

Analyzing Controlled and Affiliated Service Groups



ASPPA

Making Retirement Plans Work

Part of the American Retirement Association

Kelsey Mayo, J.D.
Partner
Poyner Spruill LLP

WHY CONTROLLED GROUPS AND AFFILIATED-SERVICE GROUPS MATTER

Why Does It Matter?

- Compliance begins with knowing the CG-ASG
- Places it might matter include:
 - Nondiscrimination testing
 - Counting service
 - Distribution timing
 - Loans



Nondiscrimination Testing

- All employees in CG-ASG count in determining compliance with certain requirements, including:
 - Minimum coverage
 - Benefits rights and features

Nondiscrimination Testing

- If two or more plans within CG-ASG, must coordinate compliance, including:
 - 402(g) contribution limits
 - Top-heavy testing
 - 415 contribution limits
 - Safe-harbor compliance

Counting Service

- All service in the controlled group must be counted for certain purposes:
 - Eligibility service
 - Vesting service
- Plan might credit service for other purposes as well

Eligibility Service

- If an employee transfers from another employer in the controlled group, must give them credit for that service for eligibility
- Example
 - Corp A and Corp B are in a controlled group, and each maintain a different plan
 - Dennis works for Corp A for five years and then transfers to Corp B

Audience Poll 1: Vesting Service

Facts

- Corp A and Corp B are in a controlled group, and each maintain a different plan
- Corp B's plan has a three-year cliff vesting schedule
- Dennis works for Corp A for five years and then transfers to Corp B

Poll Question

Can Corp B require Dennis to work for an additional three years before he is vested?

- Yes
- No

Distributions

- Employee is not eligible for distribution if he or she is employed anywhere within CG-ASG
- Must terminate from all entities before distribution



Plan Loans

- Limits on loans are aggregated among all plans in the CG-ASG
- If CG-ASG has two 401(k) plans, employee cannot have a \$50,000 loan in each plan



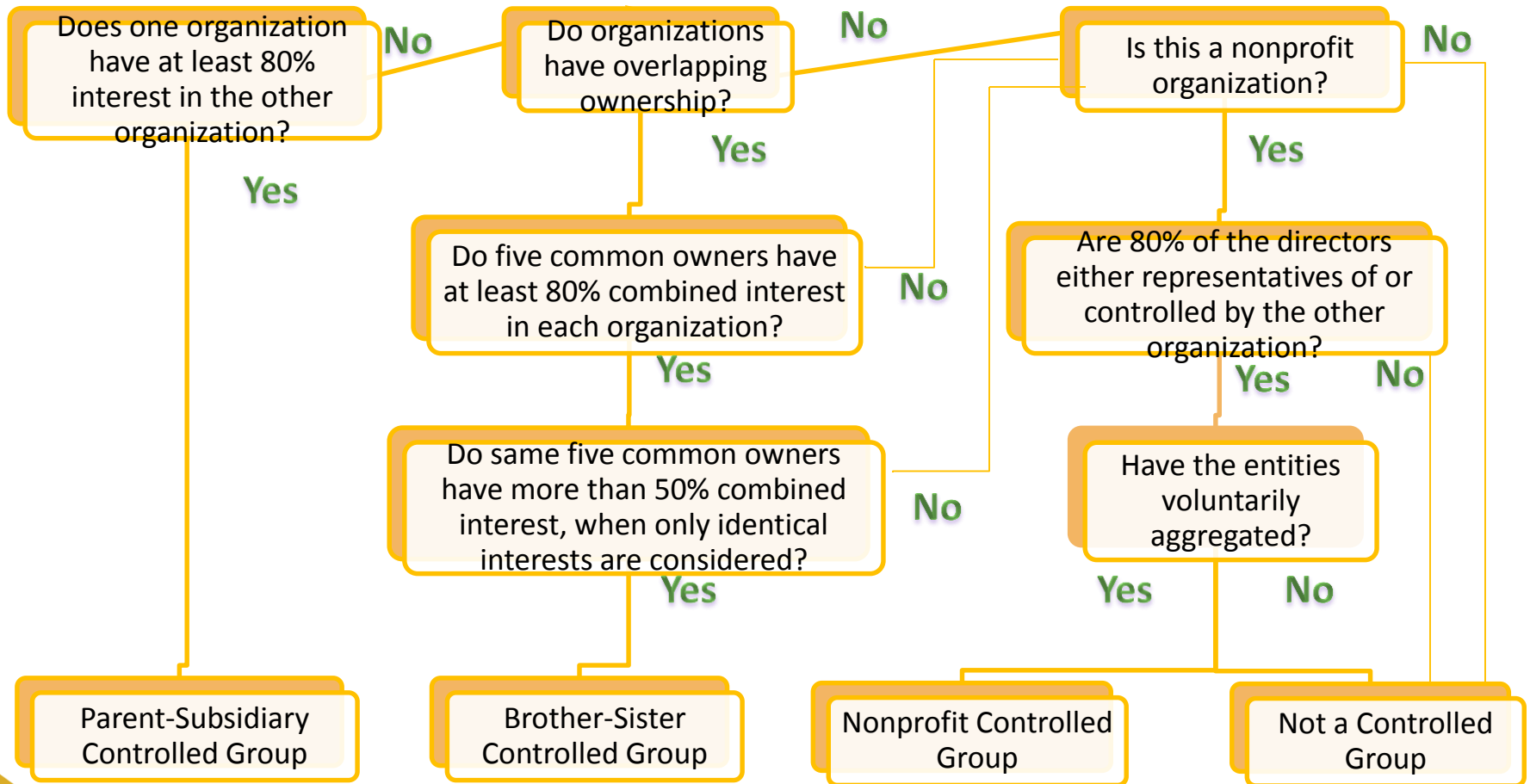
DETERMINING CONTROLLED GROUPS

Types of Controlled Groups

- Parent-subsidiary
- Brother-sister
- Nonprofit
- Combinations



Control Group Overview

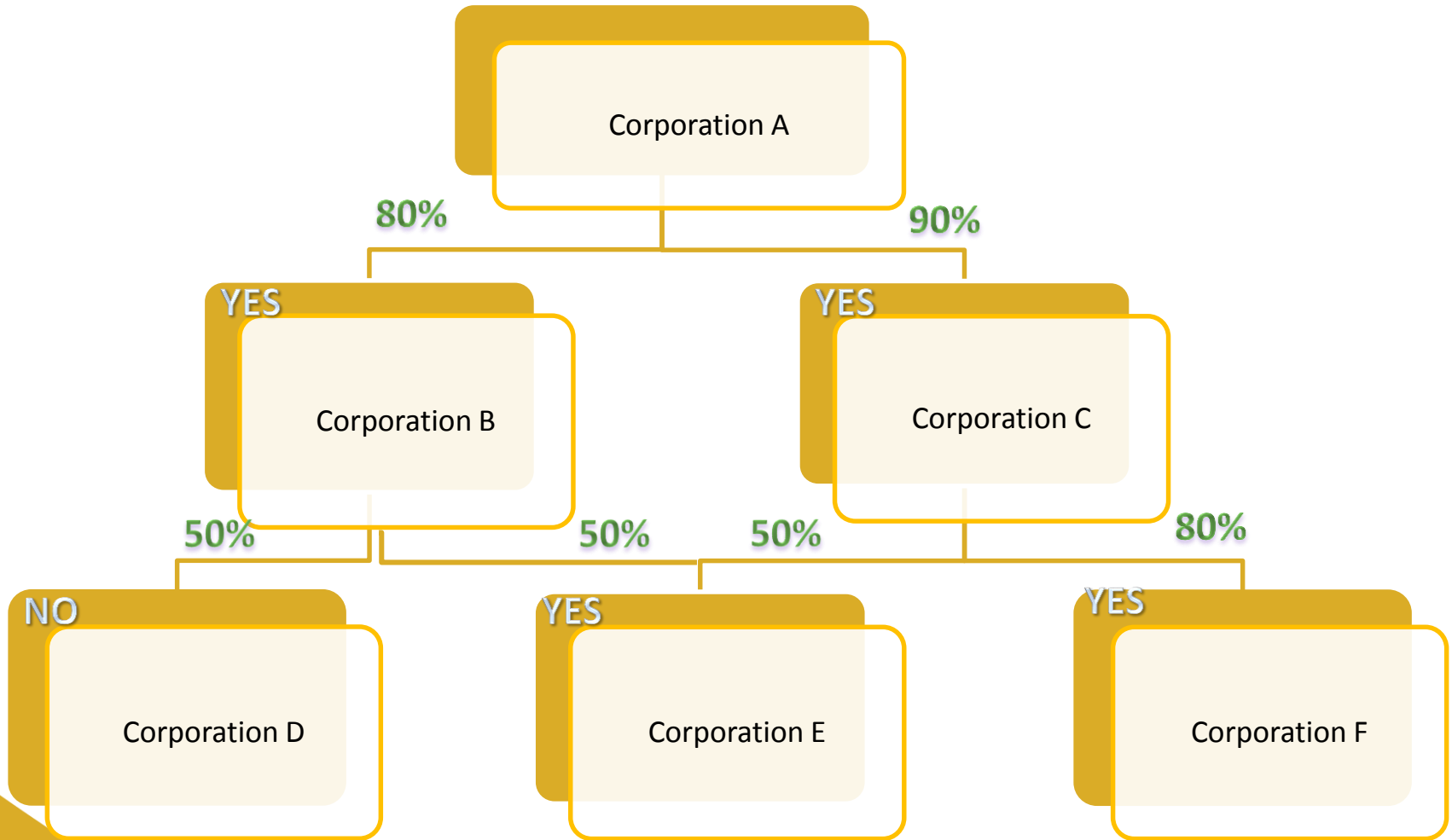


Parent-Subsidiary

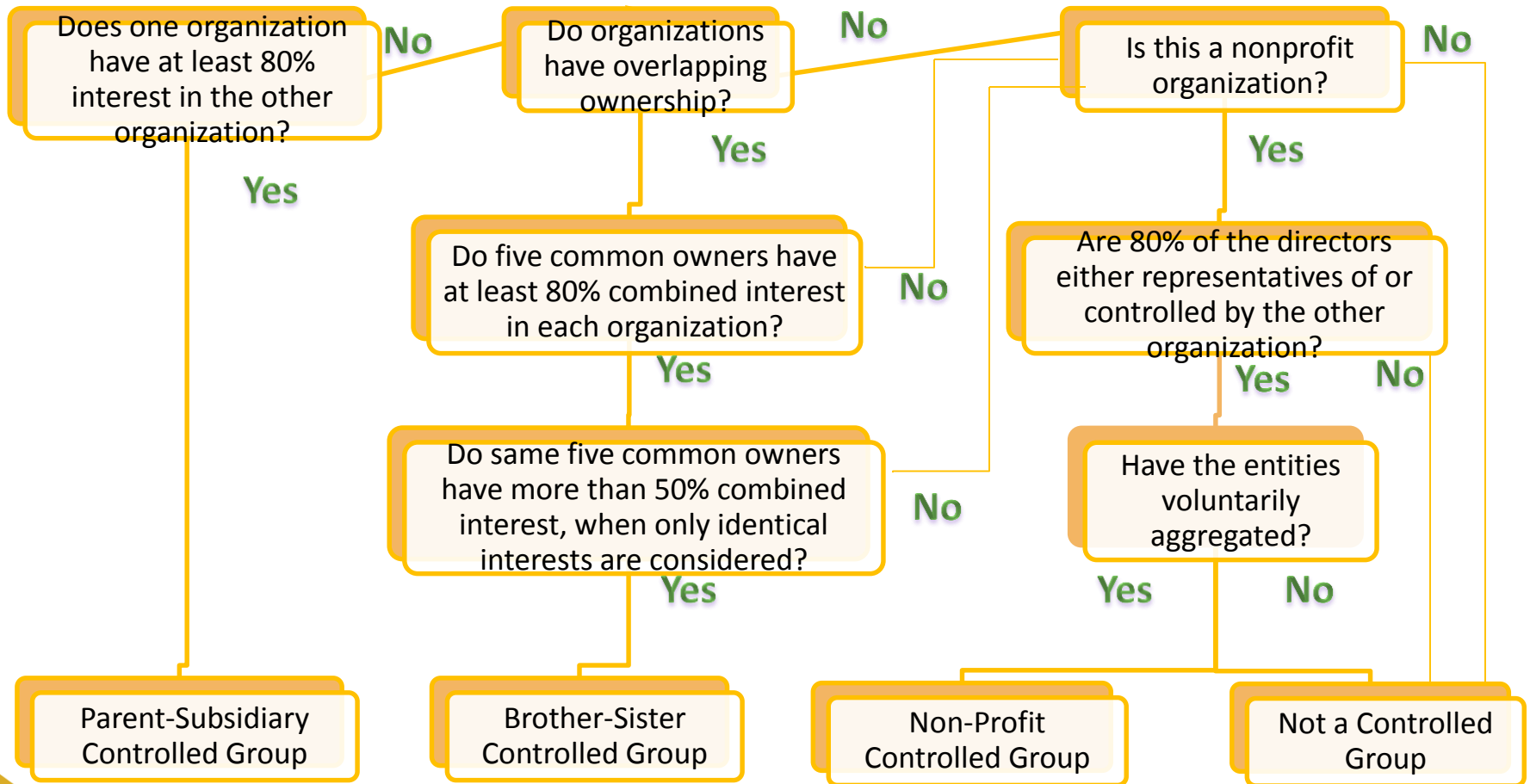
- One or more entities connected through ownership with a common parent
 - Parent entity owns 80 percent of at least one other entity
 - PLUS each other entity that is owned at least 80 percent by other entities in the group



Parent-Subsidiary Example



Control Group Overview



Brother-Sister Group

- Group of two or more organizations with common ownership
- Five or fewer common owners have
 - Controlling interest
 - Effective control

Brother-Sister Group

- Controlling interest
 - Five or fewer owners have at least 80 percent ownership in each entity
 - Considering entire interest in each entity
- Effective control
 - Five or fewer owners have more than 50 percent ownership in each entity
 - Considering only identical interest in each entity

Brother-Sister Example

Owner	Corp A	Corp B	Corp C	Corp D
Craig	100%	20%	40%	51%
Judy	0%	20%	20%	0%
Brian	0%	20%	10%	9%
Elizabeth	0%	20%	10%	20%
Ray	0%	20%	20%	20%

Brother-Sister Example

Owner	Corp A		Corp C	
	Total	Identical	Total	Identical
Craig	100%	40%	40%	40%
Judy	0%	0%	20%	0%
Brian	0%	0%	10%	0%
Elizabeth	0%	0%	10%	0%
Ray	0%	0%	20%	0%
Total	100%	40%	100%	40%

NOT a Brother-Sister Group – No Effective Control

Brother-Sister Example

Owner	Corp B		Corp C	
	Total	Identical	Total	Identical
Craig	20%	20%	40%	20%
Judy	20%	20%	20%	20%
Brian	20%	10%	10%	10%
Elizabeth	20%	10%	10%	10%
Ray	20%	20%	20%	20%
Total	100%	80%	100%	80%

**Brother-Sister Group
Controlling Interest and Effective Control**

Audience Poll 2: Brother-Sister Controlled Group

Owner	Corp A		Corp D	
	Total	Identical	Total	Identical
Craig	100%		51%	
Judy	0%		0%	
Brian	0%		9%	
Elizabeth	0%		20%	
Ray	0%		20%	
Total	100%		100%	

Is this a Brother-Sister Controlled Group?

- Yes
- No

Brother-Sister Controlled Group

Owner	Corp A		Corp D	
	Total	Identical	Total	Identical
Craig	100%	51%	51%	51%
Judy	0%	0%	0%	0%
Brian	0%	0%	9%	0%
Elizabeth	0%	0%	20%	0%
Ray	0%	0%	20%	0%
Total	100%	51%	100%	51%

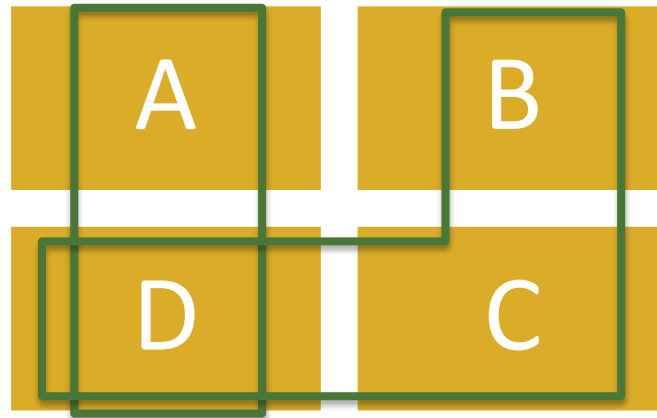
No - This is not a Brother-Sister Controlled Group
Although there is effective control, there is not a controlling interest because you count only Craig's interest (and that is less than 80%)

Brother-Sister Controlled Group

Owner	Corp B		Corp C		Corp D	
	Total	Identical	Total	Identical	Total	Identical
Craig	20%	20%	40%	20%	51%	20%
Judy	20%	0%	20%	0%	0%	0%
Brian	20%	9%	10%	9%	9%	9%
Elizabeth	20%	10%	10%	10%	20%	10%
Ray	20%	20%	20%	20%	20%	20%
Total	100%	59%	100%	59%	100%	59%

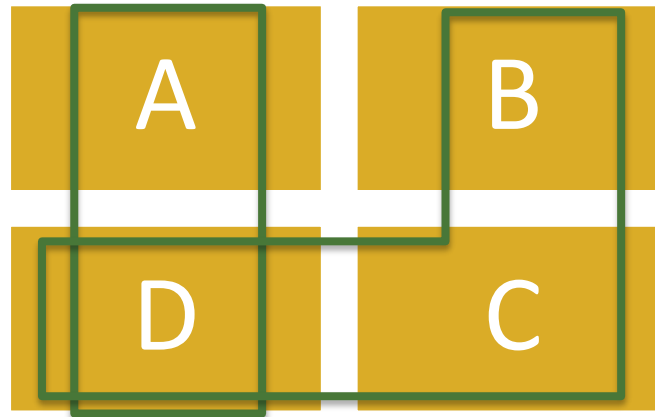
YES - This a Brother-Sister Controlled Group
Even excluding Judy's interest, the total is at least 80%
and identical interest is more than 50%

Brother-Sister Controlled Group



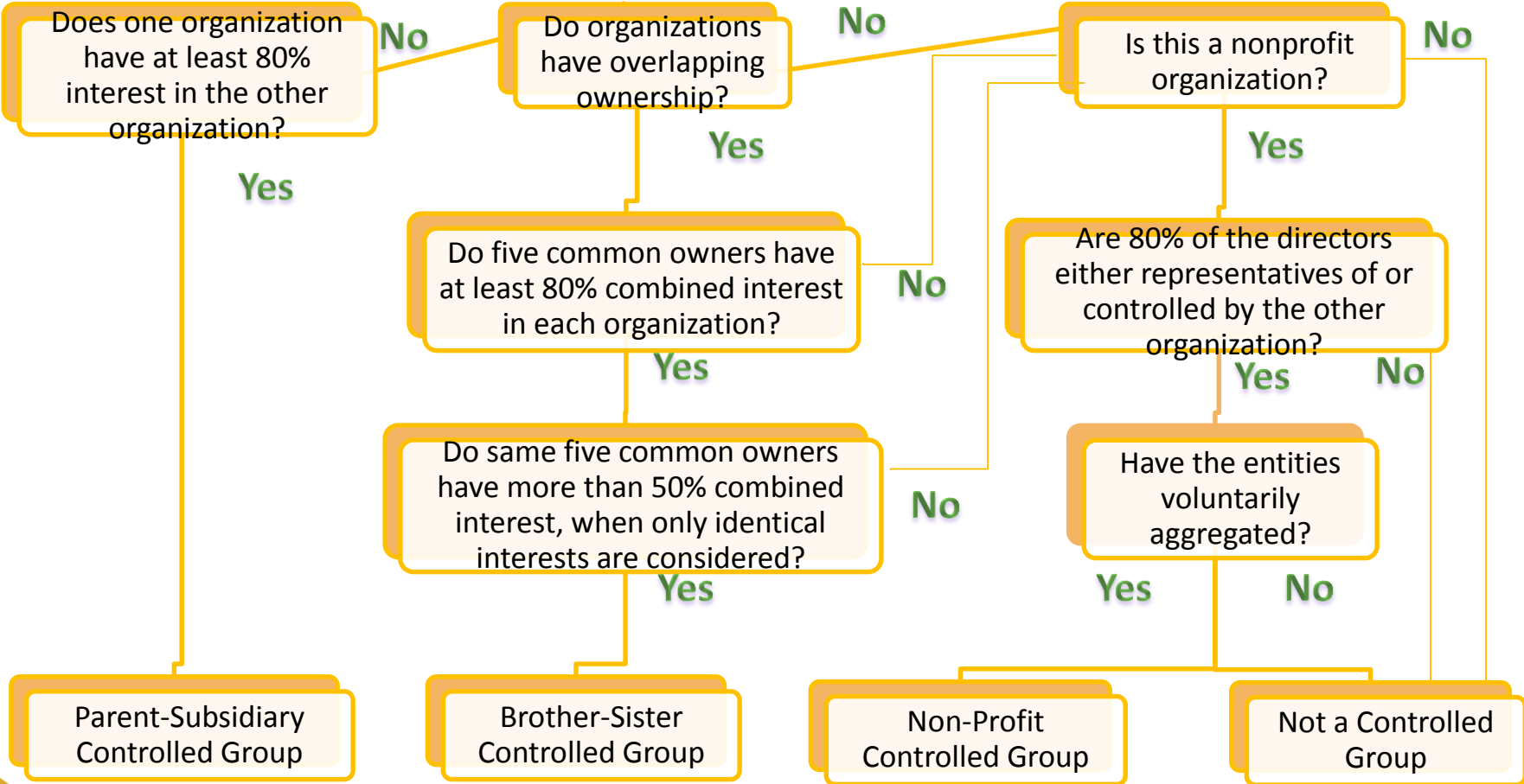
- Assume:
 - A and D are in controlled group
 - D is in a controlled group with B and C
 - BUT A is not in a controlled group with B and C
- What to do?

Brother-Sister Controlled Group



- What to do?
 - Test the two groups separately
 - Corp D gets tested twice
 - Once with A
 - Once with B and C

Control Group Overview



Nonprofit-Controlled Groups

- Nonprofits may not have stock or ownership interests
 - So, above tests may not be applicable
- Treasury issued special regulations (at the same time as the 403(b) regulations)
 - Does not apply to certain church (or church-controlled) organizations

Nonprofit-Controlled Groups

- Nonprofit is in controlled group if:
 - Meets parent-subsidiary or brother-sister test
 - Eighty percent of the nonprofit directors are
 - Representatives of other entity
 - Or are controlled by other entity
 - Or entities have voluntarily aggregated
 - Permitted in limited circumstances

Nonprofit-Controlled Groups

- Representative of other entity
 - Trustee or director
 - Employee or other agent
- Controlled by other entity
 - Power to remove trustee and designate new trustee
 - Facts and circumstances

Nonprofit-Controlled Groups

- Voluntary aggregation
 - Two nonprofit organizations
 - “Regularly coordinate their day-to-day activities”
- Nonprofits may treat themselves as under common control
 - Single-employer retirement plan
 - Health plan may be actual driving factor

Audience Poll 3

- Facts
 - Nonprofit hospital and nonprofit medical clinic in Charlotte, NC are not related entities
 - They coordinate staffing and training
 - They coordinate budgeting and goals
- May the hospital and medical clinic treat themselves as part of a controlled group?
 - Yes
 - No

Combined Groups

- One entity is in both a parent-subsubsidiary (or nonprofit) group and a brother-sister group
- Treated as a single controlled group

Controlled-Group Attribution

- For controlled groups – use Code §1563(a) attribution rules
 - Written in terms of stock
 - Apply similar rules to other entities
 - If a trust or estate rules, look at interest in the trust or estate
 - If a partnership, look at the capital or profits interest
 - If an LLC, apply rules based on how the LLC is taxed (either as a corporation or partnership)

Family Attribution

- Spouse:
 - Interest is generally attributed to other spouse
 - Unless
 - Spouses are legally separated
 - Or all the following requirements are met



Family Attribution

- Spouse:
 - Attributable UNLESS
 - The other spouse has no direct ownership in the entity
 - The other spouse has no participation in the entity
 - Not an employee
 - Not involved in management
 - No more than 50 percent of gross income is passive (rents, royalties, dividends, interest, etc.)
 - Interest is not subject to restrictions in favor of spouse or minor (under 21) children

Family Attribution

- Spouse:
 - Note, these requirements generally cannot be met in a community-property state
 - Spouse is deemed to own 50 percent of stock owned by spouse (assuming the stock is community property)

Family Attribution: Brother-Sister Example

Owner	Corp A	Corp B	Corp C	Corp D
Kelsey	100%	20%	40%	50%
Dennis	0%	20%	20%	0%
Brian	0%	20%	10%	10%
Elizabeth	0%	20%	10%	20%
Ray	0%	20%	20%	20%

Kelsey and Dennis are married

Audience Poll 4: Family Attribution

Owner	Corp A		Corp C	
	Total	Identical	Total	Identical
Kelsey	100%		40%	
Dennis	0%		20%	
Brian	0%		10%	
Elizabeth	0%		10%	
Ray	0%		20%	
Total	100%		100%	

Are Corp A and Corp C in a controlled group?

*Yes

*No

Family Attribution: Brother-Sister Example

Owner	Corp A		Corp C	
	Total	Identical	Total	Identical
Kelsey	100%	60%	60%	60%
Dennis	0%	0%	Attributed	Attributed
Brian	0%	0%	10%	0%
Elizabeth	0%	0%	10%	0%
Ray	0%	0%	20%	0%
Total	100%	60%	100%	60%

NOT a Brother-Sister Group before attribution

- No effective control and no controlling interest

Still not a Brother-Sister Group after attribution to spouse

- Although there is now effective control, Kelsey still doesn't have at least an 80% controlling interest

Family Attribution

- Children to parents
 - Parent deemed to own child's interest
 - BUT ONLY IF
 - Child is under age 21
 - Or parent controls more than 50 percent of entity

Family Attribution

- Parents to children
 - Child deemed to own parent's interest
 - BUT ONLY IF
 - Child is under age 21
 - OR child controls more than 50 percent of interests

Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third of Corp A
 - Nicole, Kelsey's 19 year-old child, owns one-third
 - Will, Kelsey's 25 year-old child, owns one-third

How much of Corp A is Kelsey deemed to own?

Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third directly
 - Nicole, Kelsey's 19 year-old child, owns one-third
 - Will, Kelsey's 25 year-old child, owns one-third
- Kelsey is deemed to own 100 percent
 - Kelsey is automatically attributed Nicole's one-third interest because she is under 21—giving Kelsey effective control of two-thirds
 - Because Kelsey has effective control of two-thirds, Will's one-third interest is attributed to Kelsey

Audience Poll 5: Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third of Corp A
 - Nicole, Kelsey's 19 year-old child, owns one-third
 - Will, Kelsey's 25 year-old child, owns one-third

How much of Corp A is Nicole deemed to own?

- A. One-third
- B. Two-thirds
- C. Three-thirds

Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third directly
 - Nicole, Kelsey’s 19 year-old child, owns one-third
 - Will, Kelsey’s 25 year-old child, owns one-third
- Nicole is deemed to own two-thirds
 - Nicole is automatically attributed Kelsey’s one-third interest because she is under 21—giving her two-thirds
 - Although Will’s interest is attributed to Kelsey, it is not “attributed again” to Nicole (no double attribution)

Family Attribution

- Grandparents to grandchildren
 - Only if grandchild owns more than 50 percent of the business
- Grandchildren to grandparents
 - Only if grandparent owns more than 50 percent of the business
- Siblings
 - No attribution

Organizational Attribution

- Corporation to shareholder
 - Shareholder owns at least five percent of corporation
 - Attributed proportionate share
- Partnership to partners
 - Same rule
- Trust to beneficiaries
 - Same rule (but applies more broadly)

DETERMINING AFFILIATED-SERVICE GROUPS

Types of Controlled Groups

- A-Org Group
- B-Org Group
- Management Service Group
- Combinations

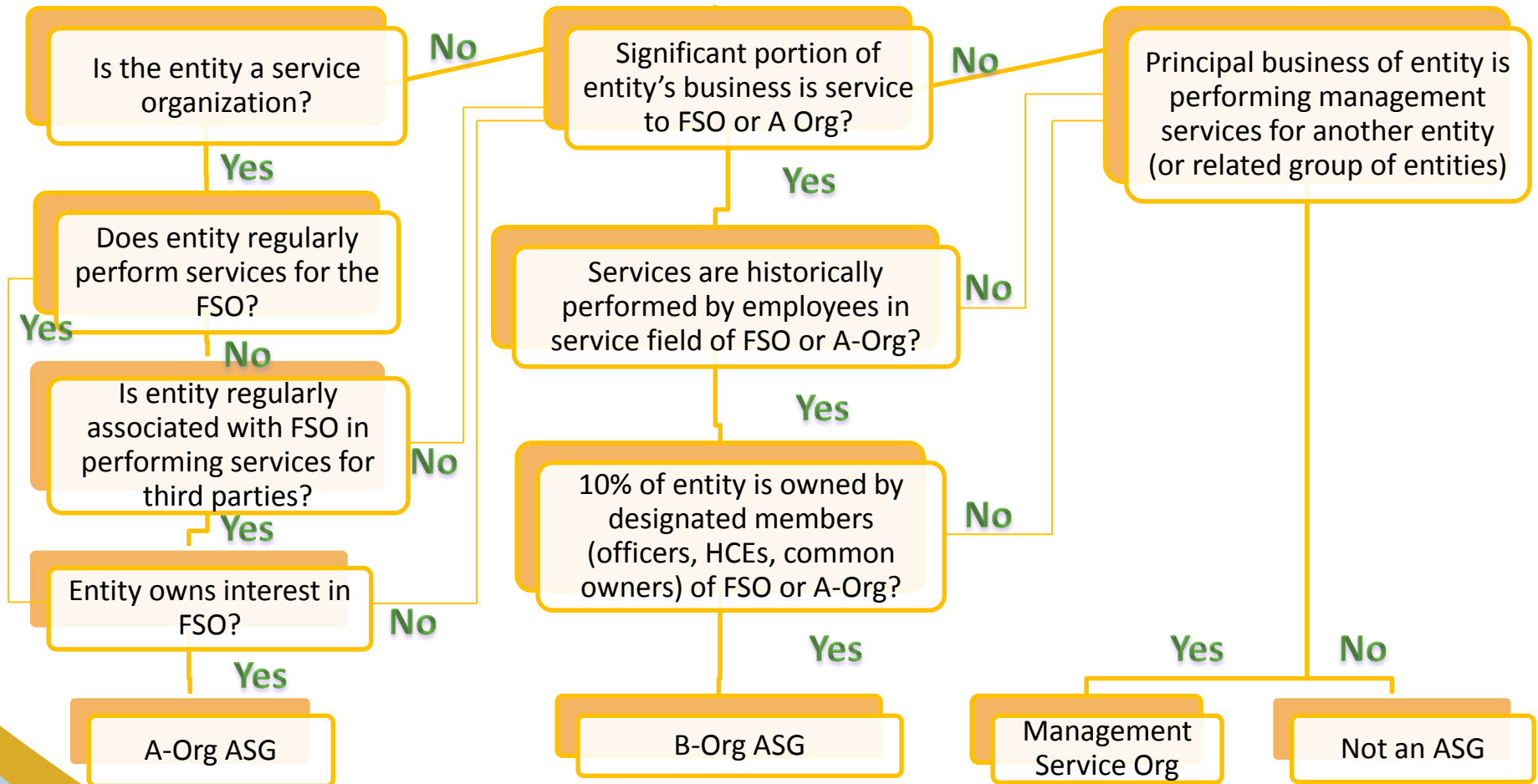
ASG Basics

- A-Organization Group
 - First Service Organization (FSO) and at least one “A Organization”
- B-Organization Group
 - First Service Organization (FSO) and at least one “B Organization”
- Management Group
 - Management organization and one other entity

ASG Basics

- First Service Organization
 - Must be a service organization
 - Capital is not a material income-producing factor
 - Facts and circumstances
 - Organizations in following fields are deemed to be service organizations:
 - Accounting
 - Actuarial science
 - Architecture
 - Consulting
 - Engineering
 - Health
 - Insurance
 - Law
 - Performing arts

Affiliated-Service Group Overview



A-Organization Group

- Requires FSO and A-Org
- A-Org
 - Is a service organization
 - Has ownership interest in FSO
 - Regularly performs services for the FSO or is regularly associated with the FSO in performing services for third parties



A-Organization Group

- “Regularly”
 - Facts and circumstances
 - Factor: amount of income derived from services performed for FSO or from services associated with FSO

Audience Poll 6: A-Organization

- Facts:
 - Kelsey owns 100% of Corporation A
 - Corporation A owns one percent of Poyner Spruill
 - Kelsey provides services to Poyner Spruill clients through Corporation A, Kelsey has Poyner Spruill business cards, etc.
- Are Corporation A and Poyner Spruill an A-Org ASG?
 - Yes
 - No

B-Organization Group



- Requires FSO and B-Organization
- B-Organization
 - Significant portion of business is performance of services for an FSO or for A-Orgs associated with FSO (or both)
 - Services are type historically performed by employees
 - Ten-percent ownership requirement met

B-Organization Group

- Significant portion of business
 - Facts and circumstances
 - BUT “safe harbors”
 - Less than five percent of service receipts = not significant
 - At least ten percent of total receipts = significant
 - Look at greater of percent for year of determination or three-year period ending in year of determination

Significant Portion

- Corp A has the following receipts for the last three years:

		All Clients	Law Firm
2014	Service Receipts	\$100,000	\$5,000
	Total Receipts	\$200,000	
2015	Service Receipts	\$300,000	\$6,000
	Total Receipts	\$600,000	
2016	Service Receipts	\$400,000	\$8,000
	Total Receipts	\$600,000	

- Is a significant portion of Corp A's business providing services to the law firm?

Significant Portion

- Corp A has the following receipts for the last three years:

		All Clients	Law Firm
2014	Service Receipts	\$100,000	\$5,000
	Total Receipts	\$200,000	
2015	Service Receipts	\$300,000	\$6,000
	Total Receipts	\$600,000	
2016	Service Receipts	\$400,000	\$8,000
	Total Receipts	\$600,000	

Ratio	One-year	Three-year
Service Receipts	\$8k/\$400k = 2%	\$19k/\$800k = 2.375%
Total Receipts	\$8k/\$600k = 1.5%	\$19k/\$1400k = 1.36%

B-Organization Group

- Historically performed by employees
 - For a particular service field, if it were not unusual for the services to be performed by employees of organizations in that service field
 - In the U.S. on December 13, 1980



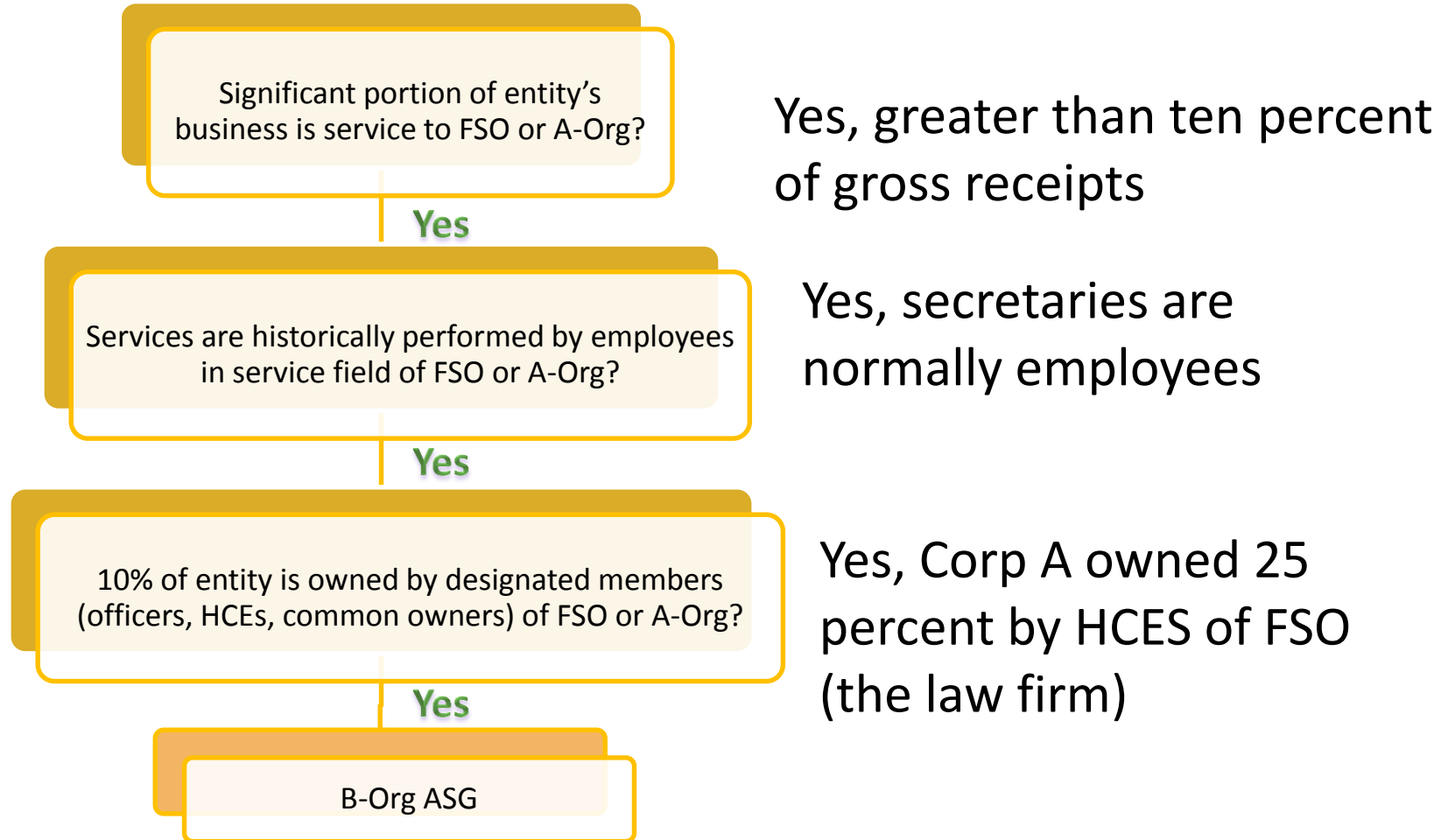
B-Organization Group

- Ten percent ownership test
 - At least ten percent of B-Org is owned by
 - Officers, HCEs, or common owners of FSO or A-Orgs
 - Common owner = someone who owns at least three percent of FSO or A-org

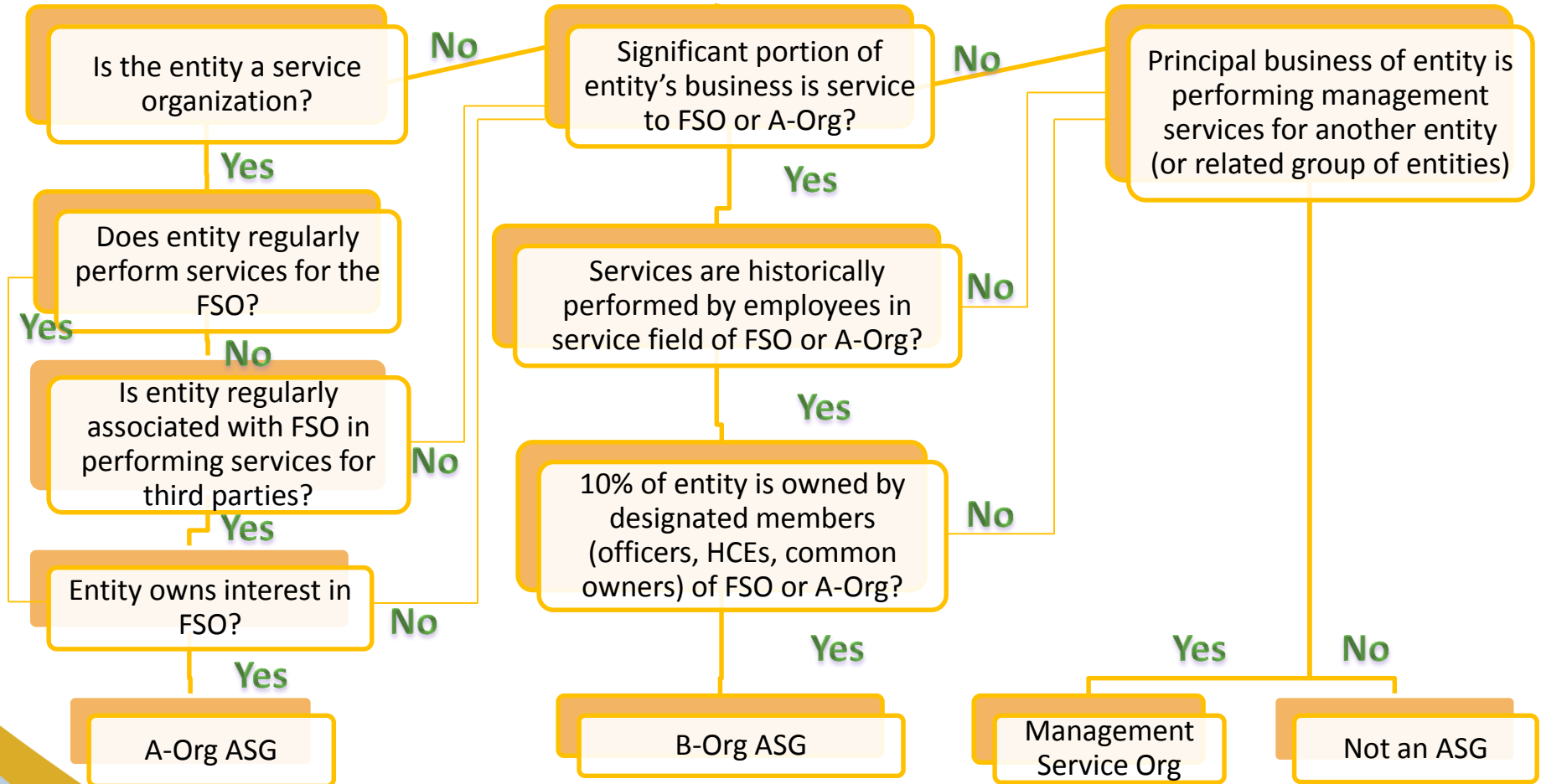
Audience Poll 7: B-Organization

- Facts:
 - Four law firms decide to create Corporation A to provide legal assistant support
 - HCEs of each firm owns 25 percent of Corporation A
 - Each firm accounts for 25 percent of Corporation A's gross receipts
- Is there a B-Org ASG here?
 - Yes
 - No

B-Organization Example



Affiliated-Service Group Overview



Management Organization

- Two organizations
 - One performs management functions
 - Principal business of management organization is
 - Performing management function
 - On a regular and continuing basis
 - To a recipient organization
 - No need for overlapping ownership

Management Organizations

- Management functions, examples
 - Running daily business operations
 - Personnel decisions
 - Setting compensation and benefits
 - Goal setting and planning

Management Organization

- Principal business
 - Facts and circumstances test
 - Tests in withdrawn regulations
 - Two-year rolling percentage
 - Gross receipts

Management Organization

- Two-year rolling percentage
- Performance of management functions for recipient organization is 50 percent of activities during two-year period
 - Current tax year
 - And preceding tax year

Management Organization

- Once 50-percent test met, continued management group until:
 - Management functions for recipient organization is less than 40 percent of activities during two-year period
 - Management organization meets 50-percent test for a different recipient organization
 - Services for recipient organization are less than five percent of management organization's receipts

Gross Receipts

- Determination of principal business based on gross receipts from all business activities
- Commissioner can determine use of gross receipts is not appropriate

Audience Poll 8

- Facts
 - Kelsey owns Good Eats restaurant
 - Toni incorporates Amazing Restaurants, Inc.
 - Kelsey and Toni are not related and there is no overlapping ownership interests
 - Amazing Restaurants, Inc.'s sole business in 2016 is to run the day-to-day operations of Good Eats
- Is this a management-service organization?
 - Yes
 - No

Audience Poll 9

- Facts
 - Same facts
 - But in 2017 Amazing Restaurants, Inc. gets a second restaurant customer, The Greasy Spoon
 - Kelsey does not have any interest in The Greasy Spoon
- Are Good Eats and Amazing Restaurants still in a management-service organization?
 - Yes
 - No
 - It depends

Affiliated-Service Group Attribution

- For affiliated-service groups – Use Code §318 attribution rules
- Different than the controlled-group rules

Family Attribution

- Spouse:
 - Interest is generally attributed to other spouse
 - No exception for limited involvement

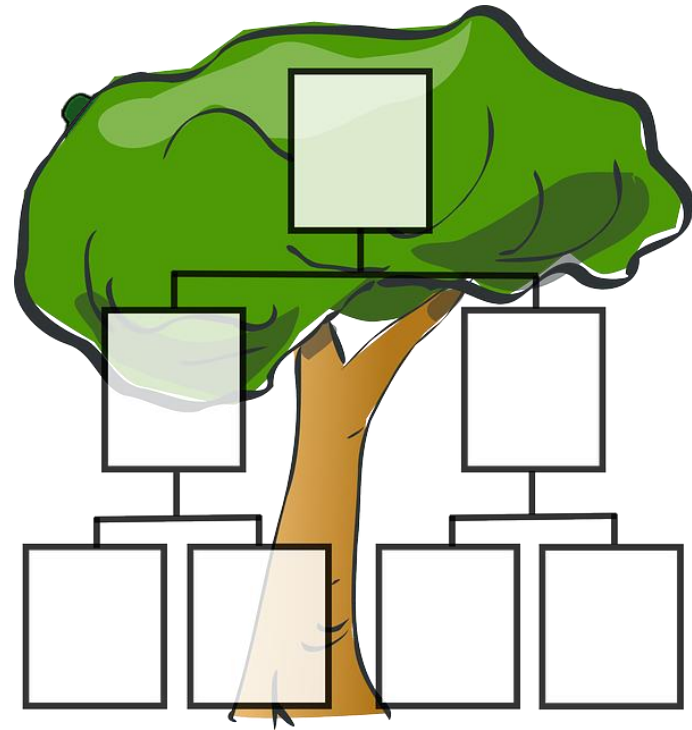


Family Attribution

- Children to parents
 - Parent deemed to own child's interest
 - No exception for age or ownership interest
- Parents to children
 - Child deemed to own parent's interest
 - No exception for age or ownership interest

Family Attribution

- Grandparents-grandchildren
 - No attribution
- Siblings
 - No attribution



Attribution to Organization

- Shareholder to C corporation
 - Shareholder owns at least 50 percent of corporation
 - Attributed shareholder's interest
- Partners to partnership
 - Attributed partner's interest
- Beneficiaries to trust
 - Attributed beneficiary's interest

Audience Poll 10: Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third of Corp A
 - Nicole, Kelsey's 19 year-old child, owns one-third
 - Will, Kelsey's 25 year-old child, owns one-third

How much of Corp A is Kelsey deemed to own?

- A. One-third
- B. Two-thirds
- C. Three-thirds

Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third directly
 - Nicole, Kelsey's 19 year-old child, owns one-third
 - Will, Kelsey's 25 year-old child, owns one-third
- Kelsey is deemed to own 100 percent
 - Kelsey is automatically attributed both Nicole's one-third interest and Will's one-third interest
 - Age of children does not matter

Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third of Corp A
 - Nicole, Kelsey's 19 year-old child, owns one-third
 - Will, Kelsey's 25 year-old child, owns one-third

How much of Corp A is Will deemed to own?

Family Attribution

- Ownership of Corp A
 - Kelsey owns one-third directly
 - Nicole, Kelsey’s 19 year-old child, owns one-third
 - Will, Kelsey’s 25 year-old child, owns one-third
- Will is deemed to own two-thirds
 - Will is attributed Kelsey’s one-third interest—giving him two-thirds
 - Age does not matter
 - Although Nicole’s interest is attributed to Kelsey, it is not “attributed again” to Will (no double attribution)

Questions?

