

**SUNGARD** WEALTH & RETIREMENT ADMINISTRATION

## Who's the Employer – Part 2 Attribution

S. Derrin Watson

### 3 sets of retirement plan attribution rules

<b>Code §318</b>	<ul style="list-style-type: none"><li>• HCEs</li><li>• Key Employees</li><li>• 5% owner for RMD/ S Corp owner-employee</li><li>• Tax credit ESOPs</li><li>• Traditional affiliated service group (ASG)</li></ul>
<b>Code §1563</b>	<ul style="list-style-type: none"><li>• Controlled groups</li><li>• Groups of trades or businesses under common control</li><li>• PBGC majority/substantial owner (limited to attribution of corporate stock)</li></ul>
<b>Code §267(c) Code §4975</b>	<ul style="list-style-type: none"><li>• Management function groups</li><li>• Substantially full-time status of leased employees</li><li>• Prohibited transaction (with modifications)</li><li>• ESOPs</li></ul>

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation) **SUNGARD**

## Examples of attribution

- » Ed owns 100% of Corporation E, which sponsors a plan
  - Sam, Ed’s 20 year old son, owns 100% of S. S regularly performs services for E
  - S and E are both professional service corporations.
- » Under all sets of attribution rules, Ed is deemed to own Sam’s stock and vice versa

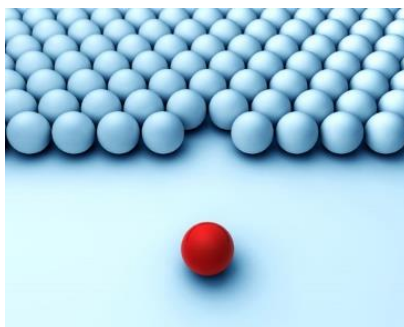
318 attribution	1563 attribution	267/4975 attribution
S and E are an affiliated service group	S and E are a controlled group	S and E are related employers
Sam is a 5% owner of E for the RMD rules	Sam is a majority owner of E for PBGC	Sam is a disqualified person for E
Sam is a key employee of E		
Sam is an HCE of E		

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Only universal rule

- » Under all three attribution systems, there is always attribution (going both ways) between a parent and a child under age 21
- » That is the only rule that is universally true
  - For every other situation, there is some difference between the three systems



[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD** 4


## What gets attributed

<ul style="list-style-type: none"> <li>» You can attribute ownership of                     <ul style="list-style-type: none"> <li>– Stock</li> <li>– Corporate voting power</li> <li>– Partnership capital</li> <li>– Partnership profits</li> <li>– Sole proprietorship</li> </ul> </li> <li>» When we refer to attribution of <i>stock</i>, it includes all ownership types unless otherwise specified</li> </ul>	<ul style="list-style-type: none"> <li>» You can't attribute:                     <ul style="list-style-type: none"> <li>– Compensation</li> <li>– Employee status</li> <li>– Account balances</li> </ul> </li> <li>» LLCs and similar entities may be taxed as corporations, partnerships or disregarded (e.g., taxed as sole proprietorships)</li> </ul>
--	--

---

www.sungard.com/reliuseducation
**SUNGARD**

## Case study: What is attributed



- » Dad owned 100% of X
  - X maintains a calendar year plan
- » December 31, 2013, Dad sells 100% of X to his 20-year-old Daughter
- » Dad retires from the business on December 31, 2013
  - Does not perform 1 hour of service thereafter
- a) Does Dad still own more than 5% of X on January 1, 2014?
- b) Is Dad a key employee December 31, 2014?
- c) Is Dad an HCE in 2014?

---

www.sungard.com/reliuseducation
**SUNGARD**

## Operating principles

- » The controlled group attribution rules create two possible owners, not two stock certificates:
  - Example
    - Harry owns 20% of X
    - Harry's 20-year old child Carla doesn't own any
    - Under the controlled group attribution rules you can treat:
      - Harry as owning 20%
      - Carla as owning 20%
      - Harry as owning 10% and Carla as owning 10%
    - But you don't treat Harry and Carla as jointly owning 40%

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Family attribution

- » Under all three systems, the family attribution rules can only be used once
  - Example
    - My wife is deemed to own my stock under Code §318
    - I'm deemed to own my mother's stock under Code §318
    - But my wife isn't deemed to own my mother's stock (i.e., from my mother to me to my wife) because that would be two instances of family attribution

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Spousal attribution

- » Spouse now includes same-gender spouse
- » Code §318 (HCE, Key employee, ASG)
  - You are deemed to own your spouse's stock
  - Exceptions:
    - Final decree of divorce (so s/he isn't your spouse!)
    - Legally separated
- » Code §267(c) (Management function groups, PT)
  - You are deemed to own your spouse's stock
  - No exceptions

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Spousal attribution §1563 (controlled groups)

- » You are deemed to own your spouse's stock unless any of the following is true:
  - Divorce (final or interlocutory)
  - Legal separation
  - Qualify for noninvolvement exception:
    - You don't own any stock directly
    - You aren't a director, employee, or participate in management
    - No more than 50% of company income is from passive sources
    - The stock is not subject to transfer restrictions in favor of you or your children under age 21

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Parent-child attribution

- » Code §318 (HCE, key employee) and 267 (management function)
  - Always attribution between you and your children
  - Always attribution between you and your parents
- » Code §1563 (controlled groups)
  - Always attribution between parent and child under age 21
  - If you own (or are deemed to own) more than 50% of the stock (voting power or value), you are deemed to own the stock held by
    - Your children over age 21
    - Your parents

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## JOHN & MARY EXAMPLE 1



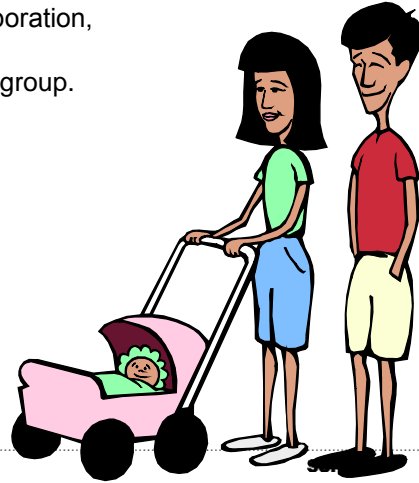
John and Mary are a happily married couple in New York. Each owns 100% of a medical corporation as his or her separate property. Neither is involved in the other's business. They have no children. There is no controlled group. The noninvolvement exception prevents attribution between them.

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## JOHN & MARY EXAMPLE 2

- » Same facts, but along comes Bambino, the infant child of John and Mary. At the instant of birth Bambino owns 100% of John's corporation and 100% of Mary's corporation, by parent child attribution. The two corporations are now in a controlled group.



[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

## JOHN & MARY EXAMPLE 3

- » Same facts. John is so distressed, he decides to get a divorce. Nothing changes. Attribution is based on the parent-child relationship, not the husband-wife relationship. The businesses will be in a controlled group until Bambino is 21.



[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## JOHN & MARY EXAMPLE 4



Same facts, except John and Mary were never married. Bambino came from a night of passion in medical school. The only contact is in child support checks. It doesn't matter. There is still a controlled group.

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Attribution to other generations

» You are deemed to own stock held by:

	318 (HCE)	1563 (CG)	267 (MFG)	4975 (PT)
Your grandchildren	Yes	Perhaps	Yes	Yes
Your grandparents		Perhaps	Yes	Yes
Great- or more remote ancestors or descendants			Yes	Yes
Spouses of descendants				Yes
Brothers/sisters			Yes	
Half-brothers/half-sisters			Yes	
Your partner			Yes	

» Under Code §1563 (controlled group), if you own or are deemed to own more than 50% of the stock, you are deemed to own stock held by your grandchildren and grandparents



[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**



### Case study: HCE family attribution

- » Sue works for Employer E and owns 1% of E
- » The following all own 1% of E
  - Sue's grandmother
  - Sue's mother
  - Sue's aunt
  - Sue's husband
  - Sue's sister
  - Sue's daughter
  - Sue's daughter-in-law
  - Sue's granddaughter
- » Is Sue an HCE by virtue of stock ownership?





www.sungard.com/reliuseducation **SUNGARD**

### Case study: CG attribution

- » Harry was married to Olga and they had a son, Arthur, who is now 30
- » Harry is now married to Wilma, and they have three children,
  - Betty, age 21,
  - Carol, age 15, and
  - David, age 10.
- » Arthur has a 5 year old daughter, Eliza.
- » X corporation stock is owned as shown
- » How much X stock is Harry deemed to own? What about Arthur? What about David?

Name	%
Harry	31%
Wilma	9%
Arthur	25%
Betty	12%
Carol	9%
David	9%
Eliza	5%



www.sungard.com/reliuseducation **SUNGARD**

## Case study: Parent-child attribution



- » Adam owns 100% of A
- » Seth, Adam's son (age 30) owns 100% of S
- a) Are A and S in a controlled group? What if the son were age 20?
- » Adam's wife, Eve, owns 100% of E
  - Neither Adam nor E has any involvement with the other's business
  - A and E are active businesses with little passive income
  - There are no transfer restrictions affecting either corporation
- b) If Seth is the only surviving child of Adam and Eve, are A and E a controlled group? If Adam and Eve have a 5-year old daughter, would A and E be in a controlled group

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Case study: Management function group



- » A management function group exists if an organization has as its principal business purpose providing management functions to
  - One other organization or
  - One other organizations and businesses related to that one other organization
- » All businesses an individual owns or is deemed to own are related
  - There are several other related party rules
- » Manny's business is managing 4 nursing homes
  - He gets about 25% of his receipts from each
  - Nancy owns one home, her sister the second, her grandmother the third, and her domestic partner the fourth
- a) Which of the homes is Nancy deemed to own?
- b) Is Manny in a management function group with one or more of the homes?

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Option attribution

- » If you own an attribution to buy stock then you are deemed to own the stock for purposes of:
  - Code §318 (HCE, key employee, ASG)
  - Code §1563 (controlled groups)
- » Option attribution does not apply under Code §267(c) (Management function groups, prohibited transactions)



[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Options can't break controlled group

- » *Failed attempt to divide group.* Lilly owns 100% of Uno and Dos. Each company has 100 shares of stock outstanding, and Lilly owns them all. They are a controlled group.
- » Uno gives Victor an option to buy 50 shares of Uno stock. If Victor exercises the option, there would be 150 shares outstanding. If Victor is treated as owning the stock, Lilly owns only 67%.
- » Lilly currently owns 100% of Uno, and the deemed attribution of 33% to Victor does not take away the fact that she owns 100% now. If Lilly had given Victor an option to buy 33 shares of her stock, she would still own all 100 shares until the option is exercised. Even with the option, a controlled group exists.

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Use options to create HCEs

- » Charlie Cheapskate never contributes to the 401(k) plan. He's a perpetual drag on the ADP.
- » So, his company gives him an option to buy 5.1% of the stock. Now, he's an HCE, and boosts what the other HCEs can contribute.
- » Warnings:
  - Can't use with nonprofessionals in pro. corp.
  - Must make price realistic
  - He may surprise you and try to exercise the option
  - Check on securities rules



[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Attribution from entities to owners

	§ 318 (HCE)	§ 1563 (CG)	§ 267 (MFG)
C Corporation	To 5% shareholder	To 5% shareholder	To shareholder
S Corporation	To shareholder	To 5% shareholder	To shareholder
Partnership	To partner	To 5% partner	To partner
Trust	To beneficiary	To 5% beneficiary	To beneficiary
Grantor trust	To grantor	To grantor	None
Estate	To beneficiary	To 5% beneficiary	To beneficiary
Retirement trust	None	To 5% beneficiary	To beneficiary

- » For purposes of affiliated service groups, there is attribution from S Corporation to 50% shareholder
- » Partnership attribution based on greater of profits or income interest
- » Corporate attribution based on value of stock held

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Case study: Partnership attribution



- » Able owns 4% of the profits and 30% of the capital of the AB partnership
- » AB owns 1000 shares of XYZ corporation
- a) How many shares is Able deemed to own?
- b) Suppose Able owned only 3% of the capital of AB partnership:
  - i. How many shares of XYZ would Able be deemed to own for purposes of determining if Able is an HCE of XYZ?
  - ii. How many shares of XYZ would Able be deemed to own for purposes of determining if a controlled group exists?

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## What about LLCs and similar entities?

- » Tax law recognizes a few basic types of entities
  - Sole proprietorships
  - Partnerships
  - Corporations (S & C)
  - Estates and trusts
- » Everything else gets reclassified as one of those types
  - Attribution rules and ownership rules follow from there
  - So does computation of income

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**


## So what is an LLC?

- » An LLC can elect to be taxed as a corporation
  - S or C
  - Form 8832
- » If it doesn't:
  - If it has 1 owner, tax law disregards the LLC as a separate entity
    - Sole proprietorship or division of another business entity
  - If it has more than 1 owner, tax law treats it as a partnership

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

SUNGARD 27

## Case study: LLC

- 
- » Betty owns 40% of the BC LLC
    - BC LLC owns 1000 shares of XYZ corporation
  - a) Suppose BC did not elect to be taxed as a corporation. How many shares of XYZ is Betty deemed to own?
  - b) Suppose BC elected to be taxed as a C corporation. How many shares of XYZ is Betty deemed to own for purposes of determining:
    - i. If Betty is an HCE of XYZ?
    - ii. If XYZ is in a controlled group with another entity?
    - iii. If XYZ is in an affiliated service group with another entity?

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

SUNGARD

## Operating rules on entity/option attribution

- » You can have multiple levels of entity or option attribution
  - Plus one level of family attribution
- » Example:
  - AB partnership has an option to buy 2000 shares of XYZ corporation stock.
    - The partnership is deemed to own the stock under the option attribution rules.
  - DEF corporation holds a 30% interest in AB
    - DEF is deemed to own 600 XYZ shares
  - Jack owns 40% of the value of DEF
    - Jack is deemed to own 240 XYZ shares
    - So is Jack's 19-year-old daughter

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Attribution to entities

- » Under Code §318, there is attribution from
  - 50% C Corporation shareholders to the C corporation
  - S Corporation shareholders to the S Corporation
  - Partners to partnerships
  - Beneficiaries to trusts and estates
    - Except for remote (<5% beneficial interest) contingent beneficiaries
- » Stock attributed UP to the entity can't be attributed DOWN to entity's owners
- » Only place this matters in retirement plan rules is affiliated service groups

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## ASG Example

- » An A-Org must be an owner or shareholder in a First Service Organization
- » PM is an incorporated law firm
  - Perry owns 50% of PM
- » DS is a corporate law practice owned 100% by Della, Perry's daughter
  - DS regularly performs service for PM
- » Della is deemed to own Perry's stock in PM
- » DS is deemed to own Della's stock in PM: so DS is deemed to be a shareholder in PM
- » PM and DS are an ASG

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**

## Case study: Retirement trust



- » You are a disqualified person if you own (or are deemed to own) 50% of the stock of the plan sponsor
- » Corporation X sponsors an ESOP
  - The ESOP owns 100% of the stock of X
  - The ESOP has one participant, Patty
- a) Is Patty a disqualified person with regard to the ESOP?
- b) Is Patty an HCE by virtue of ownership?
- c) Is Patty deemed to own the stock of X for purposes of determining if X is in a controlled group with a different corporation Patty owns?

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**





## Key points

- » Make sure you use the proper attribution system
- » Apply double attribution to the extent you can
- » Make sure you have the right family definition and proper thresholds

---

[www.sungard.com/reliuseducation](http://www.sungard.com/reliuseducation)

**SUNGARD**