

Affiliated Service Groups

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Affiliated Service Group (ASG) – IRC 414(m)

Two or more related service organizations become one Employer for purposes of participation, non-discrimination, vesting, 415 limits, SEP coverage, 105(h) medical reimbursement for highly compensated individuals, and 125 cafeteria plan coverage.

An ASG relationship exists in scenario (1), (2), or (3):

Scenario (1) – “A” Organization

Service Provider

“A” Organization (e.g., incorporated Doctor)

1. Must itself be a “service organization” *
2. Can be any type of business entity (sole prop., corporation, etc.)
3. Must be a shareholder or partner (to any degree) in the First Service Organization (FSO), with the constructive ownership rules of IRC 267(c) applying subject to the exceptions in IRC 414(m)
4. Must regularly perform services for such FSO, or be regularly associated with the FSO in performing services for third parties

Service Recipient

“FSO” Organization (e.g., Medical Partnership, Sole Practice or P.C.)

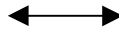
1. Must itself be a “service organization” *
2. The FSO cannot be a regular corporation, and therefore is limited to being one of the following:
 - Sole proprietorship
 - Partnership
 - Professional service corporation
 - Organized under state law
 - Must have at least one shareholder licensed to perform the professional services for which the professional service corporation was organized.
 - Principle purpose to provide “professional services” as:
 - Accountant
 - Actuary
 - Architect
 - Attorney
 - Chiropracist
 - Chiropractor
 - Medical Doctor
 - Dentist
 - Professional Engineer
 - Optometrist
 - Osteopath
 - Podiatrist
 - Psychologist
 - Veterinarian

* “service organization” is defined on page 4

Scenario (2) – “B” Organization

Service Provider

“B” Organization



Service Recipient

“FSO” Organization (or an “A” Organization or combination group)

This scenario requires that all of the following be true regarding “B”.

1. B need not be a “service organization”.* Instead a “significant portion” of B’s business must be performance of service for the FSO/A Organization determined under a two pronged gross receipts test for the current year or the three-year period ending with the current year, whichever results in a larger ratio:

- Total Receipts: B’s gross receipts from FSO/A Organization ÷ B’s total gross receipts from all sources => 10%

And

- Service Receipts: B’s gross receipts from services to FSO/A Organization ÷ B’s total gross receipts from all service activities = ≥ 5%

And

2. The services performed by B are of a type historically performed by employees in the service field of the FSO/A Organization

And

3. 10% or more (in aggregate) of ownership interests in B are held by officers and HCEs of the FSO/A Organization (constructive ownership rules of 1.414(m)-2(c) (1) apply)

*an organization “provides services” (i.e. is a service organization) if (1) or (2) is true:

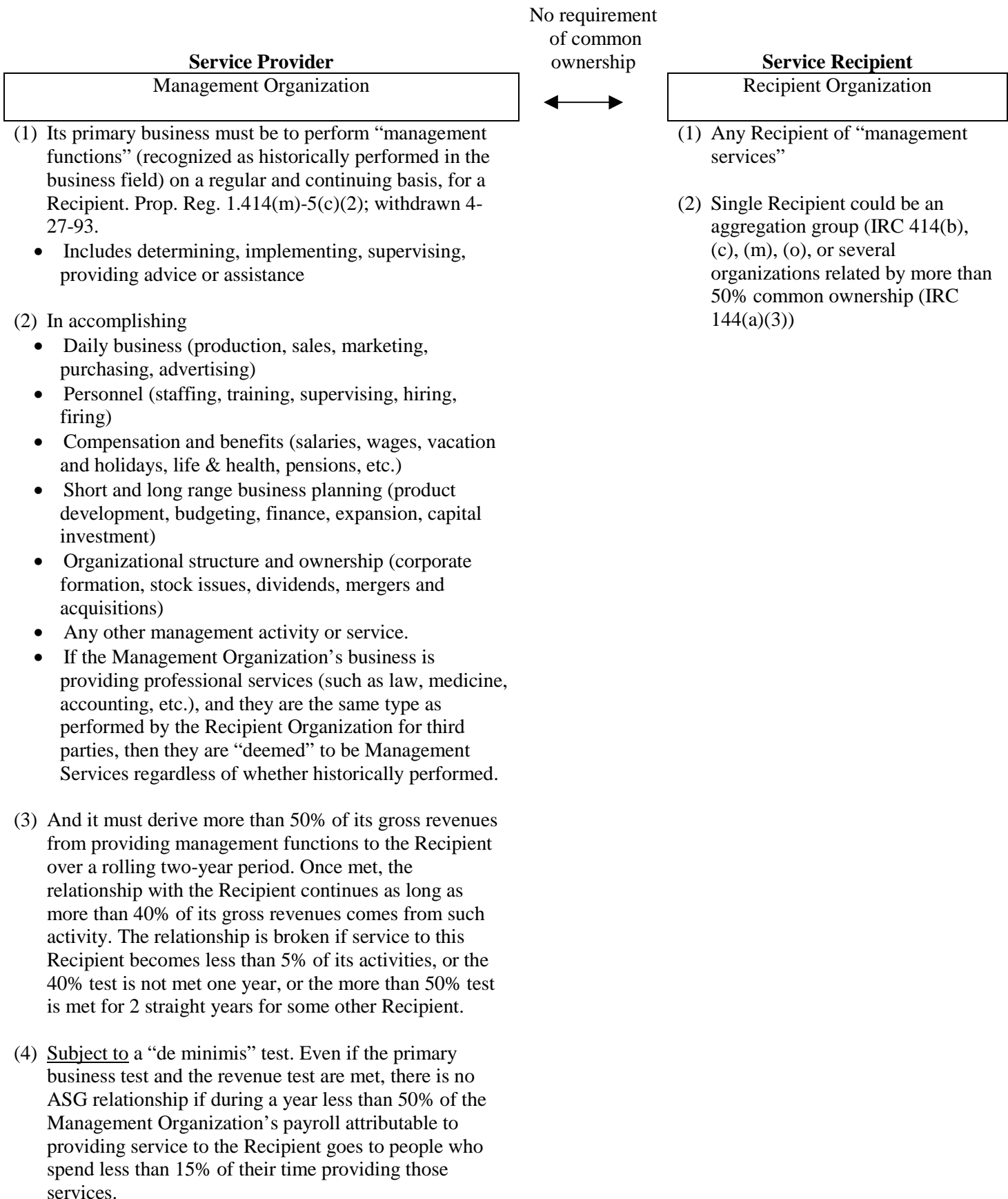
- (1) Capital is not a “material income producing factor” (facts and circumstances test) Reg. 1.1348-3(a)(3)(ii).

- Capital is not such a factor where gross income of the business consists principally of fees, commissions, and compensation for personal services.
- Capital is such a factor if a substantial portion of business gross income is attributable to the employment of capital in the business. Example: where there is substantial investment in inventories, plant, or equipment. Example: banks and similar institutions.

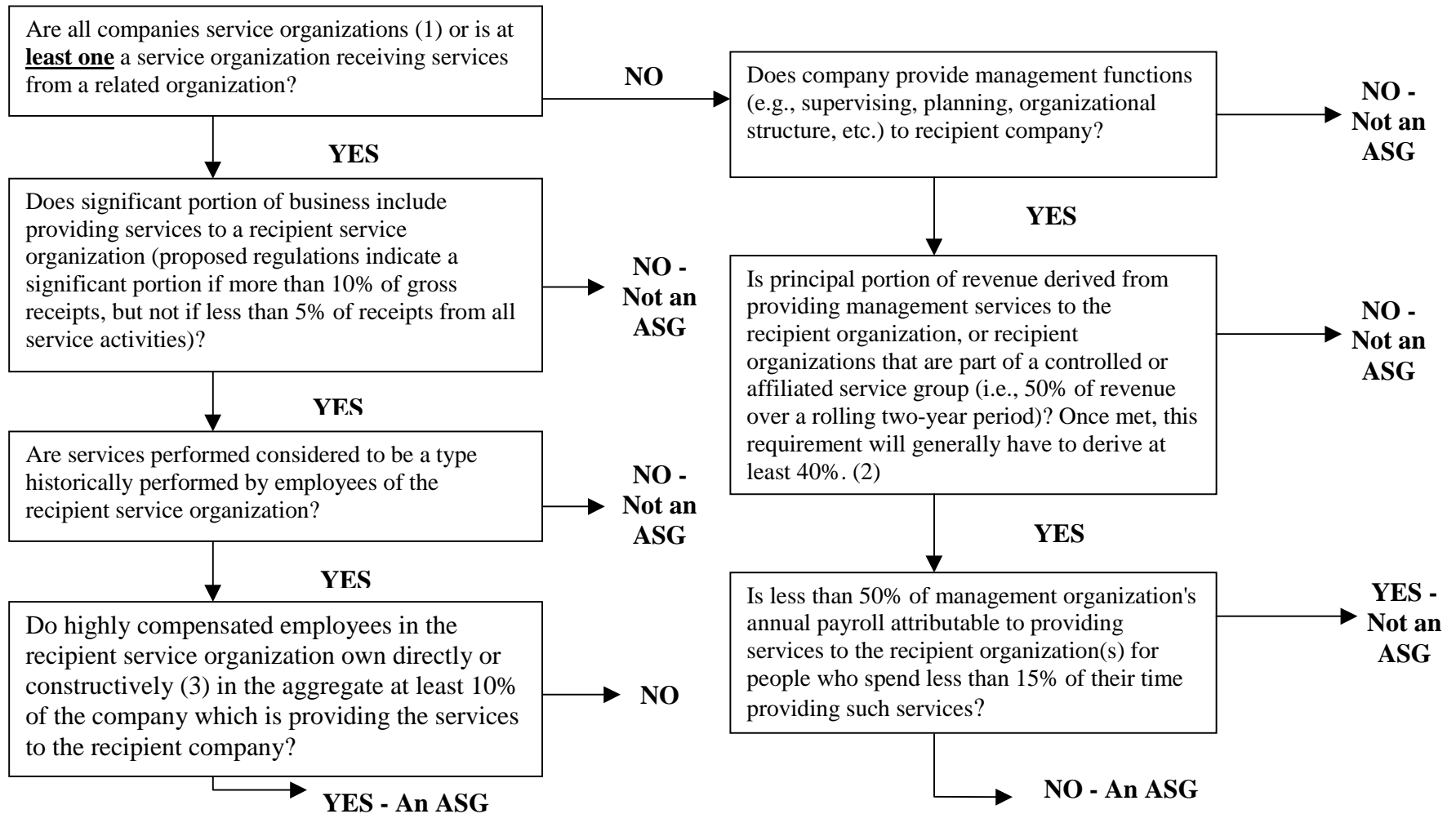
(2) Each of the following is deemed to be a service field (unless engaged only in the non-personal service activities in that field such as manufacturing, equipment, or publishing). Prop. Reg. 1.414(m)-2(f)(2).

- Health
- Law
- Engineering
- Architecture
- Accounting
- Actuarial Science
- Performing Arts
- Consulting
- Insurance

Scenario (3) – Management Organization



**Basic Steps In Determining Affiliated Service Group (ASG)
(other than for professional service organizations, e.g., doctors)**



- (1) **Service Organizations:** While most businesses would argue they are in the business of servicing their customers, to qualify as a service organization, capital must not be a material income producing factor. In other words, an employer is not a service organization if a substantial portion of the business is attributable to the employment of capital in the business such as investment in inventories, plant, equipment, machinery or financial capital as a bank or similar financial institution.
- (2) With respect to **management organization tests**, the Code does require that a principal portion of the business on a regular and continuing basis is the providing of management functions to a recipient organization, but does not delineate specific mathematical tests. The revenue tests described herein are based on proposed regulations withdrawn in 1993 without explanation by the IRS. However, in the absence of other guidelines, they are offered here as a reasonable good faith interpretation of these Code requirements.
- (3) **Aggregate Ownership:** An individual will be considered as also owning the interests of his/her spouse, brothers, sisters, ancestors, and lineal descendants.