

# **CONTROLLED AND AFFILIATED SERVICE GROUPS – A QUICK OVERVIEW**

**Charles M. Lax, Esq.**

## Controlled and Affiliated Service Groups – A Quick Overview

- What's So Important About Controlled Groups (“CGs”) and Affiliated Service Groups (“ASGs”)
  - Generally all members of CGs and ASGs must be aggregated for testing and limits in qualified retirement plans
  - Generally all members of CGs and ASGs must be aggregated for determining the 50 full time equivalent employee threshold under ACA

## Controlled and Affiliated Service Groups – A Quick Overview

- Examples of Where Aggregation of Entities May Be Pertinent in Qualified Retirement Plans
  - §402(g) Contribution Limit – the maximum deferral limit for 401k plans
  - Top heavy testing
  - §415 Contribution Limits – maximum contributions or benefits

## Controlled and Affiliated Service Groups – A Quick Overview

- 401k plan safe harbor contribution rule compliance
- Minimum Coverage Rule – Are you only covering a discriminatory group of employees
- Discrimination testing on contributions of benefits
- Limitation on plan loans

## Controlled and Affiliated Service Groups – A Quick Overview

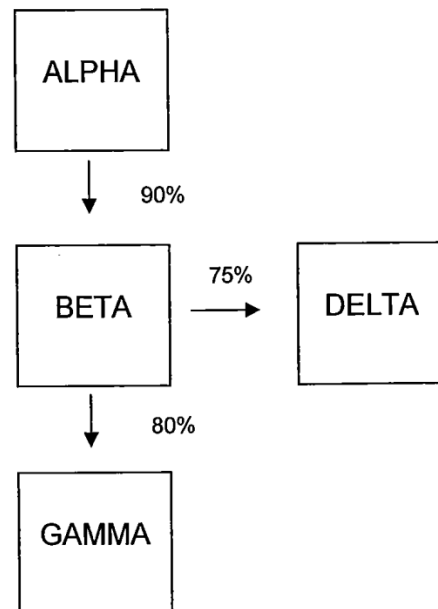
- What are CGs
  - Rules apply to corporations, partnerships, limited liability companies and proprietorships
  - Generally there are two types of CGs
    - Parent-Subsidiary
    - Brother-Sister

## Controlled and Affiliated Service Groups – A Quick Overview

- What are Parent-Subsidiary CGs
  - One or more entities connected through ownership with a common parent
    - The parent entity must own at least 80% of at least one other entity
    - The group also includes all other entities that are owned at least 80% by other entities in the group

## Controlled and Affiliated Service Groups – A Quick Overview

- Example



ALPHA, BETA, GAMMA are a CG.  
DELTA is not a member

## Controlled and Affiliated Service Groups – A Quick Overview

- What are Brother-Sister CGs
  - Groups of two or more entities with common ownership
  - The same five or fewer owners must:
    - have some ownership interest in each entity;
    - have at least 80% ownership in each entity; and
    - have more than 50% identical ownership in each entity



# Controlled and Affiliated Service Groups – A Quick Overview

- Example

<u>SHAREHOLDER</u>	<u>COMPANY</u>	<u>COMPANY</u>	<u>COMPANY</u>
	<u>X</u>	<u>Y</u>	<u>Z</u>
1	100%	79%	30%
2		20%	20%
3		1%	50%

- X is not a member of a CG with either Y or Z because shareholder 2 and 3 have no ownership in X
- Y and Z are members of a CG because all three tests are met

## Controlled and Affiliated Service Groups – A Quick Overview

- Attribution Rules for CGs
  - Generally they use IRC §1563
  - Generally there is attribution of ownership among spouses, with the exception of:
    - spouses that are legally separated, or
    - the other spouse (i) has no direct ownership (ii) has no participation as an employee or in management and (iii) no more than 50% of the gross income of the entity is from passive sources

# Controlled and Affiliated Service Groups – A Quick Overview

- Children and Parents
  - Parent is deemed to own their child's interest and the child is deemed to own their parents interest if child is under age 21
  - Parent is deemed to own their child's interest and the child is deemed to own their parent's interest if parent already controls more than 50% of the entity.

## Controlled and Affiliated Service Groups – A Quick Overview

➤ Example:

Ozie is a dentist and owns 100% of Ozie, D.D.S., P.C. Harriet, Ozie's former wife, having divorced last year, is a physician and owns 100% of Harriet, M.D., P.C. When married they had a child, Little Ricky, who is now four years old. Neither Ozie nor Harriet have involvement in the others' practice. Is this a CG?

## Controlled and Affiliated Service Groups – A Quick Overview

- Yes!
- Since Little Ricky is deemed to own both entities, even though he is four, not a dentist or physician and his parents are not married, this constitutes a CG

## Controlled and Affiliated Service Groups – A Quick Overview

- Corporations, Partnerships and Trusts to their Shareholders, Partners, and Beneficiaries
  - If a shareholder, partner or beneficiary owns or benefits by 5% or more
  - They are then deemed to own a proportionate share of the entity owned by such corporation, partnership or trust

# Controlled and Affiliated Service Groups – A Quick Overview

- What are ASGs
  - There are three types of ASGs
    - A-Organization Groups (“A-Orgs”)
    - B-Organization Groups (“B-Orgs”)
    - Management Service Groups (“MSGs”)

# Controlled and Affiliated Service Groups – A Quick Overview

- What are A-Orgs?
  - They are comprised of a First Service Organization (“FSO”) and at least one A-Organization
  - The first component member is a FSO – which must be a service entity



## Controlled and Affiliated Service Groups – A Quick Overview

- The second component member is an A-Organization
  - ❖ This organization must also be a service organization
  - ❖ This organization must have an ownership interest in the FSO (regardless of its percentage of ownership).
  - ❖ This organization must regularly perform services for the FSO or with the FSO in performing services for third parties

## Controlled and Affiliated Service Groups – A Quick Overview

➤ Example:

Lonee Anderson, CPA, a certified public accountant, is incorporated as Lonee Anderson, P.C. and this professional corporation is a partner in Anderson and Arthur, CPAs. Lonee Anderson and Lonee Anderson, P.C. are regularly associated with Anderson and Arthur, CPAs in performing accounting services for third parties.

## Controlled and Affiliated Service Groups – A Quick Overview

This is a A-Org ASG because:

- (i) Anderson and Arthur, CPAs is the FSO.  
Lonee Anderson, P.C. is the A-Org
- (ii) Both entities are service organizations
- (iii) Lonee Anderson P.C. has an ownership  
interest in Anderson and Arthur, CPAs
- (iv) Both are regularly associated in performing  
services for third parties

# Controlled and Affiliated Service Groups – A Quick Overview

- What are B-Orgs?
  - They are comprised of a FSO and at least one B-Organization
  - Any entity is a B-Organization if:

## Controlled and Affiliated Service Groups – A Quick Overview

- (i) A significant portion of its business is performing services for an FSO
- (ii) the services are the type historically performed by employees
- (iii) At least 10% of the B-Organization must be owned by Highly Compensated Employees of the FSO

## Controlled and Affiliated Service Groups – A Quick Overview

➤ Example:

Drysdale Industries is a financial service organization that has two 50% partners, Jed and Jethro. Jed and Jethro also own all of the stock of Ellie May Services, Inc. Jed owns 95% of Ellie May Services, Inc. and Jethro owns 5%. Ellie May Services, Inc. provides leased employees to Drysdale Industries.

## Controlled and Affiliated Service Groups – A Quick Overview

- This is a B-Org ASG because:
  - (i) Drysdale Industries is the FSO
  - (ii) Ellie May Services, Inc. is a B-Org because it performs services for Drysdale Industries of a type historically performed by employer and more than 10% of Ellie May Services, Inc. is held by Jed, an HCE of the FSO

# Controlled and Affiliated Service Groups – A Quick Overview

- What are Management Organizations
  - It is comprised of two organizations
    - ❖ The first organization performs management functions for the second organization



## Controlled and Affiliated Service Groups – A Quick Overview

- ❖ The principal business of the Management Organization is performing management functions on a regular and continuing basis to a recipient organization.
- There is no need to have overlapping or common ownership

# Controlled and Affiliated Service Groups – A Quick Overview

- Attribution rules for ASGs
  - Generally determined under IRC §318 rather than §1563
  - While many are similar there are differences
    - Always attribution among spouses – no limited involvement exception
    - Always attribution among parents and children – no exception based upon the age of the child