



Workshop 26 Advanced Affiliated Service Group and Controlled Group Case Studies

W. Waldan Lloyd
Callister Nebeker McCullough
Salt Lake City, Utah 84133
wwlloyd@cnmlaw.com



Affiliated Service Group Rules

- IRC §414(m)
 - Enacted in 1980 as part of the Miscellaneous Tax Act
- Prop. Regs. §1.414(m)-1 through 4
 - Issued February 28, 1983
 - Preamble states that taxpayers may rely on the proposed regulations, “pending the adoption of final regulations”
 - Final regulations have never been issued



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- IRC §414(m)(5) – management function rules added
 - Enacted in 1982 as part of TEFRA
- Prop. Regs. §1.414(m)-5 and 6
 - Issued in last half of 1987
 - No indication of taxpayer reliance
 - Withdrawn in April, 1993



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Congressional Intent
 - When applying the qualification rules of the Code to retirement plans, certain multiple employer arrangements should be viewed on a combined basis
 - The controlled group rules (IRC §§414(b) and (c)) are not broad enough to cover all ownership situations
 - Service organizations present particular opportunities for abuses



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Initial Guidance – Rev. Rul. 81-105
 - Provided examples of how the ASG rules are to be applied
 - Rules in Rev. Rul. 81-105 still apply
 - Not affected or superseded by the proposed §414(m) regulations



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Basic Rule – When considering the status of a qualified plan under §401(a), all employees of the members of an ASG are treated as employed by a single employer
- Basic Rule applies when considering
 - §401(a)(4) – general non-discrimination
 - §401(a)(5) – integration
 - §401(a)(17) – annual compensation limit
 - §401(a)(26) – minimum participation rule (DB plans)



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Basic Rule also applies to
 - SEPs and Simples - §408(k) and §408(p)
 - AND also applies the following rules to a qualified retirement plan:
 - Coverage rules – §410
 - Vesting rules – §411
 - Limitations on accruals – §415
 - Top heavy rules – §416



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- The ASG rules (as well as the controlled group rules under §414(b) and §414(c)) also apply (see §414(t)) to:
 - §79 – Group term life insurance rules
 - §106 – Contributions to health plans, MSAs, HSAs and HRAs
 - §117(d) – Tuition reduction programs
 - §120 – Group legal services plans
 - §125 – Cafeteria plans



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- ASG rules apply to (cont'd)
 - §127 – Educational assistance plans
 - §129 – Dependent care assistance programs
 - §132 – Fringe benefits
 - §137 – Adoption assistance programs
 - §274(j) – Deduction limits on employee achievement awards
 - §505 – Welfare trust (VEBA) non-discrimination rules
 - §4980B – Cobra continuation coverage



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- AND finally, the ASG rules (and the controlled group rules under §§414(b) and (c)) apply to determine applicable large employer (ALE) status under §4980H
- An ALE under §4980H that fails to offer minimum essential coverage (MEC) is subject to excise taxes, depending on the nature of the failure



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules
- An ASG consists of a service organization – a First Service Organization or FSO – and either:
 - One or more “A Organizations” (A-Org) or
 - One or more “B Organizations” (B-Org)
- An ASG can also consist of one or more A Orgs and one or more B Orgs



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- The FSO, A-Org and B-Org must all be “service organizations”
- An organization is a “service organization” if it is engaged in the following fields:
 - Health
 - Law
 - Engineering



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- Additional service organization fields
 - Architecture
 - Accounting
 - Actuarial science
 - Performing arts
 - Consulting
 - Insurance



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- Additional service organization rules:
 - Capital is not a material income-producing factor
 - “Capital” means a substantial investment in inventory, plants, machinery, equipment
 - Capital is always material for banks and similar institutions
 - Capital is not considered material if gross income from business consists primarily of fees, commissions or other compensation for personal services



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- To determine FSO and A-Org status
 - If the FSO is a corporation, it must be a “professional service corporation”
 - A “professional service corporation” has at least one shareholder who is licensed to render the professional services for which the “professional service corporation” is organized



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- “Professional services” are rendered by
 - CPAs
 - Actuaries
 - Architects
 - Attorneys
 - Chiropractors
 - Chiropractors
 - Medical doctors



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- “Professional services” (cont'd)
 - Dentists
 - Professional engineers
 - Optometrists
 - Osteopaths
 - Podiatrists
 - Psychologists
 - Veterinarians



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- To determine FSO and A-Org status
 - A-Org is a partner or shareholder in the FSO (regardless of percentage interest owned) AND
 - A-Org regularly performs services for the FSO or is associated with the FSO in performing services for third persons
 - Ownership attribution rules under §318(a) apply



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- Applying the ASG rules (cont'd)
- To determine FSO and B-Org status
 - B-Org business (significant portion) performs services for the FSO or for one or more A-Orgs associated with the FSO, AND
 - Services are the type historically performed by employees in the service field of the FSO, AND
 - Ten percent or more of the B-Org ownership is held by certain members of the FSO



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Affiliated Service Group Rules

- FSO – A-Org Example
 - Dr. N is an orthopedic surgeon
 - Dr. N owns 2% of Surgical Center Y AND
 - Dr. N regularly performs knee operations on patients who come to Surgical Center Y OR
 - Dr. N regularly performs knee operations on his own patients at Surgical Center Y



Affiliated Service Group Rules

- FSO – B-Org Example
 - Attorney A practices law through a professional corporation, of which she is the sole owner
 - Attorney A also owns 20% of legal services corporation XYZ, which employs secretaries, paralegals and other lawyers
 - Secretary M and paralegals S and T, employed by corporation XYZ, provide services primarily to Attorney A



Affiliated Service Group Rules

- Management organization ASGs
 - An ASG also exists between a first organization and any other organization IF:
 - The principal business of the other organization is performing management functions on a regular and continuing basis for the first organization or for the first organization and other organization(s) related to the first organization
 - The first organization need not be a service organization



Affiliated Service Group Rules

- Management organization ASGs (cont'd)
 - There is no guidance on the meaning of “principal business,” “management functions” or “regular and continuing”
 - Organizations are treated as related to the first organization if they are related persons under §144(a)(3)
 - Withdrawn regulations attempted to define “principal business” and “regular and continuing” by establishing a bright-line percentage of gross receipts test



Affiliated Service Group Rules

- Management organization ASGs (cont'd)
 - Withdrawn regulations also defined “management functions” in specific detail
 - Professional services performed for the recipient first organization were also considered “management functions” if they were of the same type as the recipient first organization performed for third persons – a sort of FSO – A-Org result without requiring any ownership percentage



Controlled Group Rules

- Controlled Group Rules are found at IRC §§414(b) and (c) and Treas. Reg. §§1.414(b)-1 and 1.414(c)-1
- **CRITICAL DISTINCTION!**
 - §414(b) and its regulations apply solely to a controlled group of corporations
 - §414(c) and its regulations apply to all other commonly controlled groups of trades or businesses – which may include corporations



Controlled Group Rules

- Treas. Reg. §§1.414(b)-1 refers to §1563 and the regulations thereunder for guidance
- Treas. Reg. §1.414(c)-1 et seq. regulations provide separate rules for determining common control under a group of trades or businesses
- §1563(a)(2) uses a different rule for determining brother-sister status than the regulations under §1.414(c)-2, BUT §1563(f)(5) reverses that rule to conform with the §1.414(c)-2 regulations



Controlled Group Rules

- Two key controlled group rules
 - Parent subsidiary – Controlling interest rule - Company A owns at least 80% of Company B
 - Brother-sister – the same 5 or fewer individuals own at least 80% (a controlling interest) in 2 or more companies and the identical ownership interest of those individuals in each company is more than 50% (effective control)



Controlled Group Rules

- More controlled group rules
 - Details, details – the critical parts of the regulations are the rules governing attribution of ownership interests and exclusion of ownership interests
 - The §1563 regulations for corporations and the §414(c) regulations for other business groups are not the same when applying the attribution and exclusion of ownership interest rules BE AWARE!



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



ASG / Controlled Group Relief?

- IRC §410(b)(6)(C) allows transition period relief from the coverage rules of §410(b)
- Relief is available “if a person becomes, or ceases to be, a member of a group described in subsection (b), (c), (m) , or (o) of section 414”
- Transition period runs from date of event causing status change to the last day of the following plan year



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



ASG / Controlled Group Relief?

- Transition relief is only available from the application of the coverage rules under §410(b)
- No transition rule for §4980H if a small employer becomes a large employer mid-year through an event that applies §§414(b), (c) or (m)
- Treas. Reg. §1.410(b)-2(f) limits relief to “an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business.”



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- ASG Problem One – Facts
 - Entertainer A owns 100% of Corporation A, which owns 50% of AB, an LLC.
 - Entertainer B owns 100% of Corporation B, which owns the other 50% of AB. Entertainers A and B are unrelated.
 - Corporations A and B provide entertainment services to the general public through a contract with AB LLC.
 - AB has employees who perform along with Entertainers A and B.
 - Entertainer A proposes to establish a DB plan for A only. No employee of AB works more than 1,000 hours per year. Can the DB plan exclude Entertainer B?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- ASG Problem Two – Facts
 - Company XYZ offers product shipping services to a number of unrelated businesses.
 - Manager X of Company XYZ and spouse (neither of whom has an ownership in Company XYZ) establish a separate management company that then contracts to provide management services to Company XYZ and another unrelated company.
 - 80% of management company receipts under the contract come from Company XYZ
 - Management company establishes a DB Plan for employees of Management company only, excluding all Company XYZ employees. Will the plan satisfy coverage?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- Shared Responsibility Problem under IRC §4980H – Facts
 - Small employer (doctors' office) with 7 doctors and 42 other employees begins and association in March, 2016 with a larger medical center (200 employees) and starts to perform surgeries on a regular basis at the medical center.
 - The relationship creates an FSO – A-Org ASG between the doctors' office and medical center.
 - Doctors' office employees have obtained coverage through the state-sponsored exchange and continue through the rest of the year.
 - What potential penalties are there, if any, under IRC §4980H?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- **Controlled Group Problem One – Facts**
 - Corporation A owns 100% of Corporation B and 96% of Corporation C.
 - Unrelated individuals X and Y each own 2% of Corporation C. X and Y are officers and employees of Corporation C and their shares are subject to a first right of refusal in favor of Corporation A.
 - Corporation C issues a public offering equal to 25% of the outstanding shares of Corporation C. Neither X nor Y acquire any of the publicly issued shares.
 - X and Y both enter into a voting agreement granting Corporation A the right to vote X's and Y's shares.
 - After the offering what is the controlled group status of Corporations A, B and C? What if Corporation A is an LLC instead?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- **Controlled Group Problem Two – Facts**
- Corporation F is owned 60% by H and W, who are husband and wife. None of the other owners of Corporation F are related to H or W, nor are there any restrictive agreements in place.
- Corporation M is owned 100% by H and W.
- Corporation F sponsors a safe harbor 401(k) plan and a self-funded health plan. Corporation M elects in mid year to join both.
- What is the status of the 401(k) plan? Open MEP? What about the health plan? MEWA? What if no M-1 has been filed?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- **Controlled Group Problem Three – Facts**
 - H and W, husband and wife, each own 100% of their own business corporation.
 - They do not live in a community property state.
 - Neither is employed by nor is a director or in management in the other's corporation.
 - Neither corporation's income is royalties, rents or other passive income.
 - There are no restrictions on the transfer of shares in either corporation.
 - Does H-W attribution create a controlled group?
 - What if they have a child under age 21?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Case Studies

- **The ESOP Outlier – Facts**
 - Corporation M stock is owned 70% by two unrelated individuals A and B (35% each). The remaining 30% has been purchased by the Corporation M ESOP in a leveraged transaction. There are 5 years remaining on the 10 year note issued by the ESOP.
 - Corporation D buys 50% of Corporation M (25% each from individuals A and B).
 - Corporation D is a U.S. wholly-owned subsidiary of a foreign parent. The stock of the foreign parent is readily tradable and regularly traded on an established foreign national securities exchange. The stock is not traded on any U.S. exchange.
 - What is the status of the ESOP and the leveraged transaction after Corporation D buys the Corporation M stock?



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



QUESTIONS?



2015 ASPPA ANNUAL
CONFERENCE

