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Multiple Employer Plans—Opportunities and Challenges: Qualified Retirement Plans

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Introduction

Many employers looking to control the costs and potential liabilities associated with providing competitive employee benefits are taking a second glance at an alternative to single employer plans known as the “Multiple Employer Plan” or “MEP.” MEPs are being increasingly promoted by service providers as the panacea for eliminating fiduciary liability and administrative costs. The value proposition of a MEP can vary by operational design and type of plan at issue, but the common benefits of a MEP to an employer include the elimination of most plan sponsor functions such as an annual plan audit and Form 5500 filing, and some plan fiduciary functions such as choosing which investment options will be available to plan participants. Despite this attractive proposition and the fact that MEPs have existed since the 1950s, proper MEP operation and compliance remains elusive due to a lack of guidance from the Internal Revenue Service (the “Service”) and the Department of Labor (the “DOL”). Furthermore, the guidance that has been issued by the Service and the DOL conflicts in many instances.

Despite the uncertainty surrounding MEPs, when designed and operated properly, a MEP can provide significant cost savings to employers in the form of

reduced administrative fees, filing and audit requirements, and fiduciary responsibilities. However, to truly achieve these costs savings, employers and service providers would be wise to carefully consider the existing patchwork of guidance and potentially untested liability issues before joining a MEP and while participating in a MEP.

For these reasons, the authors have prepared a series of installments covering MEPs in operation, design, and correction. This first installment will cover MEPs in the qualified retirement plan arena, including compliance issues under the Internal Revenue Code (the “Code”), the Employee Retirement Income Security Act of 1974 (“ERISA”), and securities laws administered and enforced by the Securities and Exchange Commission (“SEC”). The remaining installments in this series will cover MEPs providing health and welfare benefits, MEPs in the equity compensation and deferred compensation context, and correction of MEP failures.

Common Designs and Operations

There are a variety of structures for MEPs in today's market, but three common designs have emerged.

The first is a MEP sponsored by a Professional Employer Organization (“PEO”) to be adopted by the PEO’s clients; the second is a MEP sponsored by an industry or trade group to be adopted by the group’s members; and the third, which growing in popularity, is a MEP co-sponsored by the participating employers who have no relationship or connection to each other, other than participating in a common plan (the “open” MEP).

A fourth type of MEP with a different set of issues is the accidental MEP, in which employers with common ownership participate in what was thought to be a single employer plan, but the common ownership was insufficient to treat the employers as a single employer under the Code (i.e., employers do not meet the requirements to be a “controlled group” or “affiliated service group” under the Code).

In theory, all MEPs are a single plan and are usually maintained pursuant to a single “group trust” agreement and plan document, with individual employers signing adoption agreements to participate in the MEP. The MEP often allows the employer to select basic features for their employees such as eligibility requirements, vesting schedules, and contribution rates.

Legal Definitions and Requirements

Tax Code Requirements

Control Groups

Employers that are related by sufficient common ownership do not need to adopt MEPs in order to have related employers participate in a qualified plan. Employees of all corporations that are members of a controlled group of corporations are treated as if they were employed by a single employer for most retirement plan rules. Code Section 414(b) provides that this rule applies to Code Sections 401 (tax qualification rules including the exclusive benefit rule), 410 (minimum participation rules), 411 (vesting rules), 415 (limitations on benefits) and 416 (top heavy rules).

The term “controlled group of corporations” is defined to include parent-subsidiary controlled groups, brother-sister controlled groups, and combined groups.¹ A parent subsidiary controlled group includes all corporations connected through stock ownership with a common parent if (1) 80 percent or more of the total combined voting power of all classes of stock entitled to vote (or 80 percent or more of the value of all shares of all classes of stock) of each of the corporations, except the common parent, is owned, directly or indirectly, by one or more of the other corporations, and (2) the common parent corporation owns, directly or indirectly, 80 percent or more of the total combined voting power of all classes of stock entitled to vote (or 80 percent of the value) of at least one of the other corporations.²

A brother-sister controlled group, on the other hand, is a group where five or fewer individuals, estates, or trusts own, directly or indirectly, stock possessing: (1) 80 percent or more of the total combined voting power of all classes of stock entitled to vote (or 80 percent of the value) of each corporation, and (2) more than 50 percent of the total combined voting power of all classes of stock entitled to vote (or 50 percent of the value) of each corporation, taking into account the stock ownership of each owner only to the extent that the level of ownership interest is identical with respect to each such corporation.³ A controlled group may also be a combined group where there are overlapping parent-subsidiary and brother-sister controlled groups.⁴ Additionally, Code Sections 406 and 407 contain special rules that allow a domestic corporation to treat an individual employed by certain foreign affiliates as its employee for purposes of applying qualified plan rules, thus enabling such person to be covered by the domestic company’s qualified plan, even though the foreign company and the domestic company are not part of the same controlled group under Code Section 414.

In contrast, a MEP is defined under Code Section 413(c) as a single qualified plan that is maintained by two or more employers who are *not* related under Code Section 414(b), (c), (m) or (o).⁵ However, qualified plans with multiple participating employers pursuant to one or more collective bargaining agreements are not MEPs subject to Code Section 413(c), but are instead considered multiemployer or Taft-Hartley Plans.⁶ Additionally, the mere fact that a qualified plan, or qualified plans, utilizes a common trust fund (otherwise known as a group trust) or otherwise pools plan assets for investment purposes does not, by itself, result in a particular plan being treated as a MEP under Code Section 413(c).

Once it is determined that Code Section 413(c) applies, employers and MEP plan sponsors should carefully consult the rules set forth in Code Section 413(c), which, despite the treatment of a MEP as a single plan, provide that the employers participating in the qualified plan are treated as one employer for some, but not *all*, purposes.

Treated as One Employer

Employers participating in a MEP are treated as *one* employer for the following purposes:⁷

Eligibility. Code Section 413(c)(1) provides that a MEP must apply the minimum service requirements (i.e., one year of service) under Code Section 410(a) as if the participating employers are a single employer. For example, service with all participating employers is

³ See I.R.C. §§ 414(b) and 1563(a)(2).

⁴ See I.R.C. §§ 414(b) and 1563(a)(3).

⁵ Treas. Reg. § 1.413-2(a).

⁶ Treas. Reg. § 1.413-2(a)(3). See also I.R.C. § 413(b) and Treas. Reg. § 1.413-2(a)(3).

⁷ The term “employers” for purposes of this section means all employers and all members of its controlled group. See *supra* nn. 1-4 and accompanying text.

¹ See I.R.C. §§ 414(b) and 1563(a).

² See I.R.C. §§ 414(b) and 1563(a)(1).

counted in determining an employee's eligibility to participate in the plan.

Exclusive Benefit Rule. Code Section 413(c)(2) provides that the exclusive benefit rule is applied as if the employers are a single employer. This permits the allocation of contributions and forfeitures across company lines without violating the rule that an employer's contributions must be made for the benefit of its employees and former employees. According to the Service, "the employment relationship between workers and the employer maintaining the plan is fundamental to whether a plan is qualified under Section 401(a) of the Internal Revenue Code."⁸ "If a retirement plan provides benefits for individuals who are not employees of the employer maintaining the plan, the plan does not satisfy the exclusive benefit rule contained in Section 401(a)(2), and therefore could be disqualified."⁹ However, a MEP allows the participating employers to be treated as a single employer for purposes of this requirement, even though the employers are not related under Code Section 414(b), (c), (m) or (o).

Vesting. Code Section 413(c)(3) treats the employers as a single employer for vesting purposes. Thus, service with all participating employers is counted in determining an employee's vested percentage under the MEP. Further, the discontinuance of contributions and partial termination rules of Code Section 411 also apply to MEPs as if all employers participating in the MEP were one single employer.¹⁰ Full plan terminations occur upon a complete discontinuance of contributions or benefit accruals under the plan.¹¹ Additionally, a partial plan termination can occur if a plan amendment or a reduction in force causes a 20 percent or more turnover in the number of employees receiving benefits under the plan or benefit accruals under the plan are greatly reduced.¹² Because MEPs are treated as being sponsored by one employer for purposes of Code Section 411, there would only be a complete discontinuance of contributions to a MEP, and therefore a full termination of the MEP, if every employer participating in the MEP ceased contributions to the MEP. Similarly, partial terminations due to a reduction in force would occur less frequently under a MEP than under individual plans because the turnover rate would include all participating employees in the MEP, rather than just the participating employees of the single employer who experienced the reduction in force. What is more, partial terminations in general, even when caused by a plan amendment affecting the entire MEP rather than a particular participating employer's reduction in force, will occur less frequently than under individual plans

because the turnover rate under the MEP calculation includes a greater number of participants.

Section 415 Limits. For purposes of the Code Section 415 limits, a participant's compensation from all participating employers is aggregated to determine the individual's defined contribution plan annual addition limit (\$49,000 in 2011 and \$50,000 in 2012) and annual additions from all participating employers must be taken into account.¹³

Section 402(g) Limits. For purposes of the elective deferral limit under Code Section 402(g) (\$16,500 in 2011 and \$17,000 in 2012), the limit is based on deferrals from compensation earned by all employers participating in the MEP.

Plan Disqualification. Unfortunately, because MEPs are treated as a single plan under Code Section 401(a), if any *one* employer fails to meet any requirements that are tested or required on an employer-by-employer basis (rather than on a single employer, one plan basis as explained below), the *entire* MEP fails to meet the qualification requirements of the Code.¹⁴ Given the Service's Employee Plans Compliance Resolution System, which is available for plan sponsors to voluntarily correct plan failures in both the audit and non-audit context, MEP plan disqualification is highly unlikely.¹⁵

Treated as Separate Employers

Employers participating in a MEP are treated as *separate* employers for the following purposes:

Coverage Testing. The minimum coverage requirements of Code Section 410(b) are applied as if each participating employer maintains a separate plan. The regulations provide that "the minimum coverage requirements of section 410(b) are generally applied to a 413(c) [multiple employer] plan on an employer-by-employer basis, taking into account the generally applicable rules such as section 401(a)(5) and section 414(b) and (c)."¹⁶ Therefore, each employer in the MEP must separately satisfy either the "ratio percentage test" or the "average benefits test."¹⁷

Highly Compensated Employee Determination. In determining whether an employee is a highly com-

⁸ Rev. Proc. 2002-21.

⁹ *Id.*

¹⁰ I.R.C. § 413(c)(3). *See also* Treas. Reg. § 1.413-2(a)(iii).

¹¹ Treas. Reg. § 1.411(d)-2(a).

¹² Treas. Reg. § 1.411(d)-2(b). Whether a partial plan termination has occurred depends on the facts and circumstances of the case; however, there is a presumption that a partial plan termination has occurred if the turnover rate is at least 20 percent. *See* Rev. Rul. 2007-43.

¹³ *See* Treas. Reg. § 1.415(a)-1(e). In general, "annual additions" mean the sum, credited to a participant's account for any limitation year of: (1) employer contributions, (2) employee contributions, and (3) forfeitures. *See* Treas. Reg. § 1.413-6(b)(1)(i).

¹⁴ Treas. Reg. § 1.413-2(a)(3)(iv).

¹⁵ *See* Rev. Rul. 2008-50, § 10.12. The plan administrator of a MEP, rather than any contributing or participating employer, must request consideration of the plan under the Service's correction programs, and the request must be made with respect to the entire MEP, rather than a portion of the MEP affecting any particular employer. *Id.* In some instances, however, the plan administrator of the MEP may choose to have the correction compliance fee calculated separately for each employer based on the assets attributable to that employer, rather than being attributable to the assets of the entire plan. *Id.* MEP corrections are further discussed in a further installment of this article series.

¹⁶ Treas. Reg. § 1.413-2(a)(3)(ii).

¹⁷ *See* Treas. Reg. §§ 1.410(b)-2(b)(2) and 1.410(b)-2(b)(3).

pensated employee, only the employee's compensation for services to the participating employer being tested should be considered.¹⁸ For example, if an employee's total compensation from all employers in the plan is \$185,000, with \$120,000 allocated to Corporation A and \$65,000 allocated to Corporation B, the employee would be a highly compensated employee for purposes of Corporation A's test but would not be a highly compensated employee for Corporation B's test.¹⁹

Benefits, Rights, and Features Testing. Each employer in the MEP must show, after being disaggregated from all other employers in the MEP, that all "benefits, rights or features" are currently available to a nondiscriminatory group under Code Section 401(a)(4) and that minimum participation under Code Section 401(a)(26) has been met.²⁰

Nondiscrimination Testing. The nondiscrimination rules under Code Section 401(a)(4) are also applied on an employer-by-employer basis so that each participating employer is treated as a single employer. Similarly, nondiscrimination testing under Code Section 401(k) and (m) is determined on an employer-by-employer basis.²¹

Top Heavy Testing. Top heavy testing must be performed as if each participating employer maintains a separate plan.²²

Deductions. The contribution deduction limits are applied as if each participating employer maintains a separate plan.²³

ERISA Requirements

Unlike the Code, ERISA does not define MEPs but ERISA does recognize MEPs by referring to them in various sections.²⁴

Single Plan Reporting and Documenting

One advantage of MEPs is that they are treated as a single plan for purposes of the Form 5500 and plan audit requirements under ERISA.²⁵ Therefore, employers adopting a MEP escape the expense and hassle of completing annual plan audits and Form 5500s. Additionally, MEPs are maintained pursuant to one plan and one trust document which reduces costs associated with maintaining multiple documents.

Commonality

The question of whether there must be a common relationship among employers participating in a MEP appears to be answered differently under the Code and

ERISA. Both the Code and ERISA require that each employer participating in and/or maintaining a MEP (in the "open" MEP context) have employees that are covered by the MEP.²⁶ However, the Code contemplates the establishment of one single qualified employee benefit plan by multiple, unrelated employers while ERISA's definition does not readily appear to allow the association of unrelated, unconnected employers.²⁷ Yet ERISA does not appear to ban unrelated employers from participating in an "open" MEP as described below.²⁸

ERISA defines an employee pension benefit plan as "any plan, fund, or program which was . . . established or maintained by an *employer* or by an employee organization, or by both, to the extent that by its express terms . . . it provides retirement income to employees. . . ."²⁹ The term "employer" is further defined as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity."³⁰ The DOL has opined that in order to be considered "an association of employers" and therefore an "employer" and an "employee benefit pension plan" under ERISA, a MEP must be established by a "bona fide group or association of employers" to benefit their employees.³¹ The DOL has further opined that "where several unrelated employers merely execute participation agreements. . . as a means to fund benefits, in the absence of any genuine organizational relationship between the employers, no employer *association* can be recognized."³²

A "bona fide group or association of employers" requires that a common economic or representation interest or genuine organizational relationship unrelated to the provision of benefits exist.³³ Whether a "bona fide group or association of employers" has been formed depends heavily on the facts and circumstances of each case. For example, the DOL has held that a city chamber of commerce and non-profit health trade association of small employers are not "bona fide groups or associations of employers" while an automotive lobbying organization is a "bona fide group or association of employers."³⁴ In order to establish this relationship, the DOL will consider "how members are solicited; who is entitled to participate and who actually participates in the association; the process by which the association was formed, the purposes for which it was formed, and what, if any, were the preexisting relationships of its members; the powers, rights and privileges of employer

¹⁸ See I.R.C. § 413(c)(6) and Treas. Reg. § 1.414(q)-1T, Q&A-6.

¹⁹ *Id.* Generally, a highly compensated employee is any employee who was a 5 percent owner of the company anytime during the year or preceding year or, for 2011, had compensation in excess of \$110,000 (\$115,000 for 2012). I.R.C. § 414(q)(1).

²⁰ Treas. Reg. §§ 1.401(a)(4)-4 and 1.413-2(a)(3)(iii).

²¹ See *infra* nn. 56-60 and accompanying text.

²² Treas. Reg. § 1.416-1, G-2.

²³ I.R.C. § 413(c)(6).

²⁴ See ERISA §§ 3(16)(B)(iii) and 210.

²⁵ Form 5500 Instructions, Line A, Box for Multi-Employer Plan.

²⁶ I.R.C. § 413(c)(6) and ERISA § 3(2)(A).

²⁷ *Id.* See also ERISA § 3(5).

²⁸ See *infra* nn. 39-41 and accompanying text.

²⁹ ERISA § 3(2)(A) (emphasis added).

³⁰ ERISA § 3(5).

³¹ See Op. Dep't. of Labor 2008-07A; Op. Dep't. of Labor 1990-43A; Op. Dep't. of Labor 1994-07A; Op. Dep't. of Labor 2001-04A.

³² *Id.* (emphasis added.)

³³ *Id.*

³⁴ See *supra* and *infra* nn. 31-37 and accompanying text.

members that exist by reason of their status as employers; and who actually controls and directs the activities and operations of the benefit program.”³⁵ The most important factors for the DOL when considering the issue of commonality seems to be whether all members of the association are “employers” as defined by ERISA and whether the employer members have the ability to directly or indirectly exercise control over the plan both in form and in substance.³⁶ The DOL is more likely to find commonality to exist amongst the sponsors of the MEP if the association’s membership is limited to “employers” as defined by ERISA and all employers participating in the MEP have the ability to be a part of the decision-making processes regarding changes to the MEP, i.e. voting abilities.³⁷

However, MEPs do not have to be established by “an association of employers” having a common nexus between them; they can also be established by multiple individual employers as well. While ERISA requires *associations* of employers to have commonality in order to sponsor a MEP, MEPs sponsored by multiple employers who act as independent co-sponsors, called “open” MEPs as described above, rather than one *association* sponsor, appear to escape ERISA’s commonality requirements.³⁸ This exemption from ERISA’s commonality requirement is based on the notion that in an “open” MEP, the adopting employer remains a co-sponsor of the MEP.³⁹ Therefore, the MEP meets the definition of an “employee benefit pension plan” because the plan continues to be maintained by each “employer” for the benefit of their employees. Employers co-sponsoring a MEP are not attempting to form an association of employers but are acting on their own behalf. Further, the DOL’s opinions that require commonality cover association organizations of which the underlying employers were members, such as trade associations and a city chamber of commerce.⁴⁰ While the statutory definitional arguments that “open” MEPs escape ERISA’s commonality requirements are clear on their face, it is important to note that the DOL has not yet opined on the matter.⁴¹

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ See Robert J. Toth Jr., *The Workings of the “Open” Multiple Employer 401(k) Plan* (TAG Res., LLC, White Paper 2011), available at <http://tagresources.com/pages/for-advisors.html>.

³⁹ Note that an employer co-sponsor of a MEP can still take advantage of the fiduciary risk mitigation aspects of a MEP by delegating its fiduciary responsibilities to the plan administrator or a lead employer sponsor.

⁴⁰ See *supra* nn. 33-38 and accompanying text. These opinion letters deal with Multiple Employer Welfare Arrangements (“MEWAs”) that were abusive and designed to use ERISA to circumvent the application of state insurance law protections. *Id.* These same policy considerations for MEWAs do not apply in the context of MEPs.

⁴¹ Many commentators expect the DOL to opine on the issue of “open” MEPs in the near future as the number of “open” MEPs has greatly increased in recent years.

MEPs sponsored by “organizations” can be considered either an “employer” or an “association of employers” under ERISA depending on the facts and circumstances of each case. For example, in the context of a PEO-sponsored MEP, participants are actually employees of the PEO rather than the employer clients of the PEO. Therefore, the PEO is an “employer” under ERISA, not an “association of employers” even though it is an organization of employers. In recent years, an increasing number of MEPs sponsored by retirement plan third-party administrators (“TPAs”) have been established; however, this structure appears to be problematic because the TPA does not have employees participating in the MEP and is therefore not an “employer” as defined under ERISA. Therefore, a TPA must be considered an “association of employers” under ERISA in order to maintain a MEP. However, DOL representatives have expressed in informal communications with the authors that the DOL’s position is that the TPA structure lacks the necessary commonality to be considered a “bona fide group or association of employers.”

Fiduciary Responsibilities

Employers may also be able to utilize MEPs as a tool in mitigating fiduciary risks. Under ERISA, there are generally four primary types of “named” fiduciary responsibilities that can be transferred to the primary MEP sponsor or another independent third party as follows:

- ERISA Section 403(a) Trustee,
- ERISA Section 3(16) Plan Administrator,
- ERISA Section 3(21) Named Fiduciary, and
- ERISA Section 3(38) Investment Manager.

By adopting a MEP or merging its single-employer plan into a MEP, an employer may transfer all or some of these fiduciary roles to the primary sponsor of the MEP.⁴² Some practitioners take the view that because the remaining responsibilities of the employer under a MEP are merely “settlor” or ministerial functions, the employer can effectively transfer all of its fiduciary responsibility to the MEP. This concept remains true for even an “open” MEP described above, because each co-sponsor of an “open” MEP could transfer these primary fiduciary roles to the primary employer sponsor of the MEP. Typically, the MEP’s primary sponsor or the primary sponsor’s appointees handle the tasks of plan administration, fund selection and monitoring, asset management recordkeeping, plan document maintenance and interpretation, and Form 5500 preparation and audit. Therefore, the only tasks remaining for other employers to complete are ministerial functions or “settlor” functions such as plan design decisions and submission of plan contributions, and the decision to join or withdraw from the MEP. When an employer is merely acting as a plan sponsor carrying out “settlor” or min-

⁴² Note that depending on the actual structure of the MEP and the roles of the MEP sponsor and the employers, all four fiduciary roles may not be transferred to the MEP sponsor in all cases.

isterial responsibilities, ERISA's fiduciary duties do not apply.⁴³ Further, decisions regarding the form or structure of a plan and the decision of whether to terminate a plan are generally "settlor" functions.⁴⁴

Despite the apparent ability to transfer many fiduciary responsibilities from participating employers to the primary employer sponsor of the MEP as discussed above, a number of practitioners believe that the employer retains the residual fiduciary responsibility to monitor the MEP and the "discretionary authority or discretionary responsibility in the administration of the MEP" as referred to in the definition of a "fiduciary" under ERISA.⁴⁵ Therefore, until the DOL opines on the matter, it appears the best practice for employers participating in or co-sponsoring a MEP is for the employer to assume it has a fiduciary responsibility for all acts performed for the benefit of participants and to regularly evaluate and monitor the MEP and any service providers of the MEP.

Defined Benefit Plans—Minimum Funding Requirements

In addition to the basic requirements explained above, employers sponsoring a defined benefit MEP must maintain minimum funding limits under Code Section 412 and ERISA Section 302.⁴⁶ The minimum funding requirements of defined benefit plans depend generally on a comparison of the value of the plan's assets with the plan's funding target and target normal cost.⁴⁷ Under the Code, for defined benefit MEPs established after 1988, each employer is treated as maintaining a separate plan for purposes of the minimum funding standards unless the MEP requires all employers to contribute an amount that would not be less than the minimum required contribution if the employer maintained a separate plan.⁴⁸ For all other defined benefit MEPs, the Code provides that the minimum funding requirements are determined as if all the participants were employed by a single employer.⁴⁹ Under ERISA, however, minimum funding requirements are determined as if all the participants were employed by a single employer for all MEPs, regardless of when the MEP was established or the plan's provisions regarding minimum required contributions.⁵⁰

Because a defined benefit MEP meeting the Code's minimum funding requirements will automatically satisfy the minimum funding requirements under ERISA,

⁴³ *Beck v. Pace Int'l Union*, 551 U.S. 96, 101, 40 EBC 2281 (2007).

⁴⁴ *Id.* (citing *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 444, 22 EBC 2265 (1999)). See also *King v. Nat'l Human Res. Comm., Inc.*, 218 F3d 719, 1 EXC 439 (7th Cir. 2000).

⁴⁵ ERISA § 3(21)(A)(iii).

⁴⁶ See I.R.C. §§ 412, 430 and 436. See also ERISA § 302.

⁴⁷ Treas. Reg. § 1.430(d)-1.

⁴⁸ I.R.C. § 413(c)(4)(A).

⁴⁹ I.R.C. § 413(c)(4)(B). In the first plan year after Nov. 10, 1998, a plan administrator could have elected separate plan treatment for each employer. *Id.* Such election was irrevocable absent the Service's approval. *Id.*

⁵⁰ ERISA § 210(a)(3).

MEPs should focus on the Code's requirements regarding separate versus single plan applicability for minimum funding requirements.⁵¹ Therefore, unless the MEP was established before 1989 or provides that all employers must contribute at least the amount that would be required under Code Section 412 if the employer had maintained an individual plan, the minimum funding requirements of the Code must be satisfied on an employer-by-employer basis under the MEP.⁵² For that reason, under most MEPs, the funding target, target normal cost, value of plan assets, funding standard carryover balance, and prefunding balance are computed separately for each employer under the MEP.⁵³ Furthermore, each employer under the MEP may make interest rate elections that are independent of the elections of other employers under the MEP, and the "at-risk" status is determined separately for each employer under the MEP.⁵⁴

The separate defined benefit funding requirements described above greatly reduce the administrative efficiency otherwise produced under a MEP. If the MEP provides that all employers participating in the MEP must contribute at least the amount that they would have to contribute under an individual plan, some administrative conveniences may be preserved even though the minimum contribution amounts would still have to be calculated on an employer-by-employer basis in accordance with the Code in order to calculate the contribution amounts for each employer.⁵⁵

Defined Contribution Plans—Nondiscrimination Testing

Although historically the vast majority of existing MEPs have been defined benefit plans, defined contribution MEPs are becoming increasingly popular and provide administrative and cost savings efficiencies as well. Perhaps the biggest reason defined contribution MEPs were historically not as popular as defined benefit MEPs is due to the requirement of separate employer-by-employer nondiscrimination testing under Code Sections 401(k) and 401(m). The MEP must be disaggregated for purposes of Actual Deferral Percentage ("ADP") testing, which ensures that elective deferrals under the plan are being made in a nondiscriminatory manner, and each employer participating in the MEP must separately satisfy the ADP test with respect to only its employees.⁵⁶

Similarly, if a MEP allows for after-tax employee contributions or employer matching contributions, the MEP must be disaggregated for purposes of Actual Contribution Percentage ("ACP") testing which ensures that after-tax employee contributions and employer matching contributions under the plan are being made

⁵¹ See I.R.C. §§ 412, 430 and 436. See also ERISA § 302.

⁵² I.R.C. § 413(c)(4).

⁵³ Treas. Reg. §§ 1.430(d)-1(a)(3), 1.430(g)-1(a)(2), and 1.430(f)-1(a)(2).

⁵⁴ Treas. Reg. §§ 1.430(h)(2)-1(a)(2) and 1.430(i)-1(a)(2).

⁵⁵ I.R.C. § 413(c)(4)(A)-(B).

⁵⁶ Treas. Reg. § 1.401(k)-1(b)(4)(iv).

in a nondiscriminatory manner.⁵⁷ Each employer participating in the MEP must separately satisfy the ACP test with respect to only its employees.⁵⁸ With respect to both the ACP and ADP tests, employees are only treated as the employees of their actual employer, not of all employers participating in the MEP.⁵⁹ If nondiscrimination testing could be passed on a single-plan basis rather than on an employer-by-employer basis, employers who normally fail the ADP and/or ACP tests would have a great incentive to join a MEP. Therefore, conducting individual nondiscrimination testing eliminates a large incentive to participate in a defined contribution MEP.

Employers participating in MEPs that satisfy the minimum safe harbor contribution requirements of Code Sections 401(k)(12) and 401(m)(10), however, would be exempt from annual ADP and ACP testing requirements. Because nondiscrimination testing is determined on an employer-by-employer basis, the “safe harbor” status of a MEP would also be determined on an employer-by-employer basis.⁶⁰ Therefore, some employers participating in a “safe harbor” MEP could be exempt from ADP and ACP testing while others are not exempt.

Plans Holding Employer Securities

Prohibited Transaction Concerns

ERISA

Very little guidance exists regarding the ability to form MEPs that hold employer securities. Further, the treatment of employer securities under the Code and ERISA differs slightly which adds complexity to the already opaque MEP rules. ERISA provides that a prohibited transaction (“PT”) occurs when a plan acquires any “employer security” unless the employer security is a “qualifying employer security” obtained for adequate consideration, with no commission charges, and the plan is an eligible individual account plan.⁶¹

ERISA defines “employer securities” to include securities “issued by *an* employer of employees covered by the plan, or by an affiliate of such employer.”⁶² ERISA further defines “qualifying employer securities” to include stock or other marketable obligations.⁶³ The DOL has never opined on the applicability of these definitions to securities held in a MEP.⁶⁴ However, based upon the plain meaning of the statute, it appears that any stock issued by any employer participating in a MEP should

be considered a qualifying employer security under ERISA with respect to all employers under the MEP. Therefore, it appears that a PT under ERISA should arguably not occur due to the MEP’s holding of employer securities.

The Code

The Code contains PT rules that are similar to the rules provided under ERISA and imposes an excise tax of 15 percent of the total amount involved in the PT on the disqualified person.⁶⁵ Like ERISA, the Code exempts the acquisition of “qualifying employer securities” obtained for adequate consideration with no commissions charged by an eligible individual account plan from being a PT.⁶⁶ Even though the Code contains a different definition of “qualifying employer securities” than the definition found in ERISA, the Code defers to ERISA’s definition of “qualifying employer securities” for purposes of this PT.⁶⁷ Therefore, as under ERISA, the mere fact that a MEP holds employer securities of the various participating employers should not create a PT.

Multiple Employer Stock Ownership Plans

Perhaps the most popular type of plan that holds employer securities is an employee stock ownership plan (“ESOP”) developed under Code Sections 409 and 4975(e). ESOPs are attractive for employers looking to borrow money on a pretax basis, refinance existing debt, solve ownership succession issues, eliminate federal income tax at both the corporate and shareholder levels, facilitate an acquisition or divestiture, and provide employees with incentives for productivity. Even though holding employer securities, as defined under ERISA, does not create a PT, it appears that a Multiple Employer Stock Ownership Plan (“MESOP”) arrangement would not be achievable or at a minimum would be impracticable.

Generally, an ESOP is a defined contribution plan meeting the requirements of Code Section 401(a) that is designed to invest primarily in “qualifying employer securities” as defined under the Code.⁶⁸ As previously mentioned, the Code defines “qualifying employer securities” slightly differently than ERISA. Under the Code, “qualifying employer securities” means common stock issued by *the* employer (or by a corporation which is a member of the same controlled group) that is readily tradable on an established securities market or, if there is no readily tradable common stock, the class of common stock of the employer having the greatest voting power and dividend rights.⁶⁹ Unlike ERISA, under the Code’s definition of “qualifying employer securities,” stock is only a “qualifying employer security” with respect to *the* employer who issued the stock.⁷⁰ There-

⁵⁷ Treas. Reg. § 1.401(m)-1(b)(4)(iv).

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ See *supra* nn. 56-59 and accompanying text.

⁶¹ See ERISA §§ 406(a)(1)(E) and 408(e).

⁶² ERISA § 407(d)(1).

⁶³ ERISA § 407(d)(5).

⁶⁴ See DOL Adv. Op. 77-06 which discusses a plan’s sale of stock that was not employer securities. In 77-06, the DOL opined that the transaction would be prohibited because the stock owned by the plan was neither employer securities nor qualifying employer securities and was merely property.

⁶⁵ I.R.C. § 4975.

⁶⁶ I.R.C. § 4975(d)(13).

⁶⁷ *Id.* See also ERISA § 408(e) (stating that “qualifying employer securities” is as defined in ERISA Section 407(d)(4)).

⁶⁸ I.R.C. §§ 409(a) and 4975(e)(7).

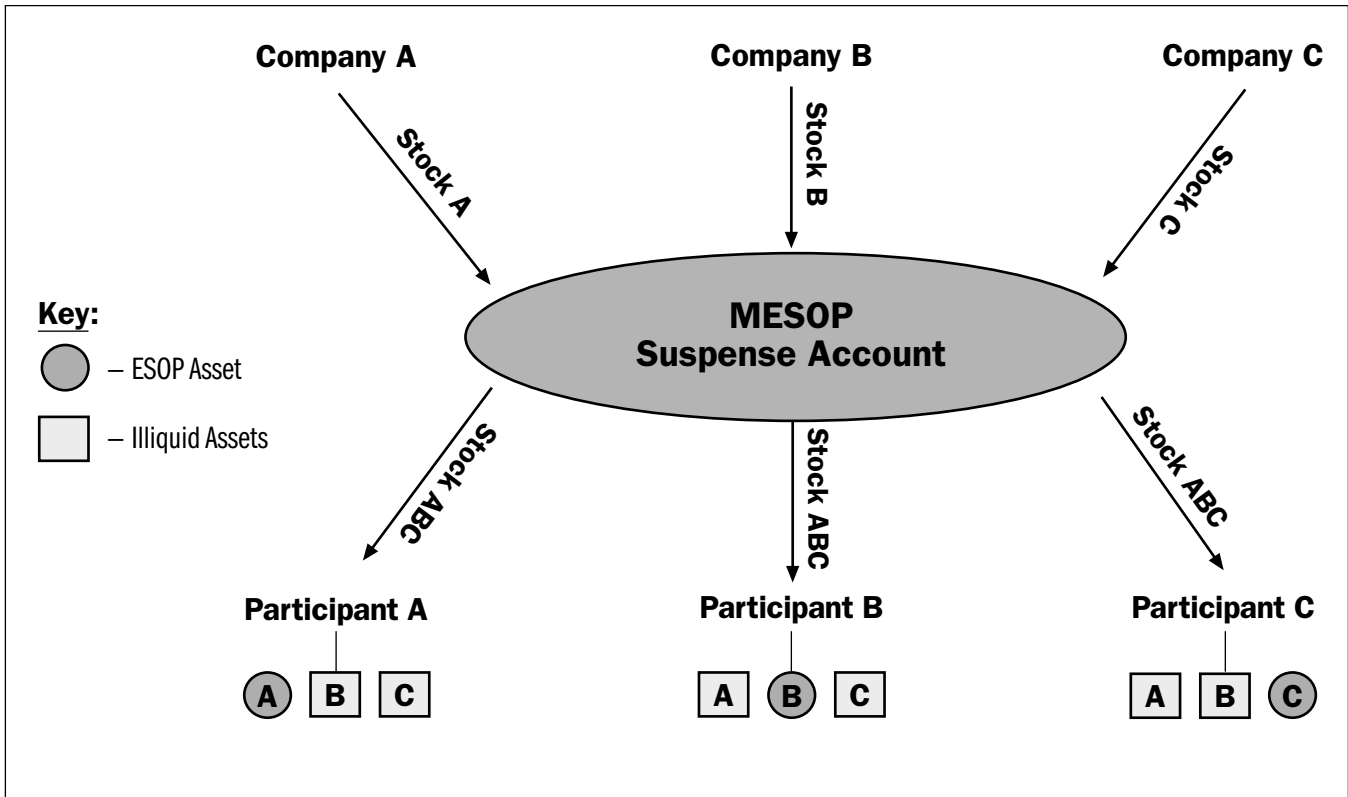
⁶⁹ I.R.C. §§ 409(l) and 4975(e)(8).

⁷⁰ *Id.*

fore, in the MEP context, an ESOP can only exist on an employer-by-employer basis. In other words, if three employers are participating in a MEP and each employer is contributing employer stock, the MEP would only be an ESOP with respect to each separate employer as to its own employees and would not be an ESOP with respect to the employees of the other two employers. Employer stock issued and contributed by one employer could not be treated as “qualifying employer securities” when held in the account of another employer’s participant. Simply put, a true MESOP that provides that all stock issued by all employers participating under the MESOP is “qualifying employer securities” with respect to all employers participating in the MESOP does not comply with the Code and therefore would not be a qualified plan.

For example, Companies A, B and C are non-related, privately-held entities participating in a MEP that is structured as a MESOP. Employer securities issued by

the participating companies and held in a suspense account in the MESOP are released from the suspense account and allocated to participants without a restriction as to which company’s employer securities are allocated to which participants. This results in a participant employed by Company A (“Participant A”) holding employer securities issued by Companies B and C in his account. Under the Code, only employer securities issued by Company A are “qualifying employer securities” with respect to Participant A, and the MESOP is in reality three separate ESOPs, one maintained by Company A for Company A employees, Company B for Company B employees, and Company C for Company C employees. Therefore, the employer securities issued by Companies B and C that are held in Participant A’s account (assuming Company A, Company B and Company C are not publicly traded entities) are hard to value illiquid assets rather than qualifying employer securities. The following diagram illustrates this example:



Further, both ERISA and the Code provide that a PT exists when the plan sponsor (as a “party in interest” under ERISA and a “disqualified person” under the Code) makes a loan to a qualified plan unless that plan is an ESOP as defined under the Code and the loan is made for the purpose of purchasing “qualified employer securities.”⁷¹ Because a true qualified MESOP is unattainable, the PT exemption for a loan made to an ESOP to purchase employer securities under both the Code and ERISA would be unavailable if, for example, Company A in the above example made a loan to the MESOP to purchase the employer securities of Company B.⁷² In order for this PT exemption to be available, the loan must be made to an ESOP as defined by the Code.⁷³ As previously discussed, an ESOP must be invested primarily in “qualifying employer securities” as that term is defined under the Code, and therefore in the MEP context, an ESOP only exists on an employer-by-employer basis, and an exempt loan can only be used to purchase employer securities of the loaning employer.⁷⁴

Therefore, in order to avoid a PT and prevent participant investments in potentially illiquid assets (depending on the publicly traded status of the issuer), a MEP could not operate as a true MESOP and would need to maintain and track separate suspense accounts and exempt loans for each company participating in the MEP. This requirement further complicates the already complex structure of an ESOP and eliminates the administrative conveniences that make MEPs attractive to plan sponsors.

General Concerns

In addition to potential PT issues, sponsors of MEPs holding employer securities should also be concerned about the potential for the MEP to hold illiquid assets. In the private company context, if employer stock of one employer is held in the account of a participant employed by another employer, that stock is an illiquid asset. Further, while the MESOP structure (that being the individual employer-by-employer ESOP under a MEP document) appears to be permissible under the Code and ERISA, it would not be advantageous to the employers and participants involved, particularly in the situation of privately-held employers because the securities would only be “qualifying employer securities” with respect to the employers who issued them, and when these securities are held by the participants of other employees, the securities become hard-to-value private investments.⁷⁵

⁷¹ See I.R.C. § 4975(d)(3) and ERISA § 408(b)(3).

⁷² *Id.*

⁷³ *Id.* Note that even the PT exemption under ERISA for an exempt loan defers to the Code’s definition of an ESOP. See ERISA § 407(d)(4).

⁷⁴ See *supra* nn. 68-70 and accompanying text. This creates the need for separate suspense accounts under each ESOP, which further diminishes the administrative efficiencies normally achieved through MEPs.

⁷⁵ The concept of illiquid assets that are difficult to value applies in the context of any MEP holding privately-held employer securities, not just ESOPs.

Additionally, participants who receive allocations of employer stock issued by employers participating in the MEP other than their employer (“non-ESOP participant”) are not granted the same protections granted to employee-participants of the issuing employer (“ESOP participants”). For example, ESOP participants have the right to receive their distributions in employer stock and then “put” that stock back to the employer in order to create a market for those shares. Under the MESOP structure, that “put” option right would only apply to participants who are employed by the employer who issued the securities, i.e., ESOP participants. All other participants, i.e., all non-ESOP participants, would be left holding illiquid assets because the issuing employer is not required to purchase these securities. Other rights available to ESOP participants and plan sponsors that would not be available to non-ESOP participants include voting and tender offer rights for shares held in their accounts. Further, the issuing employer does not have a right of first refusal as to employer securities held by non-ESOP participants.

SEC Requirements

SEC Requirements

The Securities Act of 1933 - Registration Requirement

The Securities Act of 1933 (the “Securities Act”) defines the term “security” so broadly that employer securities held in a MEP are subject to the requirements of the Securities Act absent an exemption, regardless of whether the company issuing those securities is privately or publicly held.⁷⁶ The Securities Act prohibits the sale of unregistered securities unless such securities are exempt from the Securities Act. Section 3(2) of the Securities Act exempts participants’ interests in a single employer plan holding securities from the registration requirements so long as the plan is qualified under Code Section 401(a) and the amount invested in employer securities does not exceed the amount of employer contributions made to the plan. However, the SEC has opined in several no-action letters that this registration exemption is not available for employer securities held in a MEP because a MEP is not a single employer plan as defined under the Securities Act.⁷⁷ Therefore, employer securities held in a MEP are required to be registered under the Securities Act.⁷⁸

The Investment Company Act of 1940

The Investment Company Act of 1940 (the “Investment Act”) broadly defines an “investment company” to include a corporation, a group of persons, or fund that is engaged in the business of investing, reinvesting, or

⁷⁶ Securities Act of 1933 § 2.

⁷⁷ Employee Benefit Plans, Securities Act Release No. 6188 at part IV. See also New England Electric System Companies, SEC No-Action Letter (May 7, 1979); Health Future/Hospital Joint Retirement Trust, SEC No-Action Letter (Feb. 13, 1984); Samaritan Health System, SEC No-Action Letter (Dec. 14, 1993); The E.W. Scripps Company, SEC No-Action Letter (Dec. 6, 1982).

⁷⁸ *Id.*

trading securities, and subjects the investment company to extensive regulation.⁷⁹ Stock bonus or profit sharing plans qualified under Code Section 401(a) are generally exempt from the Investment Act; however, the SEC staff has taken the position that the exemption only applies to a single trust or a group trust involving bank-trusted pension and profit sharing plans.⁸⁰ Further, the SEC has taken a similar position under the Investment Act regarding the exemption of MEPs as that taken under the Securities Act and states that MEPs are not exempt from the Investment Act.⁸¹ Therefore, MEPs, regardless whether the participating employers are publicly or privately held, are “investment companies” under the Investment Act and are required to register as an investment company under the Investment Act.⁸²

Conclusion

After over 60 years of existence, MEPs still remain a mystery to most employers and employee benefit practitioners due to the extreme lack of guidance covering the topic. Like all employee benefit plans, MEPs are

subject to requirements under the Code and ERISA. Unfortunately, the Code and ERISA do not exactly agree regarding the treatment of MEPs; however, through careful design strategy practitioners can reconcile these differences. Further guidance should be issued regarding MEPs to enable employers and practitioners to have confidence in the structure and operation of MEPs.

If structured properly, a MEP can provide significant cost savings in the form of administrative conveniences, fewer filing and audit requirements, and fiduciary risk mitigation to its participating employers. MEPs can provide administrative convenience for both defined contribution and defined benefit plans. However, MEPs are not without disadvantages. MEPs cannot operate as true MESOPs, and MEPs holding employer securities (in the private context) tend to be problematic and inefficient. Practically speaking, employers wishing to maintain an ESOP for the benefit of their employees would be better served by maintaining their own individually designed ESOP. Furthermore, MEPs are not exempt from the securities laws and can be contaminated by one employer’s refusing to comply with the Code. Despite these disadvantages and challenges, some employers may want to consider the cost savings opportunities available through the use of non-employer security holding MEPs.

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⁷⁹ Investment Company Act of 1940 § 3.

⁸⁰ Lanchart Industries, Inc., SEC No-Action (Jan. 27, 1977).

⁸¹ See *supra* nn. 77-80 and accompanying text.

⁸² *Id.*