CYCLE A

Employee Benefit Plans

Explanation No. 10

Affiliated Service Group

Note:

Plans submitted during the Cycle A submission period must satisfy the applicable changes in plan qualification requirements listed in Section IV of Notice 2010-90, 2010-52 I.R.B. 909 (the 2010 Cumulative List).

Worksheet Number 10 (Form 8388) and this explanation are designed to aid the specialist in identifying and resolving issues pertaining to affiliated service groups as defined under section 414(m) of the Code.

The general rule of section 414(m) is that employees of employers that are members of an affiliated service group are considered to be employed by a single employer for purposes of certain provisions of section 401(a), and sections 408(k), 408(p), 410, 411, 415 and 416.

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The technical principles in this publication may be changed by future regulations or guidelines.

I. Required Information

If the information described in section 5.01 of Rev. Proc. 85-43, 1985-2 C.B. 501, has not been submitted with the application and there are indications that the plan may be subject to section 414(m), the information should be requested. If it is not submitted within a reasonable period of time, this worksheet should not be completed. If the plan is otherwise qualified, a favorable determination letter should be issued without a caveat addressing section 414(m). See IRM 7.11.1.26. In such instances, the employer may not rely on the letter for qualification of the plan under section 414(m).

II. Management Organizations

Line a. Under section 414(m)(5) of the Code, two or more organizations comprise an affiliated service group if the principal business of one of the organizations is performing management functions on a regular and continuing basis for the other organization(s) (or organizations related to the other organization (s)). Note that there is no requirement of common ownership of the managing and managed entities, unlike organizations affiliated under other provisions of section 414(m).
Whether an organization's principal business is performing management functions on a regular and continuing basis for another organization is essentially a facts and circumstances question. Factors to be considered in making this determination could include the percentage of the organization's gross receipts that are derived from performing management functions for the other organization and the amount of time individuals actually spend performing these functions. A sufficient period of time (e.g., more than one year) must be considered to ensure that the "regular and continuing basis" condition is met. Of course, the particular activities and services that the organization provides for the other organization must also be considered in order to determine that these activities and services are in the nature of management functions.

Line b. A affiliated service group under section 414(m)(5) will not exist unless the management functions performed by the one organization for the other organization are functions that have historically been performed by employees, including partners or sole proprietors. Management functions will be considered to be of a type historically performed by employees if, in other organizations in the same business field, it is not unusual for such functions to have been performed by employees. Conference Committee Report on the Tax Equity and Fiscal Responsibility Act of 1982.

III. A Organizations

Lines a., b., c., and d. Under section 414(m)(2) of the Code, an organization must be a service organization in order to be considered a "First Service Organization" (FSO) or an A Organization (A-Org.) within the meaning of section 414(m)(2)(A). The term "service organization" is defined in section 1.414(m)-2(f) of the proposed regulations. It includes organizations in which capital is not a material income producing factor and organizations engaged in one of the specific service fields listed in section 1.414(m)-2(f)(2) regardless of whether capital is a material income-producing factor.

For purposes of the A-Org. test only, an FSO must be either a partnership or a professional service corporation. See section 1.414(m)-1(c) of the proposed regulations. If the A-Org is a shareholder or partner in the FSO, and either regularly performs services for the FSO or is regularly associated with the FSO in providing services to third parties, then the organizations are an affiliated service group under section 414(m)(2) of the Code. See section 1.414(m)-2(b) of the proposed regulations.

IV. B Organizations

Line a. In order to be a B Organization, a significant portion of the organization's business must be the performance of services for an FSO, for one or more A-Orgs. determined with respect to the FSO, or for both. The services must be of a type historically performed by employees in the service field of the FSO or the A-Orgs. Note that an organization may be a B-Org. even though it does not qualify as a service organization within the meaning of section 414(m)(3) of the Code. See section 1.414(m)-2(c) of the proposed regulations.

Line b. In addition to satisfying Part IV.a. of the worksheet, 10 percent or more of the interests in the potential B-Org. must be held by persons who are highly compensated employees (within the meaning of section 414(q)) of a potential FSO or A-Org.

Line c. The test for services that are of the type "historically performed" by employees in that service field is found in section 1.414(m)-2(c)(3) of the proposed regulations. It is, essentially, a facts and circumstances question stating that a service is deemed historically performed if, as of December 13, 1980, it was not unusual for employees to perform such functions.

Line d. The services performed by the B-Org. must be "significant." A service receipts safe harbor test in the proposed regulations provides that if less than five percent of all receipts derived from an organization's performance of services originates with the potential FSO or A-Orgs. of the potential FSO, then such amounts are not considered a "significant portion" of the business of the potential B-Org. within the meaning of section 414(m)(2)(B)(i) of the Code. See section 1.414(m)- 2(c)(2)(ii) of the proposed regulations.

Line e. If 10 percent or more of a potential B-Org.'s total receipts from all sources are derived from the potential FSO, or A-Orgs. of the potential FSO, that percentage of gross receipts is deemed significant under section 414(m)(2)(B)(i) of the Code. See section 1.414(m)-2(c)(2)(iii) of the proposed regulations.

Line f. If more than five percent of service receipts but less than 10 percent of gross receipts of a potential B-Org. are derived from a potential FSO and its A-Orgs., then the determination of whether the amount is a significant portion of the potential B-Org.'s business is based on the relevant facts and circumstances. See section 1.414(m)-2(c)(2)(i) of the

V. Qualification Requirements

If the answer was "yes" in Part II.b., Part III.d., or Part IV.e. or f., the organizations to which the "yes" answers apply comprise one or more affiliated service groups. The questions in Part V of the worksheet pertain to the qualified status of the plans of organizations that are affiliated service group members.