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Speaker 1: Hello and thank you for joining today's Related Employers phone forum. Please note at this time all audience members are in a listen only mode to cut down on background noise and to ensure all participants can clearly hear the presenters. This phone forum is being recorded. I would now like to introduce, Brenda Smith Custer.

Brenda: Hi everyone. I'm Brenda Smith Custer, Acting Director of IRS Employee Plans Customer Education and Outreach. Thank you for joining us today and welcome to our phone forum on Related Employers. Today we'll be hearing from a couple of our tax law specialist. Audrey Kucia, from our Employee Plans Technical group and Don Kieffer from our Guidance group.

Before they start their presentation, I'd like to point a few things out. If you registered for today's presentation and you attend the entire 50 minutes, we'll email you a completion certificate in about a week. Enrolled agents, retirement plan agents, and actuaries can receive continuing education credit for this session. Other tax professionals should consult their licensing organization to see if today's session qualifies for CE credit. As with all our presentations, the comments expressed by our speakers today shouldn't be taken as formal IRS guidance.

Here at the IRS we have many retirement plan resources available. If you look at slide 2 in your hand out, you'll see a snapshot of our retirement plans web page. You can get there by going to the main IRS.gov landing page, click on the “Information for” drop down box in the upper right side of the screen and select “Retirement plans.”

On slide 3 you'll see how to subscribe to our free electronic newsletters. Select “Newsletters” in the left navigation bar, choose “subscribe” and then select “Retirement News for Employers,” our newsletter for employers sponsoring retirement plans, and “Employee Plans News,” for retirement plans professionals.

Now let's hear from Don and Audrey.

Don: Okay thank you Brenda, good afternoon everybody. Or good morning for those of you in the West. I'm Don Kieffer, and if you're following along on our PowerPoint that we've prepared as the handout material, let me start on slide 5, very quickly by giving an over view of our agenda for today. First I'm going to start with a quick introduction on why we're talking about related employers at all, in the context of employee benefit plans. Then I will turn it over to my co-presenter, Audrey, to go over the rules for affiliated service groups. I'll come back and talk about some of the controlled group rules. Then we will finish up with questions and answers.

Quite frankly, this is enough material to probably do 3 one hour segments on each of those topics. So we will admittedly shoe horn this all into one hour, by giving a very general overview. If we don't get to the questions you've submitted in advance, by all means feel free to contact us after the presentation if we've raised others, or you wanted us to go into something a little more in depth.

So with that, let's go to slide 7 and begin. We're talking today about related employers, and for employee benefit purposes, there are two types of employers that are of importance. One are controlled groups, and usually when you're dealing with controlled groups, you're looking at a collection of employers that are linked together because they have some type of common owner attributes. We're also going to talk about affiliated services groups. They also have this linkage of common ownership attributes, but usually that common ownership percentage is far less than it would be to get to a controlled group. But as a substitute for that lesser ownership percentage, you've got some degree of related service, either between the two entities, or the two entities are performing that service together to the public. So you have a lesser degree of ownership, but as a substitute you have some commonality of business or services.

The purpose of all these rules is to avoid having non-highly compensated rank and file of employees excluded from retirement plan coverage just because employers segregate their businesses, or segregate their entity structure to put a plan, for example, into one entity and then none in another. And the general thing we want to leave you with today, when you're looking at related employers, is if you have a relationship that meets one of these criteria, controlled group or affiliated service group, all the employees and all the businesses are treated as if it's one employer-employee relationship, one giant employer and all the employees are essentially folded under that employer.

If we turn to slide 8, we're talking today about controlled groups and the sections of the law that are implicated, are code sections 414(b) and (c). 414(b) deals with incorporated businesses, 414(c) deals with unincorporated businesses, and as we'll talk about in a little bit there are two types of controlled groups, and parent subsidiary groups and brother sister groups. And I'll go over those rules when we get there. Most of those rules are supplied by final regulations that have been on the books for quite a long time.

Audrey's going to talk about affiliated services groups to get us started momentarily. Those rules are all under code section 414(m)(2)(A) that has the A-Org rules, 414(m)(2)(B) has the B-Org rules, and 414(M)(5) has the management groups, the 3 different types of affiliated service group arrangements that you may encounter in your practice.

Parenthetically most of the administrable rules for those are proposed regulations that have been in existence since 1983, there's actually a second set of proposed regs that were withdrawn, I think in 1984. But that proposed regulations structure still remains implementing authority for many of the factual analysis that go on with looking at affiliated service groups.

If we turn to slide 9, as I said in introduction, if you have a controlled group or affiliated service group, then for most purposes that you're going to consider all the employees as if they're employed by one single employer. That means, for example, looking at what we have on Slide 9,

the employer would have to run a none discrimination test on an aggregated or a consolidated basis, or have to look at the elected deferral limitations, as if everybody is employed by one single employer. There are other tests for other compliances issues that I don't have on slide 9. Very quickly off the top of my head, 401(a)(26), minimum participation, some of the deduction rules under section 404. These rules also apply to SEPs, and to SIMPLEs. And they also are implicated by the Affordable Care Act, for purposes of determining whether or not you've got one employer that meets the 100 employee rule. We actually received a couple of questions on that, and perhaps we'll go into that a little bit further when we get to the end. As a general rule, if you have a related employer relationship, for most IRS compliances purposes, you treat all the employees as if they are all folded into one employer uniformly.

With that, let me turn this over at slide 10, to Audrey Kucia, to start us today by going over the affiliated service group rules on section 414(m)(2).

Audrey: Thank you so much, Don. Hi, this is Audrey Kucia, thank you so much for joining us. And thank you also for all of your enthusiasm. We're very excited at all the questions that we received. As Don noted, we will try to incorporate answers to some of your questions while we go through the slides. And we will also try to answer as many questions as we can at the end.

When you're looking at affiliated services groups, this can be a difficult analysis, because you're making an evaluation of entity ownership. You're looking at common business transactions and services that are being provided. You also are required to develop a comprehensive understanding of the business affairs of several entities. All of this information can be, well, it can seem to be unrelated to plan administrations. As Don has noted, there's some history here. On December 28th, 1980, President Carter signed into law section 414(m), as in Mary, of the Code. And it requires for affiliated service organizations, all employees of the organization will be treated as employed by one employer. As Don has said, the intention was to expand the employee pool that has access to employer provided retirement plans. Also, as Don had noted, the Affordable Care Act does have a provision, section 4980H, the shared responsibility provision, that looks at affiliated services groups and controlled groups. In these cases you're aggregating groups together to determine whether the shared responsibility provision applies. Please note that for the penalties provision of the Affordable Care Act, you disaggregate and you look at a per entity basis.

The purpose of our phone forum today is to look at retirement plans. In the IRS Office of Chief Counsel, Katy Johnson is your point of contact for section 4980H of the Code, which is employer shared responsibility. In addition, please note that initially when section 414(m) was implemented, it was only looking at A organizations and B organizations. It wasn't until after the Tax Court decision in Achiro v. Commissioner, 77 Tax Court 881 (1981) that Congress decided to add section 414(m)(5) to the Code. They added it as part of the Tax Equity and Fiscal Responsibility Act of 1982, or what many of you will refer to as TEFRA, which is Public Law 97-248.

Moving on to slide number 11. Really if we're looking at an affiliated service group, we clearly are looking at more than one entity. One of these entities has to be a First Service Organization, or an FSO. The FSO receives services from, or shares them with an A organization, a B

organization, or a management group. Please note we're looking at slide 11 here. It's very helpful to actually look at the Code, and look at the regulations. We've received some questions asking specifically how certain things were defined, for example. If you look at Code section 4141(m)(2)(A), it literally starts with "any service organization." But in contrast, if you look at code section 414(m)(2)(B), it starts with "any other organization." Similarly, looking at the regulations, starting at 1.414(m)-1 and onwards, though these are proposed regulations, they do provide further discussion and illustration. Please note that the regulations that are proposed are for A organizations and B organizations. And while we did have proposed regulations, which Don mentioned, for management groups, those regulations were withdrawn.

Moving on to slide number 12. Looking at A organizations and B organizations, you want to examine the degree to which one group is performing services with or for another group with which it has common ownership. For management groups, you're not looking at common ownership, you're really just looking at providing management services. Here, I would note, Revenue Ruling 68-370, provides guidance on section 414(m) of the Code.

Moving on to slide number 13. An FSO can exist as any form of business entity but its principal business must be the performance of services, and it must have at least one shareholder licensed or legally authorized to perform those services. Also please note, an FSO corporation must be a professional service corporation, or what we will refer to as a PSC. We did receive a question asking us, "Well, what does it mean to have a shareholder who is legally authorized to perform those services?" What I would say is, it depends. Something that would seem to be a very straight forward analysis would be if you have a licensed surgeon who is also a shareholder in a surgical services center. What I would say here, is that you likely need to look at state law for the jurisdiction in question with regards to licensing. In some cases, for some professions, you're going to be looking at membership in professional societies and associations, perhaps membership in a state bar. Also please note that we did receive a question as to whether a shareholder could be a partner. If you look at the regulations at 1.414(m)-(2)(b)(1)(i), for an A organization it does specify partner or shareholder in the FSO. Later we will distinguish B organizations, which require a minimum of 10% ownership of the B org in the FSO by HCEs. A caveat that I would give here is that some state laws preclude certain professionals from partnering with non- professionals in their field to provide licensed services. So always keep in mind, do the state laws allow for this? And there are certain contexts where certain professionals are allowed to partner with non-professionals in their field, but it really depends on their state law.

Moving on to slide number 14. Looking at affiliated service groups, you are asking the question, "Does a relationship exist between the FSO and another entity?" Considerations are the degree of common ownership and who owns it, and also the degree to which there is a conjoined business relationship.

Moving on to slide 15, very specifically A organizations. The tests that you're looking at are an ownership test and a relationship test. A theme you will find with me here, with affiliated services groups, or in your own practice with affiliated services groups, is there's always some sort of facts and circumstances evaluation. Please note that for purposes of ownership and for applying the attribution rules, very specifically for A orgs and B orgs, you're going to use the

rules under Code section 318(a). However, for management groups, although Code section 414(m)(6)(B) suggests that 318 attribution is to be used generally for affiliated services groups, please remember that 414(m)(5), for just management groups, that was added after the initial A org and B org sections of 414(m) of the Code. Also remember, management groups come with their own attribution principal. You're looking at Code section 267 for that attribution rule. Also please note that before the U.S. Supreme Court decision in U.S. v. Windsor, 570 U.S. 12 (2013), the federal definition of spouse was limited to an opposite sex spouse, however, after the Windsor decision, the federal definition of spouse, or I guess what I'm saying, what the IRS uses, we include same sex spouse or an opposite sex spouse. Finally, on slide number 15, please note that regularly performing services, or regularly associating in performing services for third persons, this is an inherently facts and circumstances determination. The starting point of this analysis usually begins with an examination of the revenue stream of each company. Then you go on, you try to understand the relationship between the entities. Then you're looking for information that may be relevant to forming a conclusion about whether you satisfy the relationship test.

Moving on to slide number 16. Please note that both the FSO and the A organization must be service organizations. Again, we have a subjective decision here with regards to "What do we mean by primarily engaged in the performance of services?" Very special note here, capital cannot be a material income producing factor for an organization. As a rule of thumb, where is capital reflected in a business? Are you making substantial investments in inventory, in plants, in machinery, in other equipment? Specific examples of businesses where capital is an income producing factor: banks, similar institutions. Please note, however, that capital is not considered a material income producing factor if the gross income of the business consists principally of fees, commissions or other compensation for personal services performed by an individual. Please always keep in mind that what Congress intended was to cover service organizations, and the specific list in Treasury Regulation 1.414(m)-2(f) describes service organizations as those in the following fields: health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, and insurance.

Moving on to slide 17. For a B organization, it has to satisfy 3 tests. There's a significant portion test, a historically performed test, and a common ownership test. Please note here, we did have a couple of questions on whether or not the same definitions for an FSO applies for a B organization as for an A organization. It does, you use the exact same definition. Please also note a B organization itself does not have to be a service organization, and in the interest of time, I'm just going to move on to slide number 18.

A summary of tests for the B organizations, questions you're asking here are: Does the B organization receive substantial income from servicing the FSO? Does the B organization perform services for the FSO that would have been, prior to 1981, performed by the FSO's own employees? Then, very specific to a B organization, you want to know, do the highly compensated employees, the HCEs of the FSO, own 10% or more of the B organization?

Moving on to Slide number 19. For the significant portion test, it's a facts and circumstances evaluation, but you have 2 significant business activity safe harbors: the service receipts and the total receipts threshold. Number one, for the service receipts safe harbor, a B organization has to

provide services of more than 5% of those receipts. If you don't meet the 5% test, then you're not providing a significant portion of the services and you're not a B organization. However, if you do meet the 5% test or more, you go on to the next test. Please note that for this particular test you have the current year, and they're looking back 3 years. You are using the highest computed results. As I had said, if you have 5% or more, you're going on to the next test.

Moving on to slide number 20. The total receipts threshold test. Here your concern is whether 10% or more of the potential B org's gross receipts are from services to the FSO. So your prior test was whether 5% of services receipts are met. This test is concerned with 10% of all receipts, whether or not they are from services to the FSO.

Moving on to slide number 21. The historically performed test is usually considered the easiest test to meet because it's entirely subjective. Here, I have a note, depending on your perspective, the regulations are either visionary or they really do need an update. Either the regulations consider outsourcing or they don't. We all know that commerce today is very different from commerce as it existed in 1980. A specific example would be, in the 80s there wasn't the employment of wide spread outsourcing. So when you're looking at the regulations, you're looking at a frozen picture of what was going on in the economy in 1980. You're trying to make a determination of whether or not it's applicable to determine whether something was historically performed. Several questions that were submitted asked us, "Are there any plans to update the regulations, and even to issue regulations for management service groups?," which I will discuss in short. As of today, there is no plan to do so. However, IRS Chief Counsel and IRS Employee Plans welcome suggestions for guidance projects, so you can submit suggestions to them.

Moving on to Slide number 22. For B org affiliated services group, what you're looking at here is the common ownership test. Is the B org owned at least 10% by HCEs of the FSO? You can contrast that to the A org test, where an A org itself, or by attribution must own an interest in the FSO. Here, the FSO's owners must by themselves or by attribution own the B organization itself. Please remember you're using Code section 318 attribution. Moving on the attribution rules, A orgs and B orgs both use Code section 318. For an A organization, ownership is satisfied by an ownership interest in the FSO. If you're looking at management organizations, you're going to use Code section 267(c) for your attribution rules. Very briefly, the differences between attributions schemes are rules for family membership and minimum percentages for businesses. In case you are not familiar, attribution is a concept where the ownership held by one person is deemed to be owned by another person, so it's attributed to that person. Also please note, if the A organization has a partnership, and its partners own any interest in the FSO, which is often the case, that does satisfy the ownership test. If the B organization is a partnership, and its partners are also highly compensated employees of the FSO, this will also satisfy the ownership test.

Moving on to slide number 24, and just in the interest of time, please study the chart and make a note that the horizontal relationships with regard to attribution are flowing between spouses, parents and children. But there is no horizontal attribution between siblings for section 318, and with regards to grandchildren and grandparents, the ownership of the grandchildren flows up to grandparents, but it does not flow down to grandchildren.

Moving on to slide number 25. Attribution for organizational members. Please note that the amount attributed is in proportion to real ownership. So think of it in terms of, if you have a one third trust beneficiary, that beneficiary is deemed to own one third of any interest owned by the trust. Please also note that for corporations, stock is attributed only to 50% or more shareholders. So a corporation is deemed to own what its 60% or more shareholder owns, but it is not deemed to own what is owned by a 40% shareholder. For a partnership, there is no minimum threshold of ownership, but conversely a partnership is deemed to own anything owned by its partners, as if the partnership owned it directly.

Moving on the slide number 26. If an LLC elects a specific form of entity for taxation purposes, which is often a partnership, then that will be the business form we are looking at for attribution. Please also note there is no double attribution. And what we mean by double attribution is that if there is attribution from a parent to a child, let's say the parent owns 50% of the company and then the child has the parent's 50% ownership, it doesn't just continue on this endless chain, where that 50% is going to the child's spouse, and to the child of the child. However, this doesn't mean that the 50% ownership by the parent isn't also attributed to the spouse of the parent, and it isn't also attributed to any other of the children of the parent. You just don't have this endless chain; that it keeps going.

Moving on to slide number 27. Multiple member groups are not more technically complicated but they are more factually complicated. In the interest of time, if you have questions, please contact us off line. There was a question that said this slide wasn't clear. I would also note that for budgetary reasons, we apparently didn't have a grammar reviewer for the slide. A caveat I would use is you really are using a facts and circumstances evaluation here.

Moving on to slide number 28. Looking at management groups, you're looking at common management. You don't have an FSO concept. There's no common ownership requirement. So this is distinguishable from an A organization or a B organization. Now as Don Kieffer had noted earlier, Congress was concerned that certain entities and certain types of businesses were organizing themselves in a way that rank and file employees were being excluded from participation or being excluded from having the option of having a retirement plan. So when 414(m)(5) of the Code was enacted, it was very specifically enacted with the intention of reaching these situations where a separate management organization would be set up and just trying to give as many taxpayers the ability to participate in a retirement plan as possible.

Moving on to slide number 29. In order to have a management affiliated service group, you need one organization performing management functions for another. Also, what you're looking at here is that management organization's principal business the performance of these functions on a regular and continuing basis? As Don noted, as I'm noting now, in 1987, Treasury proposed regulations for management groups and later withdrew them. You can look at these regulations to get an idea of how Treasury was thinking in 1987. But it's been a very long time since 1987. What I would really say is that the evaluation of management groups is subjective. A note here I would make, is that at a recent American Bar Association Section of Taxation May Meeting in Washington, D.C., one of the employee benefits subcommittees asked the questions: "What is meant by principal business?, What is meant by regular and continuing basis?" If we have time at the end we'll talk about some scenarios that were posed at this meeting.

Moving on to slide number 30. What is meant by management activities and services? With this you can look to the regulations, but some example might include, making determinations, implementing, supervising. Again, as with some of the other things we'll discuss today, you're putting yourself back in a mindset of what was normal in a particular field, as of September 3rd, 1982. With management groups, do remember they are using section 262 attribution, so a minimum of 50% ownership rules for most purposes would include sibling and family attribution schemes. Siblings are not included in the 318 attribution groups.

Moving on to slide number 31. The law does not include organizations related to the management organization and the affiliated services groups. Please note that this was in the proposed regulations, but it was withdrawn. Among the questions that were submitted, someone asked when the proposed regulations would be finalized. As I said earlier, there is no current plan to do so. If you would like to suggest that the regulations be finalized, please communicate with Chief Counsel and with the IRS.

Moving on to the determination letters, which is slide number 32. You can come in on a determination letter and ask for a ruling with regards to a controlled group or an affiliated service group. For affiliated service groups, you use the same process that you would use for a controlled group. You're looking at Form 5300 line 6A for special ruling request. On the slide here, there are some references you can use, some sources. But basically, the instructions that you're following, is you're going to attach a statement for your affiliated service group, and you're going to provide details about all members of the group, the relationship of each group member, the types of plans maintain by each employer, the plans common to all members, and you're going to indicate if a member of a controlled group is a foreign entity, it can be different for an affiliated service group.

Finally, another question that was asked, was whether the IRS had any plans on issuing rulings on affiliated service groups for purposes of the Affordable Care Act. As of this afternoon, there are no plans to do that. But that does not mean it would never happen. It's possible that in the future they might, but as of today, no, they are not doing that.

With that said, Thank you so much and I will hand off to Don Kieffer to discuss controlled groups.

Don: Alright, Thank you Audrey. So we're about, a little bit past half past the hour. I want to leave about 5 to 10 minutes at the end for us to take some questions. So this is going to be an admittedly high speed, high level overview of a very difficult topic that probably doesn't render itself to a 25 minute overview. Let's see if we can do the best that we can.

I'm going to end this session talking, where Audrey left off, about the determination letter process for getting a letter on controlled group status. Let me start with a general overview. As I said before, if we're looking at a controlled group, if that type of relationship exist. Then again all the businesses, all the trades, all the trade businesses, that make up the controlled group are treated as a single employer for purposes of IRC extension 401(a) requirements.



We received the questions in advance, not too long ago that says, We're seeing more and more companies owned by capital investment firms, portfolio management firms, investment funds, and when we add up those ownership levels, it exceeds some of the levels we're about to talk about. Is there an exception for qualified retirement plans when we're dealing with investment funds that actually own all these businesses? Well the answer to that has actually been developed through litigation that doesn't involve IRS. First of all there is no IRS or tax exemption, along the lines the questioner is raising. There is the qualified separate line of businesses where you can designate these as separate entities for coverage testing. No broad exemption for investment fund holdings. This came up in a court case recently, Sun Capital Partners v. New England Teamsters. The court there applied what it crafted as an "investment-plus" test. If the investor owning these businesses and doing more than just investing in them, that is actually doing some of the management or operational changes that these entities that it owns are involved with, that is an investment plus, plus being a little something more than just being a passive investor. Then this could invoke, this collection of trades and businesses under common control, you might have a controlled group along the lines of good or bad to discuss. It's no real exemption for section 414 purposes.

Let's go to slide 34, when we're talking about controlled groups. We're looking at these investment fund entities under common control. We're looking at Code sections 414(b) and (c). Section 414(b) deals with entities that are corporations or that are stock based entities. Section 414(c) has the rules to non-stock entities. As I get to in a couple more slides, where this can become complicated is when we're dealing with entities that have no ownership. For example, governments or tax exempt organizations. Because if you look at the rules under section 414(b) and (c) and you're trying to analyze whether or not an entity is under common control. Everything is written under the context of ownership. There are many entities out there that truly do not have a truly quote unquote owner.

Let's go to slide 35. There are 3 different types of control groups. We generally think only of 2, that is a parent subsidiary and a brother sister. A parent subsidiary is where one entity owns the other. So if we're concerned that, let's say we have two entities who might be in a controlled group. If we're looking at a parent subsidiary analysis, we're trying to trace the ownership from one entity to another entity. The second type is what's known as a brother sister group. That's where a person or people own shares in two entities. Not where one entity owns the other, but where the owners of one entity own the other entity. The third type is the combined group, which usually a blend of the two – where you have a parent subsidiary relationship and then for example, the parent has common ownership with another entity through that other entities common owners. So those are the 3 different types of groups.

If you go to slide 36, the regulations applied these rules to just about any form of ownership structure. What they're doing with corporations, proprietorships, and even down to trust and estates, the rules for looking at ownership are a bit complicated and unfortunately they don't lend themselves to a quick 25 minute overview, but I'm going to get into a little bit of them, when we deal with trusts, and tax-exempt organizations momentarily.

Let's start on slide 37. Talking about ownership in the context of a corporation, when you're looking at corporation, we're obviously concerned about stock, not just any stock, but voting

stock. The power to vote for the power to make the decisions through the voting of the shares that affect the entity. This might help you understand, even when you're looking at non-corporate structures, the Service's primary concern when we're looking at 414 rules, is who actually has control. If we're dealing with, for example, with a tax exempt organization where there is no stock, we're trying to see who actually has the control over the other entity. So going back to corporations we're concerned obviously about the power to vote the shares. The voting power is what truly has the control. The other two things you have to be concerned about with corporations are options and covenants. These are things that can come out of nowhere and all of the sudden put the unintended employer arrangement into a controlled group. Generally when you have options, the options are deemed to be owned by whomever has the ability to exercise them.

Let's say two corporations exist, one issues a bunch of shares, it also issues options to some other individual. Whoever has the right to exercise those options is deemed to be an owner of those, and this could come into play when you're trying to look at "what is the total amount of outstanding shares?" And what percentage do we actually have? The other is restricted covenant. If you have restricted covenants for example, a corporation issues shares to an individual and that person can only sell them back to the issuers, or sell them back to another person, generally that other person or that issuer is deemed to own, based on the fact that the shares are subject to a covenant restriction. Those shares give that person control over the entity.

If you go to slide 38, if we're talking about non-corporate structures, again we're still trying to look at control. For a partnership, we're looking at who has the capital, or profit interest, whichever one it is that vests the control. If we're looking at a trust, usually the beneficiaries are deemed to be the people that control the trust. I'll get to this in a little bit. There are actually some very different rules that apply when you're dealing with trust, especially in the context of employee benefit trusts. If we're dealing with none profits and we start off without any ownership to begin with, then we're trying to look at, as I said before, who has the control by looking at who has the actual directorship over the non-profit entity.

Let's go to slide 39 and start with our two groups. Parent Subsidiary group. To have a parent subsidiary group you have one entity that owns at least 80% of the other business. So for example, if you have company A and it owns 70% of company B, both A and B each sponsor their own retirement plan, this is not a controlled group because we're not going to satisfy the 80%. We're probably not going to satisfy the brother sister test. One caveat about this, if we're dealing with section 415 issues, that 80% is reduced to 50%. So, notwithstanding the fact that company A owns 70% of B, if we're trying to test these plans for section 415 compliances, these are going to be treated for 415 purposes only, as if it's a single employer. So I have a live question, by presenting and reading your emails as I do. I have a question that says, when we're talking about this on slide 39, and that the reduction of the 80% to the 50% limit. Clarify, does this refer solely to the determining whether annual additions for 415 are met, or does this include everything else where section 415 compensation is invoked. If you think about most plan documents, you have the definition of compensation, definition of compensation for 415 purposes. That definition is used all around the plan for highly compensated determinations, top heavy testing, nondiscrimination. The only one we're concerned about is literally section 415 compliance. Testing the annual additions that are 415(c), the annual benefits under 415(b). The

highly compensated, nondiscrimination, the top heavy status. Those, although they use 415 compensation, those are not aggregated unless the levels are at least 80%.

The other type of the group is on slide 40, which is the brother sister group. If we think about the parent subsidiary group, you have entity A owning Entity B. In the brother sister group, the relationship exists to make these two employers related if the same five or fewer people own directly, or indirectly, a controlling interest of 80% or more. And that 50% of that ownership is identical. Wow, what a mouthful that one is. So, let's try to punch this out into simpler terms. When you're looking at brother sister groups, you generally have a two part test that has to be met. One is an 80% common control test, and the other is a 50% effective control test. The 80% common, 50% effective. So if you punch these out, and figures these are two separate requirements, it makes looking at brother sister intentional relationships a little bit easier.

The 80% common control test is there, if you look on slide 41, if you've got 5 or fewer owners who own at least 80% of each company. When we're dealing with this, we're only dealing with individuals, trusts and estates, not other businesses. That would fall under parent subsidiary roles. When we're dealing with the common ownership test, you would ignore the common owners who own no interest in one or more of the companies under consideration. But be careful, there is a situation in which that ownership can be attributed. It's actually in an old 1984 Supreme Court Case, called *Vogel Fertilizer*. Then the other test is the 50% effective control test, the easiest way to do this if we could do a webinar, I could make it a chart. My words are not going to simplify it to the degree that it is. If you were to take the same people that have the 80% of common ownership, look at their lowest ownership in each of the two entities, and add up all those percentages. If that is 50% or more, then the two entities are under effective control. I have a question submitted in advance that asks, I'll probably have to pick this up later, I'm going to be flipping pages and wasting time. Asked if the two are independent or if you can meet one but not the other. You have to meet both in order to have a brother sister controlled.

In the interest of time, let me skip forward a little bit to slide 43 and talk about the rules for tax-exempt orgs. Tax-exempt orgs. are deemed to be owned by no one. They are kind of a creation of state law, founded under any states' uniform nonprofit statutes. When you're trying to analogize relationship groups like we're describing, you have to look into a situation where at least one organization has no ownership attributes. The rules that govern tax-exempt orgs are actually in 2007 regulations that were issued, that were effective as of January 1st, 2009. Most people, when you're looking for these rights, these are the ones that deal primarily with 403(b). The reg package has controlled group rules for nonprofits attached to it. This reg package is the one that most people tend to know as the one that says, a 403(b) plan has to have a written plan document. These regulations say, when you're looking at tax exempt organizations, they are considered under common control if at least 80% of the board of one organization is a representative, or the magic word again, controlled by the other. Again, these are subject to that same 50% reduction, 415 testing purposes. As shown on the screen, representative means a trustee, a director, an agent or employee of the organization that has the ability and the control means that the other organization has the ability to remove such trustee or director and replace them with someone else.

Two points I want to leave those of you who have questions about tax exempt orgs with. Number one this is an inherently fact circumstances based decision. Looking at all the facts involved, does one entity have the ability to control the other through directorship or through trusteeship. It's not always a bright-lined test. Whether that applies. But you have to look at all the facts and circumstances to see if one entity crosses that 80% threshold. The other point I want to leave you with is that this regulation section contains a little known, anti-abuse provision. That basically allows the IRS to reclassify the structure as a controlled group if it appears based on all the facts and circumstances, there are segregations in place that are designed specifically to avoid having retirement plan coverage. All that is in a series of 2007 regulations.

Let me go to slide 44. Foreign businesses can be part of a controlled group. Just because one entity isn't US based, doesn't mean that these general control group rules do not apply. The added wrinkle is if you have a foreign group member looking at the employees census, and who should be eligible and who gets allocations under this plan, might be a little more difficult. Now you have to start looking at, well do we have US source income? Do these individuals do US services performed? Are they classifiable as excludable non-resident aliens? That type of employee census information can become difficult, the only point I want to leave you with, just by virtue of the fact that the entity is not US based, does not mean that our discussion today is not applicable, it can be. We're running very low on time and I'm not even sure if I should start the next topic.

Slides 45 through 50 deal with attribution. Attribution is a set of rules where shares owned by one person are deemed as if they are owned by another. There are two types of attribution structures. One is what we would call family attribution, where stocks owned by members of a family is treated as if it's owned by other members of that family. The other is organizational attribution, where for example, stock owned by a partnership, might be attributed to its partners. I think I have about 5 or 6 slides on this, and I'm going to try to sum them up in about 5 or 6 sentences. This is probably not going to do a very good job. Let's start with the second one first. Organizational attribution. If we're looking at stock for example, owned by an entity, it is generally attributed as if it's owned by that entity's owners if that owner owns at least 5%. That's a very over-simplified, generalizing statement about the attribution rules for controlled groups. A 5% partner for example, is considered to own a proportionate share of whatever the partnership owns. A 5% shareholder is deemed to own whatever the corporation owns. A 5% beneficiary of a trust is deemed to own whatever the trust owns. So there's a general rule about 5%. This rule applies to LLC's as well, and Audrey mentioned this, this is the one thing you need to keep in mind, there elections for tax purposes generally controls how they are looked at for both attribution and for control group and also for affiliated service group purposes.

One quick note, as Audrey discussed in the attribution under affiliated service group. The section of law you're dealing with, section 318. Under control group rules, I won't even go into this in the interest of time, but you're under a different attribution scheme, you need to have at least a 5% threshold before anything is attributed under section 318. For affiliated service groups, you need their minimum threshold. That is where, for example, an LLC, that is elected to be taxed as partnership. If you're looking at that, for example, an affiliated service group context, it's very easy to wind up with unintended attribution.

On the family side, if we go to, for example, Slide 48. Generally that interest owned by parents, and children and spouses are cross-attributed. If we look at slide 49, we really only concerned about attribution between minor children and their parents. Adult children we'd have to rise to a 50% level, that same 50% level generally applies between grandparents and grandchildren. And I'm going to have to have skip the rest of my presentation. Let's go to slide 56, and then we're going to take some questions and answer.

As Audrey mentioned we do give determination letters on affiliated service groups. You come in with a set of facts, you can put forward a description of the basis upon which two entities may or may not be linked. Here is entity A and it's owned by people who also own entity B and here's the level of service that they do. Here's what they do. Here's the historical volume of work that's been done. The IRS will review that information and give you a ruling. There's actually a caveat on our favorable determination letter. Who you are. Or you are not an affiliated service group.

A little bit different, but similar for control group purposes. On a control group purpose, we generally don't review and issue a ruling. We don't say 'We don't agree that you are.' Or, "give us some more information." You would send us all the information that's available. In the past, what we would do is say specifically on this determination letter, "this letter applies to all the members of the group or all the member that you identified." We don't do any form of formal ruling like we do with a service group.

The one change I guess I want to leave you with, in the past we would put out an addendum to our letter. It would basically described all the members of a group. Or might even discuss some of the membership of the group, how it is, it's not under common control. Now we don't do that, basically under the interest of time. Whatever you represent to the service, whatever information you give to us in the determination submission, is the information we rule on. We don't come back with something that says for example, Yes, based on all this information you are a controlled group and this letter's expanded to the following members. Whatever you send in, is your representation. You will need to save that information and that is by implication what we've ruled on.

So with that, we're almost to the end of time. We got a little less than ten minutes to answer questions in advance. Looking at the questions in advance, it's clear to me that Audrey and I did set the world record for the most number of questions submitted in advance to an IRS phone forum. What's not clear if that also means we've set the record for the most confusing number of people in advance of an IRS phone forum. I'm going to hope it's that people are generally interested in the subject matter. Which is something I honestly, when we were approached to do this, I wasn't even sure how much interest there would be. Now I think maybe an hour wasn't a sufficient amount of time to cover it.

We're going to try to do our best to take on all these questions, as many as we can get through in the time allotted. For those of you who we don't answer your question live, we'll definitely get back to you next week, either individually or perhaps we'll look and see if we can put some type of published Q&A up on the website where you link in to join the program. We'll figure it out next week. For now, we'll try to knock out as many as we can quickly. I'll do all the easy ones,

Audrey you can take all the hard ones. Why don't you start, Audrey. Whatever two you want to do.

Audrey: Okay, thank you so much Don. The first question I have here is, someone wants to know "Is it reasonable under the A org affiliated service group rules, to consider an LLC that is taxed as either an S corporation or a C corporation as a corporation for purposes of the first service organization definition?" And the person says further, "This would mean, for example, that an LLC that is taxed as a corporation cannot be considered a first service organization unless it is a professional service organization, within the meaning of proposed Treasury Regulation 1.414(m)-1(c)." What I would say here, it's very important for you to actually just go look at the regulations and look at the rule, look at the definition. When we are looking at the definition for professional service organizations, please note that it does refer to state law. For your question, I think we need more context. We need more facts and circumstances. I would need to determine does state law allow for example for this type of organization. Don and I agreed in advance that we would try to do two questions, so if that's okay Don. I'm going to go on to the next question.

The other question that I have, that I'm going to address right now is, "Please elaborate on when a potential A organization is regularly associated with an FSO." I'm given the context of a surgical center where a surgeon is a 5% partner in a limited partnership. The question asks, "What is the threshold for the surgeon referring patients to the surgical center, and deriving profits from these referrals, but the surgeon is not actually performing surgeries there?" I'm given numbers of 10% of the surgeon's gross income is attributable to this partnership, 20%, 50%. This is a facts and circumstances determination. But as I noted earlier, if you refer to the slides and the Code and the regulations, the greater the amount of income that you're deriving from this relationship, the greater that it looks like you have a conjoined profitable business relationship, the more that we are going to tend to think that you are associated together. A second part of this question is, "What if this doctor, the surgeon's medical practice, not only refers patient to the surgical center but the doctor performs surgeries there?" And again, I'm given numbers such as 5% of the gross income for the doctor is attributable to billing patients, where the doctor is performing the surgery at the surgical center, 10%, 20%, 50%, for example, of the billing for this particular doctor. Again, this is a facts and circumstances determination. But in general, the greater your relationship with the business, the more receipts you are deriving from your relationship with the business, the more likely it looks that you are affiliated with that business.

Finally, another question that I'm going to conjoin with this question is: "Well what if bills are fluctuating? What if I'm a surgeon associated with a surgical center and in the first few years, though I have an ownership interest, I don't do any surgeries, but in year 3, 50% of my billings are from the surgical center?"

So there is a suggestion that from year to year the relationship would fluctuate. What I would say here, again we just we have a facts and circumstances determination. If it makes sense that you have a conjoined business relationship, then you're an affiliated service group. But at this point, I don't feel comfortable saying that for a specific circumstance, for one year, you have zero billings, and then the next year you have 50% of your billings, that I can necessarily on the

Phone Forum give you advice one way or another. I know that's not a satisfying answer, but I'll hand it off to Don Kieffer.

Don: Okay, Thanks Audrey. I'll try to knock 3 out real quick. Number one, does the control group analysis under sections 414 and 1563 of the code, also apply for purposes of determining whether the employer needs to comply with the Affordable Care Act based on the number of employees, the general answer to that question is yes. If you would like to see how it applies, there is actually an administrative guidance at IRS Notice 2011-36.

Question 15, again when determining brother sister control groups, assume 5 owners own a controlling interest of 80% of each corporation and the 50% of the ownership is identical. So we're saying, we've met the 80% and the 50% effective control test. What if there are more than 5 owners? Can we still have a brother sister group? Does it have to be 5 or fewer owners for each company for the group to exist? The examples in the applicable regs indicate or implied that more than 5 owners is okay. There can be as many owners as wanted, or as existed. But there has to be 5 or fewer in total, who have got common and effective control of the company. No matter how many owners there are, you have to have 5 individuals that own 80% and then their common ownership that is identical is 50%. As long as those two tests are satisfied, you can still have a brother sister group.

One can interpret the minor child attribution rules which I'm very sorry I didn't get to this afternoon. There is a lot in attribution that lends itself far beyond what I was able to give. One can determine these rules to interpret that if you have a husband or wife, and they get divorced, but they've got a minor child, that these two people, these two entities, the former husband and wife own are still linked together. That they wind up through attribution of the child. You have the child being 100% owner. Now is this a brother sister group? Is this the Service's understanding of the rules, would has the spousal exception rule apply? The answer is Yes, this is the Service's understanding of the rules. The spousal exception rule, is not an exception to child attribution.

One last one, Audrey we have a question. Can we send the power point slides, I'm taking this one hot. I was hoping it was an easy one. Could we send out the power point slides, they should be up on the link when you enrolled, but if you're not able to get it, I'll email them out after we finish.

Go ahead Audrey.

Audrey: Thank you Don. I'm not really aware of how much time we have left, but I have a question with regard to management organization tests and it specifically asks, "What is the test for a principal business?" This question gets into the withdrawn proposed regulations, the question makes the note that under the withdrawn proposed regulation there were ideas of a more than 50% test. In the interest of time, what I would say is your best answer here is if you have an organization that all that it does is provide management services. Outside of that, it's a subjective evaluation. But in addition to considering, well, "Is this an organization where all it is doing, principally what it's doing is providing management services?," there are a lot of questions out there about, "How do we define what is regular and continuing?" What I would say is you really

need to look at your industry, and for the services that you are providing, is the regular provision of management services every quarter? Is it every month? Is it every week? Unfortunately, we don't have clear guidance on what it means to regularly provide management services.

Don would you like to take another question?

Don: Sure. Let me rattle two off. I guess we're coming up to the end.

I'm sorry, go ahead.

Speaker 1: We are at the top of the hour, just letting you know.

Don: Okay. So I'll do real quick ones, and then we'll close up. First question, please address how IRS expects government entities to make a reasonable good faith determination regarding aggregation for employee benefit purposes. For example, should a fire district aggregate or not on the basis of its funding source and tax levying authority, similar to a public school district, as provided for an IRS guidance applicable to 403(b)? So if you go, as I said before, the rules for tax exempt and nonprofit organizations in that 2007 reg. package effective as of 2009 – the rule that generally sets up the written plan document requirement for 403(b) is in there as well – and if you look at that reg. package and read the preamble, it says in English terms, “These rules don't apply to governments. Keep doing whatever you were doing before.” Okay, that's an over simplified paraphrase. Well, what you were doing before was applying reasonable good faith standard of interpretation. If you look at IRS notice 89-23, which is tax levy authority, it says that this common tax levy might be an example, others include the degree of common management, if 80% of the funding is common to both employers or both entities from a common funding source. You would look at the overall facts and circumstances, tax levy could be one of them, to see if they've got some type of, one more time for the use of this word, some type of control, where the two of them are commonly controlled together.

And that last question, on tax exempt orgs, let's say we've got two tax exempt entities, and the regulation in question talks about representative status. Let's say one entity has the right to veto people on the board. Replace them with other entities that only that board can then approve, could this be sufficient to quote, unquote, be a representative? Again, when we're looking at the 2007 regulations, in this situation, one entity can control who is a composite of the other board. It has the right to decide who comes and who stays. Then the people that the board puts on, has to obviously meet with the approval of the fender of those directors. Otherwise they would be replaced. I think IRS would say, the ability to replace directors and then have those directors bring in other people is probably going to put the entity under common control with the source of the appointments.

Again this is a facts and circumstances decision and analysis when you look at tax exempt organizations. Look at all the relative circumstances and relevant circumstances and see whether one entity effectively controls the other by, among other things, putting in its director of expert.



I think that, with that we're about at the end of today's presentation. On behalf of Audrey, myself and Brenda and the rest of IRS's customer education and outreach efforts, I hope you found the information today helpful. Thank you for attending today. Have a nice holiday weekend.