



# **Controlled and Affiliated Service Groups**

**IRS Customer Education & Outreach  
Phone Forum – May 22, 2014**



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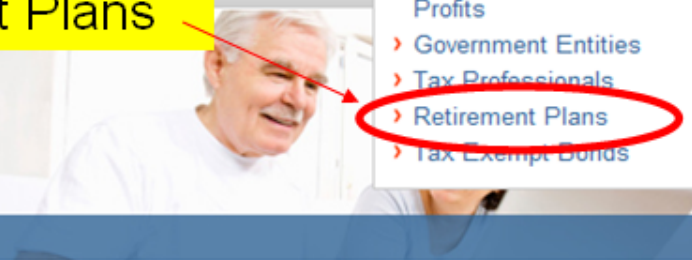
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## PRESENTERS

- Audrey Kucia, Tax Law Specialist  
IRS Employee Plans Technical  
Washington, DC
- Don Kieffer, Tax Law Specialist  
IRS Employee Plans Guidance  
Mountainside, NJ



## Agenda

- Introduction and Overview
- Affiliated Service Groups
- Controlled Groups
- Questions and Answers



# Introduction



## Introduction

- Controlled Group – A group of businesses that have common ownership attributes.
- Affiliated Service Group – A group of businesses that have some common ownership attributes
  - less than otherwise required to form a controlled group, and
  - perform services for each other.



## Introduction – Applicable Code and Reg. sections

- Controlled groups
  - Code Sections 414(b), 414(c), and 1563
  - Related Treas. Regs
- Affiliated service groups
  - Code Section 414(m)
  - Prop. Regs. Sect. 1.414(m)-1





## Introduction – Applicable Code and Reg. sections

- If a Controlled Group or Affiliated Service Group exists, employees of the businesses within those groups are considered as employed by 1 employer for Code sections for qualified plans including:
  - Nondiscrimination - 401(a)(4);
  - Compensation limitations - 401(a)(17)
  - Eligibility and Coverage - 410(a)&(b);
  - Top Heavy determinations - 416
  - Maximum benefits - 415
  - Elective deferral limits - 401(a)(30) & 414(v)



# Affiliated Service Groups



## Affiliated Service Groups

- An affiliated service group has 2 or more entities, one is a First Service Organization (FSO), which receives services from or shares them with:
  - A-Organization (A-Org) - IRC § 414(m)(2)(**A**)
  - B-Organization (B-Org) - IRC § 414(m)(2)(**B**) or
  - Management Group



## Objectives – Affiliated Service Groups

- A-Org and B-Org groups: Look at the degree to which one group performs services with/for another that has common ownership
- Management Group: Look at one group providing management services to another



## Affiliated Service Groups

- An FSO can be any form of business entity (corporation, partnership), but its principal business must be:
  - the performance of services, with
  - at least one licensed or legally authorized shareholder to perform those services (actuary, dentist)
- An FSO corporation must be a professional service corporation (PSC). Treas. Reg. § 1.414(m)-1(c).



## Affiliated Service Groups

- Does a relationship exist between an FSO and another entity? Consider:
  - Degree of common ownership (and who owns it)
  - Degree to which there is a conjoined business relationship



## Affiliated Service Groups – A-Orgs

- To be an A-Org, the org must satisfy 2 tests:
  - **Ownership test** - the org must own a direct interest in the FSO, by itself or through attribution.
  - **Relationship test** - the org must regularly perform services for the FSO, or with the FSO for third parties.
- Facts and circumstances evaluation. Treas. Reg. § 1.414(m)-2(b)



## Affiliated Service Groups – A-Orgs

- Both the FSO and the A-Org must be:
  - service organizations
  - “primarily engaged in the performance of services” (a subjective decision)
- But not if capital is a material income-producing factor for the organization (determined based on all relevant facts and circumstances).





## Affiliated Service Groups – B-Orgs

- To be a B-Org, you’ve met these 3 tests:
  1. Significant portion test – org’s significant business is performing services for the FSO (or satellite A-Orgs of the FSO)
  2. Historically performed test – org’s services would historically have been performed by the FSO itself (for example, not “outsourced”)
  3. Common ownership test – the FSO HCE’s hold 10% interest in the B-Org



## B-Org Affiliated Service Groups

### B-Org Test Summary

1. Does B-Org receive substantial income from servicing FSO ?
2. Does B-Org perform services for FSO that would have (prior to 1981) been performed by FSO's own employees ?
3. Do FSO HCEs own 10% of B-Org ?



## B-Org Affiliated Service Groups

- Significant Portion Test: facts and circumstances with 2 “significant” business activity safe harbors: service receipts and total receipts threshold
- Service Receipts Safe Harbor - B-Org provided services must be  $< 5\%$
- B-Org receipts from FSO services amount 5% of total service-based receipts?
- Current year and 3 year look-back



## B-Org Affiliated Service Groups

- Total Receipts Threshold Test -  
Concerned with whether 10% or more of the potential B-Orgs gross receipts are from services to FSO



## B-Org Affiliated Service Group

- Historically Performed Test –  
services historically performed by employees in a particular service field if it was not unusual for them to be performed by employees of organizations in that field (in the United States) on December 13, 1980



## B-Org Affiliated Service Group

- Common ownership test – is B-Org owned at least 10% by HCEs of FSO
- Contrast to A-Org test, where 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-Org



## Attribution Rules

- General rule for A-Orgs and B-Orgs: Code section 318
- For an A-Org: ownership satisfied by any ownership interest in the FSO.
- For Management: Code section 267(c)
- Difference between attribution schemes:
  - Rules for family membership
  - Minimum percents for businesses



## 318 Attribution - Family membership

<b>The ownership interests of a:</b>	<b>are attributed to a:</b>
<i>Spouse</i>	<i>Spouse</i>
<i>Parent</i>	<i>Child</i>
<i>Child</i>	<i>Parent</i>
<i>Grandchild</i>	<i>Grandparent</i>
<i>Sibling</i>	<i>None</i>





## 318 Attribution - Organizational members

<b>The ownership interests:</b>	<b>Are attributed to:</b>
<i>From a corporation to its shareholders</i>	Corp ownership interests attributed proportionately to shareholders owning at least <b>50%</b> of corporate stock
<i>From a partnership to its partners</i>	Partnership ownership interests attributed, proportionately to all partners
<i>From a trust to its beneficiaries</i>	Trust's ownership interests attributed, proportionately to all beneficiaries
<i>To a corporation</i>	Interest owned by individual owning at least <b>50%</b> of corporation is attributed to the corporation
<i>To a partnership</i>	Interest owned by partner is attributed to the partnership
<i>To a trust</i>	Interest owned by trust beneficiaries is attributed to trust



## 318 Attribution

- LLCs = form elected for taxation (usually partnership)
- No double attribution
  - (example: from partnership to Joe, not reattributed from Joe then on to another entity)



## Multiple Member Affiliated Service Groups

- Multiple member groups are not more technically complicated
  - Sometimes they are more factually complicated
- If an FSO with respect to two or more A-Orgs or two or more B-Orgs, or both, all are considered part of a single affiliated service group.
- Not clear: If an A-Org with respect to two unrelated FSOs, if are they all treated as one employer?



## Management Groups

- Management groups are concerned with common management
  - No FSO concept
  - No common ownership requirement
- (distinguishable from A-Org and B-Org common services and common ownership)



## Management Groups

- In order to have a management group affiliated service group:
  1. One organization performs management functions for another, and
  2. The performing organization's principal business is the performance of these functions on a regular and continuing basis for the recipient.



## Management Groups

- Management Activities and Services:
  - Only those historically performed by employees. Include determining, implementing, or supervising, etc.
  - If it was not unusual for such services to be performed by employees of organizations in that particular business field on September 3, 1982.
  - Use 267 attribution: Minimum 50% ownership rule for most purposes and include siblings in family attribution scheme (differs from 318 attribution)



## Management Group attribution

- The law does not include organizations related to the management organization in the affiliated service group.



## Determination Letters

- Must use Form 5300 Line 6a for special ruling request
- Rev. Proc. 2014-6 Section 14 describes procedure for request.
- See Rev. Proc. 85-43 and instructions to Form 5300.
- Provision of information enables analysis.





# Controlled Groups



## Controlled Group Definition

- Code section 414(b) relates to controlled groups that consist of corporations and ties to Code section 1563(a).
- Code section 414(c) relates to all other controlled groups and refers to the applicable regulations
  - Treas. Regs. section 1.414(c)-1 - 1.414(c)-5.
  - Based on principles similar to those that apply to Code Section 1563.



## Controlled Group Definition

- Three different types of controlled groups:
  - Parent-subsidiary = One entity owns the other
  - Brother-sister = Entities have common ownership owning each
  - Combined groups = mix of the two, at least 1 parent; some “siblings”



## Non-corporate members of controlled groups

- Treas. Reg. Section 1.414(c)-2(a) provides that an “organization” for purposes of Treas. Reg. section 1.414(c)-2 - 1.414(c)-4 means –
  - a sole proprietorship,
  - a partnership,
  - a trust,
  - an estate,
  - or corporation.

Treas. Reg. Section 1.414(c)-5 also shows how the controlled group rules apply to certain tax-exempt organizations.



## Determining Ownership

- Ownership is based on the type of business.
  - For a **corporation** → based on the % of company's stock owned. The ownership percentage is based on voting power or value of the stock.
    - When calculating the percentage for voting power, consider only classes of stock entitled to vote
    - When calculating the percentage related to the value of stock, consider all classes of stock



## Determining Ownership - Continued

- For a **partnership**, ownership is based on the capital interest or profits interest in the partnership.
- For a **sole proprietorship**, the sole proprietor is treated as the 100% owner.
- For a **trust or estate**, ownership is based on the actuarial interest in the trust or estate.



## Parent-Subsidiary Group

- A parent-subsubsidiary group exists when a “parent” business owns at least 80% of one or more other businesses (the subsidiaries). There could be one subsidiary, multiple subsidiaries, or multiple tiers of subsidiaries
- For purposes of applying § 415 limits, the “at least 80%” ownership requirement becomes “more than 50%”



## Brother-Sister Group

- A brother-sister relationship exists if, the same 5 or fewer common owners (individuals, trusts, or estates) own (directly or by attribution) a controlling interest of 80% in each business and 50% of the ownership is identical.





## Brother-sister Groups and Corporations

A brother-sister group requires the same 5 or fewer persons to have a controlling interest in each organization.

The term “persons” includes individuals, estates, or trusts. It does not include corporations.



## Combined Groups

If a business is the parent organization in a parent-subsidary group and is also part of a brother-sister group, then all members of the two groups are part of one controlled group.



## Tax Exempt Organizations

Common control exists between an exempt organization if at least 80% of the directors or trustees of one organization are either representative of, or directly or indirectly controlled by the other organization. A trustee or director is treated as a representative of another exempt organization if he or she is a trustee, director, director, agent, or employee of the other organization. A trustee or director is controlled by another organization if the other organization has the general power to remove such trustee or director and designate a new trustee or director. Whether a person has the power to remove or designate a trustee or director is based on facts and circumstances.



## Foreign Businesses

A foreign company can be part of a controlled group. Generally foreign corporations are excluded from the controlled group rules (IRC section 1563(b)(2)(C)).

However, the component member rules of IRC section 1563(b) are disregarded for the controlled group rules as related to qualified plans (Treas. Reg. section 1.414(b)-1(a)). Even though nonresident aliens are generally excluded from coverage rules, all eligible employees still need to be considered as part of one employer.



## Attribution

- When determining ownership, interests directly owned are considered along with amounts “indirectly owned” or “attributed” from another party or other parties.



## Attribution: Non-corporate entities

- Although the attribution rules are written in terms of stock ownership, the same rules are applied to organizations that are not incorporated.
- Determine interests in non-stock entities:
  - Trust or estates – based on an actuarial interest
  - Partnership – based on capital or profits interest
  - Sole proprietorship - sole proprietorship



## Attribution

- Parent-subsidiary controlled group → attribution is limited to attribution for options and attribution from organizations.
- To determine whether or not a brother-sister controlled group exists → family attribution is also considered since all of the attribution rules apply (Code Section 1563(e))



## Family Attribution

Interests owned by parents and their children, between spouses, and between grandparents and their grandchildren can be subject to attribution.





## Family Attribution Rules

- The ownership interests of:
  - Minor Children (under age 21) are attributed to a Parent.
  - Parent are attributed to a Minor Child (under age 21)
  - Parent are attributed to an Adult Child only if the Adult Child owns more than 50% of the business.
  - Adult Child are attributed to a Parent only if the Parent owns more than 50% of that business.



## Family Attribution Rules (continued)

- The ownership interests of:
  - a grandparent are attributed to a minor or adult child only if the minor or adult child owns more than 50% of that business.
  - a minor or adult child are attributed to a grandparent if the grandparent owns more than 50% of that business.
  - a sibling are not attributed to other siblings.



## Attribution - Spouses

The ownership interests of a spouse are generally attributed to the other spouse, except for persons legally separated under a:

- divorce decree or
- decree of separate maintenance.



## Spousal Attribution - Exception

There is no attribution between spouses, if:

- The spouse doesn't directly own or participate in the management of such corporation at any time during the taxable year,
- No more than 50% of the gross income of the business is from passive income, and
- Stock is not subject to conditions that restrict a spouse's right to dispose of the stock and that run in favor of the individual or his or her children under age 21.



## Attribution - Organizations

Ownership interests are attributed proportionately in—

- **Corporations** – to shareholders owning at least 5% of corporate stock (applies to brother-sister controlled groups only)
- **Partnerships** – to partners having a 5% or more capital or profits interest, whichever is greater. (applies to brother-sister and parent-subsidiary controlled groups)
- **Trusts** – to beneficiaries having a 5% or more actuarial interest. (applies to brother-sister and parent-subsidiary controlled groups)



## Other Attribution Rules

- After an individual is attributed the ownership interest from a family member, that interest does not get attributed from the individual to another family member
- However, the ownership interest of an individual may be attributed to more than one family member
- After an individual is attributed the ownership interest in a corporation, partnership, or trust, the interest may be taken into account other attribution rules



## Excluded interests

- Certain types of stock are not taken into account when determining ownership for controlled group purposes:
  - non-voting stock which is limited and preferred as to dividends
  - Treasury stock
  - stock treated as “excluded stock” (Code Section 1563(c)(2))



## Determination Letter submissions

- Must use Form 5300 Lines 3e(3) & 6a to indicate controlled group status
- Submission of information enables analysis and ruling
- Previously, the letter named all CG members but have since discontinued this practice





QUESTIONS ??????