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To Be or Not To Be the Employer: Controlled Group Analysis for Tax-Exempt Organizations

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When analyzing benefit plan requirements , it is important for tax-exempt organizations that are part of a group of related employers to identify the correct "employer." While the determination of the "employer" could appear to be simple on its face, plan sponsors should be wary of the potential layers of complexity.

Controlled Group Rules

In certain situations, related entities must be treated as a single employer under the Internal Revenue Service's rules for aggregating controlled groups of organizations and groups of organizations under common control. Proper application of the controlled group rules will help preserve the favorable tax status of retirement plans and will help comply with applicable tax rules for health and welfare plans sponsored by tax-exempt organizations. These controlled group rules may apply to treat multiple tax-exempt organizations as a single employer or to treat a group of tax-exempt organizations and a *non*-tax-exempt organization as a single employer.

The determination of whether a tax-exempt organization is under common control depends on either the level of representation or control. Tax-exempt organizations are under common control if at least 80% of the directors or trustees of one organization are either *representatives* of the other organization or are directly or indirectly *controlled by* the other organization.

- A director or trustee is a representative of another organization if she or he is also a director, trustee, agent, or employee of the other organization.
- A director or trustee is controlled by another organization if the other organization has the power to remove that individual and designate a new director or trustee.

Different controlled group rules apply to "steeple churches," qualified church-controlled organizations and governmental entities.

The controlled group rules for tax-exempt organizations have remained generally consistent. However, recent developments impacting tax-exempt plan sponsors are creating a new opportunity to take a fresh look at executive compensation and plan compliance practices.

Note¿An affiliated service group, which is another way employers may be consolidated for benefit plan purposes, might exist for a tax-exempt organization if there is a management organization whose principal business is performing, on a regular and continuing basis, management functions for a tax-exempt organization or a group of related organizations.

Executive Compensation Under Code Section 4960

Section 4960 of the Internal Revenue Code ("Code") imposes an excise tax on certain executive compensation paid by applicable tax-exempt organizations. While the basic framework of Code Section

4960 has remained in place since 2017, Congress amended the statute in 2025 to expand the definition of a covered employee and provide for annual inflation adjustments to the $1 million remuneration threshold. The IRS also issued Notice 2026-36 providing initial guidance regarding its interpretation of these changes. See our August 2026 article for additional details. (See: Executive Compensation Under Section 4960: FAQs for Tax-Exempt Organizations.)

In light of these recent changes, it is important for plan sponsors to determine who is the "employer" for purposes of timely analysis and plan compliance. Key implications include:

- The scope of "covered employees" has expanded to any employee receiving remuneration from the tax-exempt organization and its related group.
- Tax-exempt organizations will have to aggregate remuneration paid by the organization and any related organizations.
- Controlled group members could be required to combine their respective employee base for retirement plan compliance testing.
- Plan sponsors must accurately report related entities and specific transactions in annual Form 990 reporting.

If your organization would like additional information regarding this topic or any other employee compensation and benefits matters, please contact an attorney with the Boutwell Fay team.