COMPLIANCE

Who is the Employer? It Makes a Big Difference!

Failing to correctly apply the controlled or affiliated service group rules can result in big problems. Here's a quick refresher course.

BY JIM HOUPT

Businesses consist of sole proprietors, partnerships and corporations, not to mention LLC organizations. These entities often work together and often have greater or lesser ownership ties. According to the Internal Revenue Code, two or more of these enterprises may be viewed as a single "employer" for purposes of tax qualified retirement plans if they satisfy specific criteria.

This means that before anyone designs a tax-qualified retirement plan or acquires a company, they or their advisors had better be familiar with Internal Revenue Code rules concerning what constitutes an "employer" for retirement plan purposes. If not, they may design a retirement plan that will not satisfy minimum coverage requirements or may find that acquiring a company causes their own retirement plan to flunk coverage tests. Failing coverage means that either more employees must be covered by the plan or else the plan will lose its tax-favored status, to the detriment of the employer and the covered employees.

Qualified plans must satisfy complex coverage and non-discrimination tests in order to be entitled to the substantial tax breaks offered to them in the Code. In addition, vesting rules, maximum benefits and "top heavy" minimum benefits depend upon whether the same "employer" is involved. In this context, the term "employer" includes a controlled group such as parents, subsidiaries and brother/sister companies. In addition, a single employer can be recognized through

service companies that meet specific conditions under so called "affiliated service group" rules.

CONTROLLED GROUP

The parent/subsidiary relationship is pretty straightforward. If a business owns at least 80% of another business (corporations or unincorporated businesses), the Code views both the parent and the subsidiary as the same employer for qualified retirement plan purposes. Thus, if General Electric has 100 subsidiaries, GE and all subsidiaries are viewed as a single employer. Employment with any subsidiary is recognized for vesting and eligibility purposes under any of the many plans that GE and its subsidiaries may sponsor. Likewise, if an employee earns benefits under more than one of the GE plans, the aggregated benefit is subject to statutory limits.

A "controlled group of businesses" is more complicated. Here we are addressing "brother/sister" companies where five or fewer *common* owners own at least 80% of the two companies being examined. Keep in mind that a business owned entirely by one individual has no common owners, even though that individual might share ownership of another business with other individuals.

In addition to the 80% ownership requirement, these same common owners must also have more than a 50% "identical ownership." This can be explained by an example. Suppose one of the five or fewer common owners owns 55% of Company X and 30% of Company Y. The "identical ownership" equals 30%, the smaller of the two percentages. If the other four or fewer common owners collectively have more than a 20% identical ownership, the identical ownership requirement is met.

OWNERSHIP ATTRIBUTION

While these rules are relatively straightforward, things get complicated when several family members (spouses, parents, children, grandparents, etc.) own parts of the same business. If an individual owns more than 50% of a business, any portion owned by his or her children, grandchildren, parents or grandparents is attributed to that individual. For this purpose, "children" include legally adopted children. Any business interest owned by a *minor* child is attributed to the child's parents. Attribution between spouses applies unless the following conditions apply:

- The spouse owns no part of the business.
- The spouse is not an employee, officer or director of the business.
- The majority of the business income is not passive (*e.g.*, rental income).
- There are no restrictions on the spouse's ability to dispose of the business (even if the couple lives in a community property state).

Example

Suppose Fred owns 55% of Hardwood Products and his brother Art owns 20%. Alice, Fred's ex-wife, owns the remaining 25%. Discount Furniture Inc. is 60% owned by Fred, 25% owned by Art, and 15% by an unrelated investor.

Neither Alice nor the outside investor are considered common owners of the two businesses and so are ignored in the controlled group analysis. Even though Art is Fred's brother and a common owner, there is no ownership attribution between brothers. Thus, the controlled group analysis proceeds as illustrated in Fig. 1.

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The two businesses are *not* a controlled "brother/sister" group because the two common owners of Hardwood Products own less than 80%. However, suppose Alice and Fred reconcile and remarry. Now the two businesses *would be* a controlled group since Alice's 25% of Hardwood is attributed to Fred, making Fred an 80% owner of Hardwood.

AFFILIATED SERVICE GROUP

By far the most difficult part of determining who the employer is comes into play when the businesses being examined may be considered to be affiliated service groups. Two business entities are generally considered an affiliated service group when both businesses are service organizations and satisfy one of two requirements, termed "A" and "B." The "A" requirement involves a first service organization (FSO) and one or more organizations (called "A orgs") that have an ownership interest in the FSO and regularly provide services

FIG. 1: OWNERSHIP ATTRIBUTION

	Hardwood Ownership	Discount Ownership	Identical Ownership
Fred	55%	60%	55%
Art	20% 75%	25% 85%	20% 75%

for the FSO or join with the FSO in providing services to others.

For example, three lawyers each incorporate and form a partnership consisting of the three professional corporations that employ each lawyer. The partnership hires employees, rents office space, etc., and uses the professional services of the three lawyers who are employed by their professional corporations. This is an affiliated service group where the partnership is the FSO and each professional corporation is an A org.

The "B" affiliated service group is a little more complicated. It can best be described via an example. Using the above three incorporated lawyers in a partnership example, suppose that one of the lawyers owns more than 10% of Legal Secretaries Unlimited (a secretarial services business) in addition to his professional corporation. If Legal Secretaries Unlimited does more than 10% of its business with the law firm, then it is part of an affiliated service group with the partnership and each of the professional corporations.

CONCLUSION

Clearly, the admonition, "Don't try this at home" applies when dealing with affiliated service groups. If a significant pending financial transaction depends on whether two or more entities are an affiliated service group, professional guidance should definitely be obtained because the rules are complex and depend upon each fact pattern. PC

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NOTICE OF PUBLIC REPRIMAND

A Disciplinary Panel of the Joint Discipline Council of the U.S. Actuarial Professions (JDC) has met to consider the findings and recommendations of the Actuarial Board for Counseling and Discipline (ABCD) regarding Theodore F. Andersen, MSPA, MAAA, and concluded that Mr. Andersen should be publically reprimanded for materially failing to comply with Precepts 1 and 12 of the Code of Professional Conduct for Actuaries.

The JDC found that Mr. Andersen materially violated Precept 1 by failing to perform professional services with skill and care when he:

• advised his client to transfer assets from a defined benefit plan to a profit sharing plan in violation of the terms of the plan and the Internal Revenue Code and associated regulations; and

• knowingly or negligently certified material information that was false in 2010 and 2011 actuarial valuation reports and related Schedules SB.

The JDC found that Mr. Andersen materially violated Precept 12 by wrongfully using the membership designation of the American Academy of Actuaries for seven years ending in 2013.

Based on the foregoing, Mr. Andersen is hereby publically reprimanded.

DISCIPLINARY NOTICE OF SUSPENSION OF MEMBERSHIP — NEIL J. SAVASTA

In accordance with the Disciplinary Procedures of the American Society of Pension Professionals & Actuaries (ASPPA), on July 9, 2014, the Discipline Panel considered the findings from the Actuarial Board for Counseling and Discipline (ABCD) and a decision by the Disciplinary Panel of the Joint Discipline Council (JDC) regarding Neil J. Savasta. The Discipline Panel reviewed and approved the decision of the JDC and hereby suspends Mr. Savasta from membership for a period of five years for materially failing to comply with Precepts 1, 3 and 4 of the Code of Professional Conduct for Actuaries.

The June 30, 2008 and June 30, 2009 actuarial valuations of the post-retirement benefits for employees of the Nassau Board of Cooperative Educational Services (BOCES) prepared to be in compliance with Governmental Accounting Standards Board (GASB) Statement No. 45 were the subject of this action. The Disciplinary Panel of the JDC found that, in preparation and reporting on these valuations:

- Mr. Savasta materially violated Precept 1 by failing to familiarize himself with the requirements of GASB 45, failing to adequately consider a number of relevant Actuarial Standards of Practice (ASOPs), and failing to adequately supervise the actuarial valuation process.
- Mr. Savasta materially violated Precept 3 by failing to follow ASOP No. 6 ("Measuring Group Benefit Obligations"), ASOP No. 35 ("Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations") as required by ASOP No. 6, and failing to identify himself as the actuary responsible for the work as required by ASOP No. 41 ("Actuarial Communications").
- Mr. Savasta materially violated Precept 4 by failing to sign the two actuarial valuation reports in spite of the fact that he was the responsible actuary, and failing to provide adequate disclosures as required under ASOP No. 6 and ASOP No. 41.

The suspension is effective Sept. 25, 2014.