

## What is a Controlled Group?

### What types of “controlled groups” are there?

There are three primary types of controlled groups:

- Parent/subsidiary group
- Brother/sister group
- Combined group

### What criteria must be met to be considered a controlled group?

- **Parent/Subsidiary** controlled group exists when one business (parent organization) owns at least 80% of another business (subsidiary). Ownership can be direct ownership of stock, or for other non-stock companies you would look to the voting rights, membership interest, partnership interest, and other such tests of control.
  
- **Bother/Sister** controlled group must meet two criteria:
  1. Five or fewer individuals, estates, or trusts together own at least 80% of each business; and
  2. The same individuals together own more than 50% of each business, taking into account only ownership which is identical in each of the businesses involved.
  
- **Combined Group** is a group of three or more businesses if:
  1. Each business is a member of either a parent-subsidiary group or a brother/sister group; and
  2. At least one of the businesses is the common parent of a parent/subsidiary group and is also a member of a brother/sister group.

All employees of businesses, that are members of a controlled group of businesses, are treated as employed by a single Employer for certain plan qualification purposes of:

1. Crediting of service for eligibility and vesting.
2. Nondiscrimination testing.
3. Breaks in service (for severance from employment).
4. Determining compensation (depending on the plan definition).
5. Determining whether an employee is an eligible employee for participation in a plan (depends on plan definition).

For a tax exempt Employer, a controlled group may exist if 80% or more of the board of directors are representatives of, or are controlled directly or indirectly by, another business.

## What is an affiliated service group?

**Affiliated Service Group rules were added to the IRS regulations in the 1980s as part of the existing Controlled group rules (*Code §414(m)*).**

These rules are incorporated in ERISA law so that employers cannot use multiple corporations or business entities to escape coverage or nondiscrimination rules of qualified plans.

There are two types of Affiliated Service Groups (ASG):

1. Ownership-based
2. Management function-based

### **First for an overview of ownership-based ASGs:**

An ASG consists of a First Service Organization (FSO) and one or more A-Orgs and/or B-Orgs. The FSO, A-Org and/or B-Org must all be “organizations” (*e.g., sole proprietorship, partnership, corporation, LLC or other types of entities*). A business is automatically a Service Organization if it engages in one of the following fields:

- Health/medicine
- Law
- Engineering/architecture
- Insurance
- Accounting
- Actuarial science
- Performing arts
- Consulting

An A-Org meets all of the following requirements:

- It is a service organization
- It owns some interest in the FSO
- It performs services for the FSO or is regularly associated with the FSO in providing services to third parties

*Example:* Dr. Smith owns 100% of her medical corporation. Her corporation is a 50% partner in Smith & Wesson Clinic, a partnership. Her corporation provides medical services to the partnership, which in turn provides medical services to the public. Both her corporation and the partnership are service organizations. The clinic is the FSO, and her corporation is the A-Org.

A B-Org meets all of the following requirements:

- A significant portion of the business of the B-Org is the performance of services for the FSO and/or its A-Orgs
- The services provided are a type historically performed in the field of the FSO or by the employees of the A-Org.
- At least 10% of the B-Org is owned or deemed to be owned by one or more Highly Compensated Employees of the FSO and/or its A-Orgs.

*Example:* Jack and Jill are attorneys. Each has his/her own law corporation, and the two corporations own 100% of J and J, LLP. Jack and Jill's corporations are A-Orgs, J and J LLP is an FSO, and the three organizations together are an ASG.

**Management function groups** are also Affiliated Service Groups (ASG) that involve a management firm and its client.

- The management firm is the organization which performs management functions for a client and/or organizations related to that client as its principal business.
- The client is the organization for which the management firm performs services.

*Example:* A landscape design and maintenance company splits into two companies. One company, W, was established to employ the workers who perform work in the field, and a second company, M, was established to employ the management and design team. M performs management responsibilities for W, and W is the only client of M. W and M are an ASG.