cafeteria plan for all four entities. In the alternative, each entity could sponsor its own cafeteria plan. As a third option, Big Box Holdings could sponsor a cafeteria plan for its own employees and those of some but not all of its subsidiaries, leaving the remaining subsidiaries to maintain their own cafeteria plans.

Our Observation	While members of an affiliated service group may, for cafeteria plan administration purposes, provide a single cafeteria plan for their employees, that treatment does not carry over to the underlying health and welfare benefits offered through the plan, as discussed above. Whether employer-provided health benefits are excluded from employees' taxable income, and whether an employer may sponsor a group health plan covering employees of more than one entity, are determined under separate provisions of the tax code and ERISA. Affiliated service group status affects cafeteria plan administration and certain nondiscrimination rules, but it does not permit employers to jointly sponsor a single health or welfare plan. As a result, members of an affiliated service group generally must maintain separate health and welfare plans unless they also share the requisite common ownership to qualify as a controlled group. Affiliated service group members that jointly offer health or welfare plans without controlled group status risk creating a MEWA, potentially subjecting the arrangement to additional federal reporting requirements and state insurance oversight. (See MEWA discussion above.)

IRC Nondiscrimination Rules

The cafeteria plan nondiscrimination rules take into account the employees of all entities in a controlled group or affiliated service group, regardless of whether those entities maintain a single cafeteria plan or separate ones. Those nondiscrimination rules generally prohibit variances in eligibility, benefits, and contributions that disproportionately favor highly compensated employees (HCEs). On the other hand, the rules do not prohibit such variances if they are based on bona fide business classifications of employees and do not favor HCEs. A discriminatory plan design results in adverse tax consequences for HCEs but does not affect non-HCEs. Under Section 125, HCEs are generally any officer, any more-than-5% owner, or any individual who earned more than an indexed compensation threshold in the look-back year.

For purposes of applying the Section 125 nondiscrimination rules, the determination of which employees are HCEs is based on the entire controlled group or affiliated service group. Accordingly, any employees whose compensation exceeds the indexed threshold are considered HCEs, regardless of which entities in the aggregated employer group employ them.

Other nondiscrimination rules also aggregate the employees of controlled group or affiliated service group members. The nondiscrimination rules, which apply to self-insured group health plans (Section 105(h)), dependent care assistance programs (Section 129), and group term life insurance (Section 79), similarly require employees of all entities in a controlled group or affiliated service group to be aggregated when identifying highly compensated or key employees and performing the tests. (Note, however, that each set of nondiscrimination rules defines HCEs differently.) For a complete discussion of the components of the relevant nondiscrimination tests, see the PPI publications **Sections 105 and 125 Nondiscrimination Rules: A Guide for Employers**, **Dependent Care Assistance Program Nondiscrimination Rules: A Guide for Employers**, and **Group Term Life Insurance: A Guide for Employers**.

E. COBRA

COBRA requires employers that sponsor group health plans to offer continuation coverage to employees, their spouses, and their dependent children in certain circumstances under which they would otherwise lose that coverage. For this purpose, group health plans include HRAs, health FSAs, dental plans, vision plans, coverage for prescription drugs, and point solution programs that provide medical care. For more information on COBRA continuation rights and administration, see the PPI publication **COBRA: A Guide for Employers**.

COBRA generally applies to private sector group health plans maintained by employers with at least 20 employees on more than 50% of their typical business days during the preceding calendar year. If an employee count reaches or exceeds 20 on more than 50% of an employer's typical business days in a given calendar year, the employer becomes subject to COBRA for the entire following calendar year, regardless of whether the employee count subsequently drops below 20 during that time.

For purposes of determining COBRA applicability, all full- and part-time employees (not just plan participants) of all related employers under common control must be counted, including controlled groups and affiliated service groups. Part-time employees are counted as a fraction of an employee based on the number of hours an employee must work to be considered full-time by the employer (not to exceed eight hours per day or 40 hours per week). Employees outside the U.S., including those who are not receiving U.S.-source income, are also included in the count.

Our Observation	COBRA rules are unclear regarding whether an employer that loses its "small employer" status due to an acquisition becomes subject to COBRA requirements as of the transaction date or the first day of the subsequent calendar year. Since employers have discretion to provide greater protections than COBRA specifically affords (assuming the carriers, including any stop-loss carriers, agree), the cautious approach is for the acquired entity to comply with COBRA requirements immediately following the transaction.

While affiliated service group status may be relevant in certain benefits contexts, it does not automatically result in single-employer treatment for all COBRA purposes. Specifically, unlike the aggregation concepts used to determine COBRA small employer status – which look to controlled group and affiliated service group relationships – COBRA only treats all members of an employer's controlled group as a single employer for plan continuation purposes. This drives several important outcomes:

- **Bankruptcy and retirees.** Retirees and their dependents have the right to elect COBRA continuation coverage following loss of coverage due to bankruptcy if the employer or any member of its controlled group continues to offer any group health plan. Note that bankruptcy alone is not a COBRA triggering event for active employees or their dependents.
- **Plan termination.** Plan sponsors ordinarily may terminate COBRA continuation coverage earlier than the maximum coverage period if the employer stops maintaining any group health plan. However, if another employer in the employer's controlled group or a successor employer maintains a group health plan, COBRA continuation coverage cannot be terminated early. Special rules apply when a plan terminates in the context of a merger or acquisition. For more information on COBRA obligations in mergers and acquisitions, see the PPI publication **Health Benefits Compliance Considerations in Mergers and Acquisitions: A Guide for Employers**.

Our Observation	Employers should confirm with their carriers (including stop-loss carriers) that controlled group COBRA qualified beneficiaries will be covered in the event of another controlled group member's bankruptcy or plan termination.

F. MHPAEA

While the Mental Health Parity and Addiction Equity Act (MHPAEA) does not mandate mental health coverage, it requires group health plans that cover mental health or substance use disorder (MH/SUD) benefits to do so on par with the plan's medical or surgical (MED/SURG) benefits. This means plans and insurers cannot impose financial requirements (e.g., deductibles, copays, coinsurance, or out-of-pocket maximums), quantitative treatment limitations (QTLs), or nonquantitative treatment limitations (NQTLs) on MH/SUD benefits that are more restrictive than those applied to MED/SURG benefits. Examples of QTLs include number of covered days, visits, or treatments; examples of NQTLs include coverage exclusions, prior authorization requirements, medical necessity criteria, or network limitations. Parity does not mean a plan must cover all mental health treatment, only that coverage guidelines, exclusions, provider networks, claims practices, and similar criteria must not be applied more stringently to MH/SUD benefits than to MED/SURG benefits.

The Consolidated Appropriations Act, 2021 amended MHPAEA to require group health plans and insurers to perform a comparative analysis for NQTLs to document compliance with the law. Further, although QTLs and financial requirements are not subject to the comparative analysis requirement for NQTLs, they must still maintain parity. For more information on MHPAEA compliance, see the PPI publication **MHPAEA NQTL Comparative Analysis: A Guide for Employers**.

MHPAEA applies to plans and carriers offering health insurance that covers both MED/SURG and MH/SUD benefits. Self-insured plans (including level-funded plans) sponsored by small employers (50 or fewer total employees during the preceding calendar year, including part-time employees without prorating) and stand-alone retiree-only medical plans (that do not cover current employees) are exempt from MHPAEA requirements. When determining whether an employer qualifies as a small employer, all members of a controlled group or affiliated service group are treated as one employer.

Parity is assessed separately at the group health plan level, not across multiple group health plans maintained by employers in a controlled group or affiliated service group. Specifically, under the MHPAEA regulations, any combination of MH/SUD benefits and MED/SURG benefits that a participant or beneficiary can receive simultaneously is considered a single group health plan for parity purposes.

Example:

Controlled Group Scenario. Adequate Southern Hotel and Single-Letter Café, members of a controlled group, sponsor separate major medical plans for their respective employees offering both MED/SURG and MH/SUD benefits. Each employer also offers a point solution program only to employees participating in its major medical plan. Adequate Southern Hotel's point solution program provides unlimited virtual physical therapy services through a licensed provider at no cost to participants. Single-Letter Café's point solution program provides unlimited virtual mental health therapy through a licensed provider at no cost to participants.

MHPAEA Assessment. Even though Adequate Southern Hotel and Single-Letter Café are within the same controlled group, the benefit offerings are assessed separately based on each respective employer's employee eligibility. Adequate Southern Hotel's parity testing must factor in the unlimited physical therapy telehealth services, and Single-Letter Café's must factor in the unlimited mental health telehealth services on the same basis. Unless Adequate Southern Hotel also provides unlimited outpatient mental health services under its major medical plan at no cost to participants, the plan may be violating MHPAEA by imposing greater financial requirements and visit limits on MH/SUD benefits than MED/SURG benefits. In contrast, Single-Letter Café's offerings do not introduce a MHPAEA compliance concern because group health plans can provide more favorable financial requirements and visit limits for MH/SUD benefits.

G. Medicare Secondary Payer Rules

The Medicare Secondary Payer (MSP) rules generally prohibit group health plans from "taking into account" Medicare entitlement of a current employee or their spouse or dependent. Specifically, under the MSP coordination of benefits rules, for group health plan participants who are also entitled to Medicare, the employer's group health plan is generally the primary payer of claims for active employees, whereas Medicare is generally the primary payer of claims for COBRA participants and retirees. Special rules apply to individuals with disease- or disability-based Medicare and to employers with fewer than 20 employees.

For employers with 20 or more employees, the MSP rules prohibit employers from offering age-based Medicare-eligible individuals financial incentives or other benefits to waive coverage or disenroll from the employer's group health plan (i.e., actions that would cause Medicare to become the primary payer). So, for example, employers subject to these rules should not offer to reimburse Medicare premiums for active employees or their spouses. Additionally, employers should ensure that their employee communications, including with respect to Part D creditable/non-creditable coverage notices, do not appear to encourage eligible individuals to enroll in Medicare. For more information, see the PPI publication **Medicare Part D Creditability Disclosures: A Guide for Employers**.

The age-based MSP rules apply to group health plans of employers with 20 or more employees (full-time and part-time, without prorating) for each working day in at least 20 calendar weeks in either the current or preceding calendar year, regardless of how many employees are enrolled in the group health plan. The 20-employee test must be run at the time the individual receives Medicare-covered services. Once the 20-employee threshold is met, the employer's group health plan is treated as primary for the applicable period, even if fewer than 20 employees are currently employed or participate in the plan.

Our Observation	The small employer exemption for age-based MSP rules involves a rolling measurement period in the current calendar year because the count must be completed at the time Medicare-covered services are received. As a current year progresses, new weeks with higher employee headcounts can trigger a midyear loss of a small employer's exemption from age-based MSP rules. Employers near the 20-employee threshold should monitor headcount carefully and also be mindful of plan designs, communications, and administrative practices that assume Medicare is the primary payer for active employees. Once the MSP rules apply, those assumptions can create compliance and operational issues, particularly where practices are difficult to unwind midyear.

The disability-based MSP rules only apply to group health plans of employers with 100 or more employees (full-time and part-time, without prorating) on at least 50% of their regular business days during the previous calendar year.

For purposes of counting employees under the age- or disability-based small employer exemptions, all employees of employers that are treated as a single employer under the Section 414 controlled group or affiliated service group rules must be counted. Unlike other benefits laws, however, employees of employers belonging to a Section 52 controlled group must also be counted. The Section 52 controlled group rules require a lesser degree of common ownership or control than the Section 414 controlled group rules, meaning a greater number of related employers may be aggregated in order to determine whether the MSP rules apply compared to other benefits laws.

H. FMLA

The federal Family and Medical Leave Act (FMLA) provides eligible employees of covered employers with unpaid leave for specified family and medical reasons, which can be used concurrently with paid leave under an employer's policy and/or a state paid leave program. FMLA generally provides up to 12 workweeks of leave in a 12-month period, with the exception of leave to care for a covered servicemember, for which 26 workweeks of leave in a 12-month period are available. FMLA includes benefits protections that require employers to maintain an eligible employee's health benefits during a qualified leave. For more information on FMLA employee protections and employer requirements, see the DOL's Employer's Guide to The Family and Medical Leave Act.

FMLA protections apply to private employers with 50 or more employees in 20 or more workweeks in the current or prior calendar year. All part-time and full-time employees are counted without prorating; employees on leave are also counted. Once an employer exceeds the 50-employee threshold, it remains a covered employer through the following calendar year. FMLA applies to all public employers (federal, state, and local) and local educational agencies (including private elementary and secondary schools), regardless of size.

Eligible employees are those who worked for a covered employer for at least 12 months as of the FMLA leave start date and completed at least 1,250 hours of service for the covered employer during the 12-month period (approximately 24 hours per week) immediately prior to the FMLA leave start date. In addition, an eligible employee must work at a location where the employer employs at least 50 employees within 75 miles of that worksite.

Our Observation	A remote employee's worksite for FMLA eligibility purposes is the office they report to or where their assignments are made, not their remote work location. This means that the count of employees within 75 miles of a worksite includes all employees whose worksite is within that geographic area, including employees who work remotely from farther away but who report to a worksite within the same 75-mile area.

Under FMLA, separate businesses may be considered a single employer if they are an "integrated employer," which uses different evaluative criteria than the Section 414 employer aggregation rules. Specifically, integrated employer status looks to common management, interrelation between operations, centralized control of day-to-day labor operations, and degree of common ownership or financial control. Common ownership alone may be insufficient for two employers to be considered one integrated employer for FMLA applicability purposes. The integrated employer analysis is highly fact-specific, with reviewing courts typically focused on how employment and human resources decisions are made. Employers should consult with their employment law counsel for specific analysis.

> **Example:** Primo Painters, which operates a residential painting service with 40 employees, and Neighborhood Noodles, which operates a ramen restaurant with 30 employees, are part of the same controlled group. Even though they are under common ownership, Primo Painters and Neighborhood Noodles operate in distinct industries under different management and human resource departments with separate benefits, control of labor operations, and business operations. As a result, a court would likely determine they are not considered an integrated employer under FMLA.

Our Observation	The 75-mile radius is relevant only to employee FMLA eligibility, not whether the employer must comply with FMLA. Employees of businesses under common management, regardless of geographic location, are counted together to determine employer FMLA applicability.

Also, where two or more businesses exercise some control over an employee's work, such as through a temporary employment agency arrangement, the businesses are considered "joint employers" under FMLA. A jointly employed employee must be counted by both employers, even if the employee is only on one of the employer's payrolls.

3. SUMMARY

Controlled group, affiliated service group, or other related employer status often impacts when related entities are treated as a single employer for employee benefits compliance purposes. In practice, these rules often determine when employees must be counted together under the ACA, IRC Section 125, IRC nondiscrimination rules, COBRA, MHPAEA, MSP rules, and FMLA, even if a particular entity is not large enough to trigger a compliance obligation on its own. The rules also determine whether related entities can offer benefits through one group health or welfare plan under ERISA. Because these rules are highly fact-specific and apply differently depending on the statute, employers must work closely with their legal counsel and tax advisors to verify their controlled group, affiliated service group, or other related employer status and confirm the related applicable requirements under group benefits compliance laws.

PPI BENEFIT SOLUTIONS

APPENDIX A

Applicable Employer Aggregation Rules: Quick Reference Chart

	Section 414 Controlled Group	Section 414 Affiliated Service Group	Section 52 Controlled Group	Integrated Employer
ACA Employer Mandate	X	X		
ACA Market Size	X	X		
ERISA	X			
IRC Section 125 Plans	X	X		
IRC Nondiscrimination	X	X		
COBRA	X	X*		
MHPAEA	X	X		
MSP	X	X	X	
FMLA				X

*For small employer exception only

APPENDIX B

Controlled Group and Affiliated Service Group Examples

Caution and Legal Disclaimer. *Neither PPI nor its a iliates provide legal or tax advice.* Because the application of these laws can become complex and varies based on an entity's specific structure, employers must work closely with their legal counsel to determine their aggregated employer status and corresponding legal and tax obligations.

This Appendix is only intended to illustrate the basic concepts of aggregated employer status through corporation stock ownership. The IRC's employer aggregation rules also address common control of non-corporate entities, tax-exempt organizations, partnerships, proprietorships, or a combination of corporate and non-corporate trades or businesses. Ownership is determined differently for non-corporate entities. For nonprofit organizations, controlled group status depends on common control rather than common ownership. Further, the employer aggregation rules become more complex to determine constructive ownership, such as when individual, corporation, estate, trust, or partnership ownership includes the interest of a spouse or minor child.

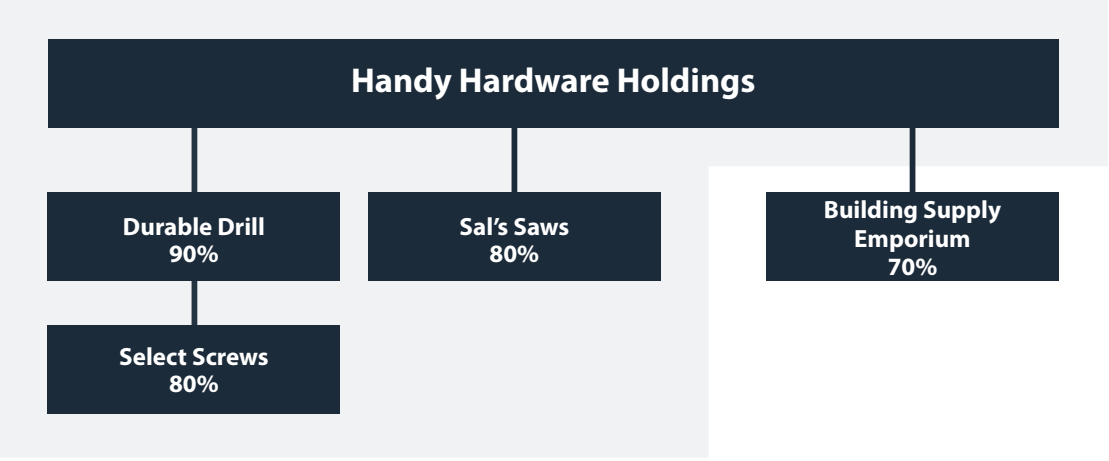
The employer aggregation rules under Section 414 were designed to prevent large employers from structuring their organizations into multiple smaller organizations to take advantage of lower tax rates and avoid certain employee benefits obligations. Two or more entities form an aggregated employer group when they share sufficient common ownership or control, or joint ownership and common business activity. Entities may belong to the same aggregated employer group even if they operate in different industries.

Controlled Groups

Under IRC Section 414, there are three basic types of "controlled groups" of corporations: *Parent-Subsidiary, Brother-Sister, and Combined* controlled groups.

In a ***Parent-Subsidiary*** controlled group, one or more chain of corporations is connected through stock ownership with a common parent. Specifically, a Parent-Subsidiary controlled group exists when the common **parent** owns at least 80% of at least one subsidiary; and to the extent that at least 80% of any other subsidiary is not owned by the parent, at least 80% of such **subsidiary** is owned by one or more of the other subsidiaries.

> **Example:** Handy Hardware Holdings owns 90% of Durable Drill Corp., 80% of Sal's Saws Corp., and 70% of Building Supply Emporium Inc. Durable Drill Corp. owns 80% of Select Screws Corp. Handy Hardware, Durable Drill, Select Screws, and Sal's Saws form a Parent-Subsidiary controlled group, with Handy Hardware as the common parent and Durable Drills, Sal's Saws, and Select Screws as subsidiaries. However, Building Supply Emporium is not part of this controlled group because Handy Hardware's ownership interest is less than 80%.



In a ***Brother-Sister*** controlled group, two or more corporations are closely held by a small number of owners. Specifically, two or more corporations form a Brother-Sister controlled group when five or fewer individuals, estates, or trusts:

- Collectively own at least 80% of the stock in each corporation, known as "controlling interest."
- Hold identical ownership of at least 50% of the stock of each corporation (this means for each owner, the lesser of that person's ownership share in each entity is counted), known as "effective control."

Example: Five shareholders – Henry, Casey, Kyle, Roman, and Constance – each have ownership interests in two corporations, Pink Tie Catering and Fun Rentals, in the following amounts:

Individual	Pink Tie Catering	Fun Rentals	Identical Ownership
Henry	50%	20%	20%
Casey	15%	20%	15%
Kyle	10%	20%	10%
Roman	10%	25%	10%
Constance	15%	10%	10%
Total	100%	95%	65%

Pink Tie Catering and Fun Rentals are members of a Brother-Sister controlled group. Collectively, the five shareholders own at least 80% of each corporation — 100% of Pink Tie Catering and 95% of Fun Rentals. The five shareholders also hold identical ownership of at least 50% of each corporation because they have 65% identical ownership shares of the two entities.

A ***Combined*** controlled group is a hybrid of a Parent-Subsidiary and Brother-Sister controlled group. Specifically, a Combined controlled group exists when three or more corporations are each a member of either a Parent-Subsidiary or Brother-Sister controlled group and one of the entities is both:

- A common parent of a Parent-Subsidiary controlled group.
- A member of a Brother-Sister controlled group.

Affiliated Service Groups

Similar to the controlled group rules, the affiliated service group rules in IRC Section 414 determine when related service organizations are treated as a single employer for the application of certain benefits laws. At a high level, an affiliated service group may exist where one service organization has an ownership interest in another service organization with which it regularly performs shared services (e.g., management services) or services for third persons, like patients or clients. A service organization is generally an organization engaged in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or insurance.

Notably, the affiliated service group rules impose less stringent requirements for common ownership and place greater emphasis on the degree to which related entities perform the same or similar services. Whereas the formation of a controlled group requires a high degree of common ownership or control, the affiliated service group rules look more to the relationship of the entities in performing common services.

Example: Fritz Laser, P.C., a professional corporation formed by medical doctors, is a partner in Silver Cosmetic Surgery Group, a surgical practice owned by a number of doctors and professional corporations. Fritz Laser's doctors regularly perform cosmetic and surgical procedures for patients of Silver Cosmetic Surgery Group. Fritz Laser and Silver Cosmetic Surgery Group may constitute an affiliated service group regardless of the level of Fritz Laser's ownership in Silver Cosmetic Surgery Group. However, if Fritz Laser's ownership in Silver Cosmetic Surgery Group is sufficient to satisfy the requirements of a controlled group (discussed above), Fritz Laser and Silver Cosmetic Surgery Group may also form a controlled group.

Our Observation	**MEWA Risk.** As discussed in the main publication, members of an affiliated service group are treated as a single employer for a narrower range of purposes compared to members of a controlled group. Most notably, ERISA does not recognize members of affiliated service groups as one employer unless they also satisfy the controlled group requirements. In practice, this means members of an affiliated service group may be treated as one employer for purposes of applying certain benefits requirements – like the ACA employer mandate, ACA market size, COBRA small employer exception, MHPAEA, and Section 125 – but risk creating a MEWA if they offer benefits jointly to their employees under one ERISA plan.

PPI BENEFIT SOLUTIONS